

# **SUGGESTED ANSWERS**

TO

## **QUESTIONS**

SET AT THE

**FINAL EXAMINATION**

**MAY, 1996 - NOVEMBER, 2010**

## **A COMPILATION**

**PAPER – 1 : ADVANCED ACCOUNTING**



**BOARD OF STUDIES**  
**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**  
**NOIDA**

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Topics Covered:

- Accounting Standards in India (Q. No. 1 to 37)
- Guidance Notes (Q. No. 38 to 43)

## Advanced Accounting

### Question 1

Write short notes on the Advantages and disadvantages of setting of Accounting Standards.

(4 marks) (May, 2002) (November, 2004)

#### Answer

The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance. The setting of accounting standards has the following advantages:

- (i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
- (ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
- (iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

However, there are some disadvantages of setting of accounting standards:

- (i) Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.
- (ii) There may be a trend towards rigidity and away from flexibility in applying the accounting standards.
- (iii) Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

### Question 2

- (a) Briefly indicate the items, which are included in the expression "borrowing cost" as explained in AS 16. (6 marks) (May, 2001)

- (b) Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3( AS 3) revised.

(8 marks)(November, 2001)

- (c) Write short note on Effect of Uncertainties on Revenue Recognition.

(10 marks) (May, 1997)

**Answer**

- (a) **Borrowing costs** : Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

As per para 4 of AS 16 on Borrowing Costs, borrowing costs may include :

- (a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;
  - (b) amortisation of discounts or premiums relating to borrowings ;
  - (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
  - (d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and
  - (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
- (b) As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:
- (a) the direct method whereby major classes of gross cash receipts and gross cash payments are disclosed; or
  - (b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

- (a) from the accounting records of the enterprise; or
- (b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:
  - (i) changes during the period in inventories and operating receivables and payables;
  - (ii) other non-cash items; and
  - (iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

- (a) changes during the period in inventories and operating receivables and payables;

## Advanced Accounting

- (b) non-cash items such as depreciation, provisions, deferred taxes, and unrealized foreign exchange gains and losses; and
- (c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

### (c) Effect of Uncertainties on Revenue Recognition

Para 9 of AS 9 on "Revenue Recognition" deals with the effect of uncertainties on Revenue Recognition. The para states:

1. Recognition of revenue requires that revenue is measurable and at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.
2. 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. When there is uncertainty as to ultimate collection, revenue is recognised at the, time of sale or rendering of service even , though payments are made by instalments.
3. When the uncertainty relating to collectability arises subsequent to the time of sale or rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.
4. An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits; the recognition of revenue is postponed.
5. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

### Question 3

How would you deal with the following in the annual accounts of a company for the year ended 31st March, 1996 ?

- (a) The company has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the Suppliers' Godown. Upto 1994-95, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 1995-96. This would result into decrease in profit by Rs. 7.60 lakhs

(3 marks)

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- (b) The company has obtained Institutional Term Loan of Rs. 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 1996 amounted to Rs. 406 lakhs, Rs. 58 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of Rs. 52.20 lakhs incurred during 1995-96 on the entire Institutional Term Loan of Rs. 580 lakhs. (3 marks)
- (c) Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of Rs. 5.30 lakhs for the period October, 1990 to September, 1994 has been received and paid in February, 1995. (3 marks)
- (d) The Board of Directors decided on 31.3.1996 to increase the sale price of certain items retrospectively from 1st January, 1996.

In view of this price revision with effect from 1st January, 1996, the company has to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 1996 to 31st March, 1996 and the Accountant cannot make up his mind whether to include Rs. 15 lakhs in the sales for 1995-96. (3 marks) (May, 1996)

### Answer

- (a) Para 29 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise. Therefore the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements. As per AS 2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards issued by the ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by Rs. 7.60 lakhs."

- (b) As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

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A qualifying asset is an asset that necessarily takes a substantial period of time\* to get ready for its intended use or sale.

The treatment for total interest amount of Rs. 52.20 lakhs can be given as:

| Purpose                                                      | Nature                    | Interest to be charged to<br>profit and loss account | Interest to be charged<br>to profit and loss<br>account |
|--------------------------------------------------------------|---------------------------|------------------------------------------------------|---------------------------------------------------------|
|                                                              |                           | Rs. in lakhs                                         | Rs. in lakhs                                            |
| Modernisation<br>and renovation of<br>plant and<br>machinery | Qualifying asset          | $52.20 \times \frac{406}{580} = 36.54$               |                                                         |
| Advance to<br>supplies for<br>additional assets              | Qualifying asset          | $52.20 \times \frac{58}{580} = 5.22$                 |                                                         |
| Working Capital                                              | Not a<br>qualifying asset |                                                      | $52.20 \times \frac{116}{580} = 10.44$                  |
|                                                              |                           | <u>41.76</u>                                         | <u>10.44</u>                                            |

\*Accounting Standards Interpretation (ASI) 1 deals with the meaning of expression 'substantial period of time'. A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

\*\* It is assumed in the above solution that the modernization and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assts. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assts on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, Rs. 52.20 lakhs will be recognized as expense in the profit and loss account for year ended 31st March, 1996.

- (c) The final bill having been paid in February, 1995 should have been accounted for in the annual accounts of the company for the year ended 31st March, 1995. However it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 1995, this material charge has arisen in the current period i.e., year ended 31st March, 1996. Therefore it should be treated as 'Prior period item' as per para 16 of AS 5. As per para 19 of AS 5 (Revised), prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after



## Accounting Theory

determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per Para 10 of AS 5 (Revised). For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

- (d) Price revision was effected during the current accounting period 1995-1996. As a result, the company stands to receive Rs. 15 lakhs from its customers in respect of sales made from 1st January, 1996 to 31st March, 1996. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognised in 1995-96 vide Para 10 of AS 9.

### Question 4

Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.96. You are required to advise the company on the following items from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards.

- (a) An audit stock verification during the year revealed that the opening stock of the year was understated by Rs. 3 lakhs due to wrong counting.
- (b) The company purchased on 01.04.95 a special purpose machinery for Rs. 25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.
- (c) The company undertook a contract for building a crane for Rs. 10 lakhs. As on 31.03.96 it incurred a cost of Rs. 1.5 lakhs and expects that there will be Rs. 9 lakhs more for completing the crane. It has received so far Rs. 1 lakh as progress payment.
- (d) The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employees is estimated to be 6 years.

(4 × 3 = 12 Marks)(November, 1996)

### Answer

- (a) The wrong counting of opening stock of the current year/closing stock of the previous year must have also resulted in lowering of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year in respect of these errors in the preparation of the financial statements of the prior period and should therefore be treated as prior period adjustments as per AS 5 (Revised). Accordingly, the rectifications relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived.

## Advanced Accounting

- (b) AS 12 'Accounting for Government Grants' regards two methods of presentation, of grants related to specific fixed assets, in financial statements as acceptable alternatives. Under the first method, the grant can be shown as a deduction from the gross book value of the machinery in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under the second method, it can be treated as deferred income which should be recognised in the profit and loss statement over the useful life of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description e.g., 'Deferred government grants' to be shown after 'Reserves and Surplus' but before 'Secured Loans'.

The following should also be disclosed:

- (i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;
  - (ii) the nature and extent of government grants recognised in the financial statement.
- (c) Para 21 of AS 7 (Revised) 'Construction Contracts' provides that when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively with reference to the stage of completion of the contract activity at the reporting date.

As per para 32 of the standard, during the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the contract costs incurred. Therefore, contract revenue is recognized only to the extent of costs incurred that are expected to be recovered. As the outcome of the contract cannot be estimated reliably, no profit is recognised. Para 35 of the standard states that when it is probable that the total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Thus the foreseeable loss of Rs. 50,000 (expected cost Rs. 10.5 lakhs less contract revenue Rs. 10 lakhs) should be recognized as an expense in the year ended 31st March, 1996.

Also, the following disclosures should be given in the financial statements:

- (a) the amount of contract revenue recognized as revenue in the period;
- (b) the aggregate amount of costs incurred and loss recognized upto the reporting date;
- (c) amount of advances received;
- (d) amount of retentions; and
- (e) gross amount due from/due to customers Amount\*

---

\* Amount due from/to customers = contract costs + Recognised profits – Recognised losses – Progress billings = 1.5 + Nil – 0.5 – 1.0 = Nil.

## Accounting Theory

- (d) As per AS 15 'Accounting for Retirement Benefits in the Financial Statements of Employers', the surplus amount of Rs. 6 lakhs can be either credited to the profit and loss account of the current year or, alternatively, spread over a period not more than the expected remaining life of the participating employees i.e. 6 years.

This change relating to actuarial valuation for its pension scheme should be treated as a change in an accounting policy and disclosed in accordance with AS 5 (Revised).

The financial statements should disclose: (a) the method for determination of these retirement benefit costs; (b) whether the actuarial valuation was made at the end of the period or at an earlier date (also specify date); and (iii) the method by which the accrual for the period has been determined (if the same is not based on the report of the actuary).

Note: AS 15 was revised in March, 2005. According to para 92 of AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus amount of Rs. 6 lakhs is required to be credited to the profit and loss statement of the current year.

### Question 5

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 1997.

|                                      | (Rs. in lakhs) |
|--------------------------------------|----------------|
| Total Contract Price                 | 1,000          |
| Work Certified                       | 500            |
| Work not Certified                   | 105            |
| Estimated further Cost to Completion | 495            |
| Progress Payment Received            | 400            |
| To be Received                       | 140            |

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by your institute. (15 marks) (November, 1997)

### Answer

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

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

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- (b) Contract work-in-progress i.e. cost incurred to date are Rs. 605 lakhs (Rs in lakhs)

|                    |            |
|--------------------|------------|
| Work certified     | 500        |
| Work not certified | <u>105</u> |
|                    | <u>605</u> |

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

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

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

- (d) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)
- = [605 + Nil – 100 – (400 + 140)] Rs. in lakhs
- = [605 – 100 – 540] Rs. in lakhs

Amount due to customers = Rs. 35 lakhs

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

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

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

### Question 6

In preparing the financial statements of R Ltd. for the year ended 31st March, 1998, you come across the following information. State with reasons, how you would deal with them in the financial statements:

- (a) An unquoted long term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 1998 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs. 20,000.
- (b) The company invested 100 lakhs in April, 1998 in the acquisition of another company doing similar business, the negotiations for which had started during the financial year.
- (c) There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (97-98). (15 marks)(May, 1998)

**Answer**

As it is stated in the question that financial statements for the year ended 31st March, 1998 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

- (a) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 20,000 in the financial statements for the year ended 31st March, 1998.
- (b) Para 3.2 of AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 1998. Applying para 15 which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 100 lakhs in April, 1998 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.
- (c) Due to major theft of stores in the preceding year (1996-97) which was detected only during the current financial year (1997- 98), there was overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived.

Note: Alternatively, it may be assumed that in the preceding year, the value of stock of stores as found out by physical verification of stocks was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 1998.

## Advanced Accounting

### Question 7

- (a) A Limited Company closed its accounting year on 30.6.98 and the accounts for that period were considered and approved by the board of directors on 20th August, 1998. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.1998 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of Rs. 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.98.

- (b) X Co. Ltd., has obtained an Institutional Loan of Rs. 680 lakhs for modernisation and renovation of its plant & machinery, Plant & machinery acquired under the modernisation scheme and installation completed on 31.3.98 amounted to Rs. 520 lakhs, 30 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 130 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to Rs. 62 lakhs during 1997-98.

You are required to state how the interest on the institutional loan is to be accounted for in the year 1997-98.

- (c) Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 1997-98.

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

- (d) A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.98 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.98 and 31.12.98 respectively. First instalment was paid on 31.12.98. The entire difference in foreign exchange has been capitalized.

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

- (e) A Limited Company finds that the stock sheets as on 31.3.97 had included twice an item the cost of which was Rs. 20,000.

You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31.3.98  
(3+ 4+3+3+3 = 16 marks)(May, 1999)

### Answer

- (a) Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

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In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report.

- (b) The treatment for total interest amount of Rs. 68 lakhs can be given as follows:

| Purpose                                                      | Nature                       | Interest to be capitalized<br>Rs. in lakhs | Interest to be charged to<br>profit and loss account<br>Rs. in lakhs |
|--------------------------------------------------------------|------------------------------|--------------------------------------------|----------------------------------------------------------------------|
| Modernisation<br>and renovation<br>of plant and<br>machinery | Qualifying<br>asset*         | $\frac{62 \times 520}{680} = 47.41$        |                                                                      |
| Advance to<br>suppliers for<br>additional<br>assets          | Qualifying<br>asset*         | $\frac{62 \times 30}{680} = 2.74$          |                                                                      |
| Working<br>Capital                                           | Not a<br>qualifying<br>asset |                                            | $\frac{62 \times 130}{680}$                                          |
|                                                              |                              | <u>50.15</u>                               | <u>= 11.85</u><br><u>11.85</u>                                       |

For details of para 6 of AS 16 'Borrowing Costs', Qualifying asset, substantial period of time, refer Answer 3(b).

- (c) As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:
- (i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.
  - (ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement.
- (d) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange

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\* Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets. In that case, the entire amount of interest Rs. 62 lakhs will be recognized as expense in the profit and loss account for the year ended 31st March, 1998.

## Advanced Accounting

differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

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

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

(including exchange loss on payment of first instalment)

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

- (e) The error in the recording of closing stock of the year ended 31st March, 1997 must have also resulted in overstatement of profits of previous year, brought forward to the current year ended 31st March, 1998. Vide para 4 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, the rectifications as required in the current year are 'Prior Period Items'. Accordingly, Rs. 20,000 should be deducted from opening stock in the profit and loss account. And Rs. 20,000 should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 1998 in accordance with para 15 of AS 5 (Revised) which requires that the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

### Question 8

- (i) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2000.

A claim lodged with the Railways in March, 1997 for loss of goods of Rs. 2,00,000 had been passed for payment in March, 2000 for Rs. 1,50,000. No entry was passed in the books of the Company, when the claim was lodged. (3 marks) (May 1996, May, 2000)

- (ii) The notes to accounts of X Ltd. for the year 1999-2000 include the following:

"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Fertiliser Project amounting to Rs. 1,80,80,000 has been capitalized during the year, which includes approximately Rs. 1,70,33,465 capitalised in respect of the utilization of loan and debenture money for the said purpose." Is the treatment correct? Briefly comment. (6 marks)(May, 2000)

### Answer

- (i) Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on Revenue Recognition states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is



postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction can not be taken as a Prior Period Item.

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

- (ii) The treatment done by the company is not in accordance with AS 16 'Borrowing Costs'. As per para 10 of AS 16, to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. Rs. 1,70,33,465. Thus, there is an excess capitalisation of Rs. 10,46,535. This has resulted in overstatement of profits by Rs. 10,46,535 and amount of fixed assets has also gone up by this amount.

**Question 9**

- (i) T. Ltd. imported fixed assets worth Rs. 1,000 lacs on 1.4.1999, when the exchange rate was Rs. 40 per US \$. The assets were fully financed by foreign currency loan repayable in five equal annual installments. As on 31.3.2000, the first installment was paid at the Exchange Rate of Rs. 42.
- (ii) The company's fixed assets stood at Rs. 3,000 lacs as on 1.4.1999. It provides depreciation at 10% per annum under the WDV method. However it noticed that about Rs. 500 lacs worth of non-imported assets acquired on 1.4.1999 will be obsolete in 2 years time. It wants to write off these assets over 2 years.
- (iii) A few days after the beginning of the year, the company acquired assets for Rs. 500 lacs on which it received a government grant of 10%.

Prepare a schedule as on 31.3.2000 in respect of the above three categories of assets and support the schedule with relevant accounting standards. (8 marks) (November, 2000)

## Advanced Accounting

Answer

### In the books of T Ltd. Schedule of Fixed Assets as on 31st March, 2000

(Amount in Rs. lacs)

| Fixed Assets                     | Gross Block (at cost) |               |                | Depreciation       |                    |                 | Net Block        |                         |                    |                    |
|----------------------------------|-----------------------|---------------|----------------|--------------------|--------------------|-----------------|------------------|-------------------------|--------------------|--------------------|
|                                  | As at<br>1.4.1999     | Additi<br>ons | Deducti<br>ons | As at<br>31.3.2000 | Up to<br>31.3.1999 | For the<br>year | On<br>Deductions | Total upto<br>31.3.2000 | As at<br>31.3.2000 | As at<br>31.3.1999 |
| Imported Assets                  | –                     | 1,000         | –              | 1,000              | –                  | 100             | –                | 100                     | 900                | –                  |
| Non - Imported                   | –                     | 500           | –              | 500                | –                  | 250             | –                | 250                     | 250                | –                  |
| Assets (acquired<br>on 1.4.1999) |                       |               |                |                    |                    |                 |                  |                         |                    |                    |
| Other Assets                     | <u>3,000</u>          | <u>450</u>    | –              | <u>3,450</u>       | –                  | <u>345</u>      | –                | <u>345</u>              | <u>3,105</u>       | <u>3,000</u>       |
| Total                            | <u>3,000</u>          | <u>1,950</u>  | –              | <u>4,950</u>       | –                  | <u>695</u>      | –                | <u>695</u>              | <u>4,255</u>       | <u>3,000</u>       |

- (1) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income/expense in the period in which they arise.

Calculation of Exchange Difference:

$$\begin{aligned}\text{Foreign currency loan} &= \frac{\text{Rs. 1,000 lacs}}{\text{Rs. 40}} \\ &= 25 \text{ lacs US \$}\end{aligned}$$

$$\text{Exchange difference} = 25 \text{ lacs US \$} \times (42 - 40)$$

$$= \text{Rs. 50 lacs (including exchange loss on payment of first instalment)}$$

Thus, exchange loss of Rs. 50 lakhs should be recognized as expense in the profit and loss account for the year ended 31st March, 2000.

- (2) It was noticed that about Rs. 500 lacs worth of non-imported assets acquired on 1.4.1999 will be obsolete in two years time. Hence, these assets have been written off at the rate of 50%.
- (3) Para 14 of AS 12 on Accounting for Government Grants regards two methods of presentation of grants related to specific fixed assets in financial statements. Under the first method which has been applied in the given case, the grant is shown as a deduction from the gross value of the fixed assets in arriving at its book value. Thus, only 90% of the cost of fixed assets has been shown as addition after adjusting the grant amount.

Alternatively, the grant can be treated as a deferred income which should be recognised in the profit and loss statement over the useful life of fixed assets in the proportions in which depreciation on the assets will be charged.

Note: As regards fixed assets standing at Rs. 3,000 lacs as on 1.4.1999, in the absence of information in respect of cost and depreciation amount provided upto 31.3.1999, the entire given amount has been shown under gross block as at 1.4.1999.

Question 10

State with reference to accounting standard, how will you value the inventories in the following cases:

- (i) Raw material was purchased at Rs. 100 per kilo. Price of raw material is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost. 10,000 kgs. of raw material is on stock at the year end. Replacement cost is Rs. 80 per kg.
- (ii) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is Rs. 1,000. The entire quantity of waste is on stock at the year end.

- (iii) Per kg. of finished goods consisted of:

|                                     |                 |
|-------------------------------------|-----------------|
| Material cost                       | Rs. 100 per kg. |
| Direct labour cost                  | Rs. 20 per kg.  |
| Direct variable production overhead | Rs. 10 per kg.  |

Fixed production charges for the year on normal capacity of one lakh kgs. is Rs. 10 lakhs. 2,000 kgs. of finished goods are on stock at the year end. (3 x 4 = 12 marks)(November, 2000)

Answer

- (a) (i) As per para 24 of AS 2 (Revised) on Valuation of Inventories, materials and other supplies held for use in the production of inventories are not written down below cost if the finished product in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Hence, in the given case, the stock of 10,000 kgs of raw material will be valued at Rs. 80 per kg. The finished goods, if on stock, should be valued at cost or net realisable value whichever is lower.

- (ii) As per para 13 of AS 2 (Revised), abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT.

The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to Rs. 50,000 (50 MT x Rs. 1,000) will be charged in the profit and loss statement.

### Advanced Accounting

- (iii) In accordance with paras 8 and 9 of AS 2 (Revised), the costs of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Thus, cost per kg. of finished goods can be computed as follows:

|                                                                                  |            |
|----------------------------------------------------------------------------------|------------|
|                                                                                  | Rs.        |
| Material cost                                                                    | 100        |
| Direct labour cost                                                               | 20         |
| Direct variable production overhead                                              | 10         |
| Fixed production overhead $\left( \frac{\text{Rs. 10,00,000}}{1,00,000} \right)$ | 10         |
|                                                                                  | <u>140</u> |

Thus, the value of 2,000 kgs. of finished goods on stock at the year end will be Rs. 2,80,000 (2,000 kgs. x Rs. 140).

#### Question 11

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2001 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

#### Summary Cash Account for the year ended 31.3.2001

|                         | Rs. '000     |                          | Rs. '000     |
|-------------------------|--------------|--------------------------|--------------|
| Balance on 1.4.2000     | 50           | Payment to Suppliers     | 2,000        |
| Issue of Equity Shares  | 300          | Purchase of Fixed Assets | 200          |
| Receipts from Customers | 2,800        | Overhead expense         | 200          |
| Sale of Fixed Assets    | 100          | Wages and Salaries       | 100          |
|                         |              | Taxation                 | 250          |
|                         |              | Dividend                 | 50           |
|                         |              | Repayment of Bank Loan   | 300          |
|                         |              | Balance on 31.3.2001     | <u>150</u>   |
|                         | <u>3,250</u> |                          | <u>3,250</u> |

(8 marks)(November, 2001)

Answer

X Ltd.

## Cash Flow Statement for the year ended 31st March, 2001

(Using the direct method)

|                                         | Rs. '000     | Rs. '000    |
|-----------------------------------------|--------------|-------------|
| Cash flows from operating activities    |              |             |
| Cash receipts from customers            | 2,800        |             |
| Cash payment to suppliers               | (2,000)      |             |
| Cash paid to employees                  | (100)        |             |
| Cash payments for overheads             | <u>(200)</u> |             |
| Cash generated from operations          | 500          |             |
| Income tax paid                         | <u>(250)</u> |             |
| Net cash from operating activities      |              | 250         |
| Cash flows from investing activities    |              |             |
| Payment for purchase of fixed assets    | (200)        |             |
| Proceeds from sale of fixed assets      | <u>100</u>   |             |
| Net cash used in investing activities   |              | (100)       |
| Cash flows from financing activities    |              |             |
| Proceeds from issuance of equity shares | 300          |             |
| Bank loan repaid                        | (300)        |             |
| Dividend paid                           | <u>(50)</u>  |             |
| Net cash used in financing activities   |              | <u>(50)</u> |
| Net increase in cash                    |              | 100         |
| Cash at beginning of the period         |              | <u>50</u>   |
| Cash at end of the period               |              | <u>150</u>  |

## Question 12

Answer the following questions by quoting the relevant Accounting Standard:

- During the year 2001-2002, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 5,00,000. Is a separate disclosure necessary?
- A Limited company has been including interest in the valuation of closing stock. In 2001-2002, the management of the company decided to follow AS 2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by Rs. 3,00,000. Is a disclosure necessary? If so, draft the same.
- A company signed an agreement with the Employees Union on 1.9.2001 for revision of wages with retrospective effect from 30.9.2000. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2001-02 ?

(12 marks) (May, 2002)

## Advanced Accounting

### Answer

- (i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS 5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that :

“When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.”

Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

- (ii) As per AS 5 (Revised), change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the instant case, the company has changed its accounting policy in order to conform with the AS 2 (Revised) on Valuation of Inventories. Therefore, a disclosure is necessary in the following lines by way of notes to the annual accounts for the year 2001-2002.

“To be in conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock unlike preceding years. Had the same principle been followed in previous years, profit for the year and its corresponding effect on the year end net assets would have been higher by Rs. 3,00,000.”

- (iii) It is given that revision of wages took place on 1st September, 2001 with retrospective effect from 30.9.2000. Therefore wages payable for the half year from 1.10.2000 to 31.3.2001 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

### Question 13

A company obtained term loan during the year ended 31st March, 2002 in an extent of Rs. 650 lakhs for modernisation and development of its factory. Buildings worth Rs. 120 lakhs were

## Accounting Theory

completed and Plant and Machinery worth Rs. 350 lakhs were installed by 31st March, 2002. A sum of Rs. 70 lakhs has been advanced for Assets the installation of which is expected in the following year. Rs. 110 lakhs has been utilised for Working Capital requirements. Interest paid on the loan of Rs. 650 lakhs during the year 2001 – 2002 amounted to Rs. 58.50 lakhs. How should the interest amount be treated in the Accounts of the Company?

(6 marks) (November, 2002)

Answer

The treatment for total interest amount of Rs. 58.50 lakhs can be given as follows:

| Purpose                                    | Nature                 | Interest to be capitalized<br>Rs. in lakhs | Interest to be charged to profit and loss account<br>Rs. in lakhs |
|--------------------------------------------|------------------------|--------------------------------------------|-------------------------------------------------------------------|
| Buildings                                  | Qualifying asset       | $\frac{58.5 \times 120}{650} = 10.8$       |                                                                   |
| Plant and machinery                        | Qualifying asset       | $\frac{58.5 \times 350}{650} = 31.5$       |                                                                   |
| Advance to suppliers for additional assets | Qualifying asset       | $\frac{58.5 \times 70}{650} = 6.3$         |                                                                   |
| Working capital                            | Not a qualifying asset |                                            | $\frac{58.5 \times 110}{650} = 9.9$                               |
|                                            |                        | <u>48.6</u>                                | <u>9.9</u>                                                        |

For details of para 6 of AS 16 'Borrowing Costs', Qualifying asset, Substantial Period of Time, refer Question 3(b).

### Question 14

In the context of relevant Accounting Standards, give your comments on any four of the following matters for the financial year ending on 31.3.2002.

- Assets and liabilities and income and expenditure items in respect of foreign branches are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue.
- Leave encashment benefit is accounted for as per "Pay-as-you-go" method.

### Advanced Accounting

- (c) Increase in pension liability on account of wage revision in 1999 – 2000 is being provided for in 5 instalments commencing from that year. The remaining liability of Rs. 300 lakhs as re-determined in actuarial valuation will be provided for in the next 2 years.
- (d) A Pharma Company spent Rs. 33 lakhs during the accounting year ended 31st March, 2002 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure.
- (e) While preparing its final accounts for the year ended 31st March, 2002 Rainbow Limited created a provision for Bad and Doubtful debts are 2% on trade debtors. A few weeks later the company found that payments from some of the major debtors were not forthcoming. Consequently the company decided to increase the provision by 10% on the debtors as on 31st March, 2002 as the accounts were still open awaiting approval of the Board of Directors. Is this to be considered as an extra-ordinary item or prior period item ?  
(4 × 4 = 16 marks) (November, 2002)

### Answer

- (a) The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax



effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

Note: For the purpose of translation of assets, liabilities, income and expenditure items of foreign operations, AS 11 (Revised 2003) classifies the foreign operation into two types – Integral foreign operation, Non-integral foreign operation. Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. Non-integral foreign operation is a foreign operation that is not an integral foreign operation. The above answer has been given on the basis that the foreign branches referred in the question are integral foreign operations.

- (b) As per para 12 of AS 15 on 'Accounting for Retirement Benefits in the Financial Statements of Employers', the cost of retirement benefits to an employer results from receiving services from the employees who are entitled to receive such benefits. Consequently, the cost of retirement benefits is accounted for in the period during which these services are rendered. Accounting for retirement benefit cost only when employees retire or receive benefits payments (i.e. as per pay as you go method) does not achieve the objective of allocation of those costs to the periods in which the services were rendered. Hence, the treatment of leave encashment benefit by the management is not in consonance with AS 15.

Note: AS 15 was revised in March, 2005. AS 15 (revised 2005) covers the leave encashment benefits under the category of short-term employee benefits. Accumulating short-term compensated absences (i.e. earned leaves) are those that are carried forward and can be used for future periods if the current period's entitlement is not used in full [para 13 of AS 15(Revised)]. Earned leaves which are encashable on retirement or resignation are vesting (which entitle employees to receive cash payment for unused entitlements on leaving the enterprise) accumulating compensated absences. 'An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date'. [Para 14 of AS 15 (Revised)].

- (c) Revision of wages and consequential increase in pension liability of employer is not a prior period item as it has not arisen out of errors or omissions of previous year. It is also not an extraordinary item as defined in AS 5 on Net profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. It is an expense arising out of the ordinary activity of the enterprise. Therefore, it should have been charged during the year 1999-2000, and disclosed separately.

The treatment of deferring to two years, Rs. 30 crores remaining pension liability as redetermined by actuarial valuation is also not in consonance with AS 15 relating to Accounting for Retirement Benefits in the Financial Statements of Employers. As per para 29 of AS 15, any alternations in the retirement benefit costs arising from changes in

## Advanced Accounting

the actuarial method used or assumptions adopted should be charged or credited to the statement of profit and loss as they arise in accordance with AS 5, "Prior Period and Extraordinary Items and Changes in Accounting Policies". Additionally, a change in the actuarial method used should be treated as a change in an accounting policy and disclosed in accordance with AS 5.

Note: AS 15 was revised in March, 2005. As per para 92 of AS 15 (Revised 2005) 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.

- (d) As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of Rs. 33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2002.
- (e) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revised an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate does not bring the resulting amount within the definition either of prior period item or of an extraordinary item [para 21, AS 5 (Revised)].

In the given case, Rainbow Limited created a provision for bad and doubtful debts at 2% on trade debtors while preparing its final accounts for the year ended 31st March, 2002. Subsequently, the company decided to increase the provision by 10%. As per AS 5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has a material effect in the current period should be disclosed and quantified. Any change in an accounting estimate which is expected to have a material effect in later periods should also be disclosed.

### Question 15

From the Books of Bharati Ltd., following informations are available as on 1.4.2001 and 1.4.2002:

|     |                                                                                                                                                  |          |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------|----------|
| (1) | Equity Shares of Rs. 10 each                                                                                                                     | 1,00,000 |
| (2) | Partly paid Equity Shares of Rs. 10 each Rs. 5 paid                                                                                              | 1,00,000 |
| (3) | Options outstanding at an exercise price of Rs. 60 for one equity share Rs. 10 each. Average Fair Value of equity share during both years Rs. 75 | 10,000   |
| (4) | 10% convertible preference shares of Rs. 100 each. Conversion ratio 2 equity shares for each preference share                                    | 80,000   |
| (5) | 12% convertible debentures of Rs. 100. Conversion ratio 4 equity shares for each debenture                                                       | 10,000   |

## Accounting Theory

- (6) 10% dividend tax is payable for the years ending 31.3.2003 and 31.3.2002.
- (7) On 1.10.2002 the partly paid shares were fully paid up
- (8) On 1.1.2003 the company issued 1 bonus share for 8 shares held on that date.

Net profit attributable to the equity shareholders for the years ending 31.3.2003 and 31.3.2002 were Rs. 10,00,000.

Calculate :

- (i) Earnings per share for years ending 31.3.2003 and 31.3.2002.
- (ii) Diluted earnings per share for years ending 31.3.2003 and 31.3.2002.
- (iii) Adjusted earnings per share and diluted EPS for the year ending 31.3.2002, assuming the same information for previous year, also assume that partly paid shares are eligible for proportionate dividend only. (14 marks) (May, 2003)

Answer

- (i) Earnings per share

|                                                                              | Year ended<br>31.3.2003 | Year ended<br>31.3.2002 |
|------------------------------------------------------------------------------|-------------------------|-------------------------|
| Net profit attributable to equity shareholders                               | Rs. 10,00,000           | Rs. 10,00,000           |
| Weighted average<br>number of equity shares                                  | 2,00,000                | 1,50,000                |
| [(W.N. 1) – without considering bonus issue<br>for the year ended 31.3.2002] |                         |                         |
| Earning per share                                                            | Rs. 5                   | Rs. 6.667               |

- (ii) Diluted earnings per share

Options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (as per W.N. 2).

|                                                                | Year ended 31.3.2003                                           |                            |                                                | Year ended 31.3.2002                                               |                                                |
|----------------------------------------------------------------|----------------------------------------------------------------|----------------------------|------------------------------------------------|--------------------------------------------------------------------|------------------------------------------------|
|                                                                | Net profit<br>attributable<br>to equity<br>shareholders<br>Rs. | No. of<br>equity<br>shares | Net Profit<br>attributable<br>per share<br>Rs. | No. of equity<br>shares<br>(without<br>considering<br>bonus issue) | Net Profit<br>attributable<br>per share<br>Rs. |
| As reported (for<br>years ended<br>31.3.2003 and<br>31.3.2002) | 10,00,000                                                      | 2,00,000                   | 5                                              | 1,50,000                                                           | 6.667                                          |

### Advanced Accounting

|                                      |                                     |                                    |                            |                                    |                   |
|--------------------------------------|-------------------------------------|------------------------------------|----------------------------|------------------------------------|-------------------|
| Options                              | <u>10,00,000</u>                    | <u>2,000</u><br><u>2,02,000</u>    | 4.95<br>Dilutive           | <u>2,000</u><br><u>1,52,000</u>    | 6.579<br>Dilutive |
| 12% Convertible<br>Debentures        | <u>84,000</u><br><u>10,84,000</u>   | <u>40,000</u><br><u>2,42,000</u>   | 4.48<br>Dilutive           | <u>40,000</u><br><u>1,92,000</u>   | 5.646<br>Dilutive |
| 10% Convertible<br>Preference Shares | <u>8,80,000</u><br><u>19,64,000</u> | <u>1,60,000</u><br><u>4,02,000</u> | 4.886<br>Anti-<br>Dilutive | <u>1,60,000</u><br><u>3,52,000</u> | 5.58<br>Dilutive  |

Since diluted earnings per share is increased when taking the convertible preference shares into account (Rs. 4.48 to Rs. 4.886), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share for the year ended 31.3.2003. Therefore, diluted earnings per share for the year ended 31st March, 2003 is Rs. 4.48.

For the year ended 31st March, 2002, Options, 12% Convertible debentures and Convertible preference shares will be considered dilutive and diluted earnings per share will be taken as Rs. 5.58.

|                            | Year ended 31.3.2003 | Year ended 31.3.2003 |
|----------------------------|----------------------|----------------------|
| Diluted earnings per Share | 4.48                 | 5.58                 |

- (iii) Adjusted earnings per share and diluted earnings per share for the year ending 31.3.2002.

|                                                                                  |               |
|----------------------------------------------------------------------------------|---------------|
| Net profit attributable to equity shareholders                                   | Rs. 10,00,000 |
| Weighted average number of equity shares<br>[(W.N. 1) – considering bonus issue] | 1,75,000      |
| Adjusted earnings per share                                                      | Rs. 5.714     |

## Accounting Theory

### Calculation of adjusted diluted earnings per share

|                                   | Net profit<br>attributable to<br>equity<br>shareholders<br>Rs. | No. of equity<br>shares (after<br>considering<br>bonus issue) | Net profit<br>attributable<br>per share<br>Rs. |
|-----------------------------------|----------------------------------------------------------------|---------------------------------------------------------------|------------------------------------------------|
| As reported                       | 10,00,000                                                      | 1,75,000                                                      | 5.714                                          |
| Options                           | <u>          </u>                                              | <u>2,000</u>                                                  |                                                |
|                                   | <u>10,00,000</u>                                               | <u>1,77,000</u>                                               | 5.65 Dilutive                                  |
| 12% Convertible Debentures        | <u>84,000</u>                                                  | <u>40,000</u>                                                 |                                                |
|                                   | <u>10,84,000</u>                                               | <u>2,17,000</u>                                               | 4.995 Dilutive                                 |
| 10% Convertible Preference Shares | <u>8,80,000</u>                                                | <u>1,60,000</u>                                               |                                                |
|                                   | <u>19,64,000</u>                                               | <u>3,77,000</u>                                               | 5.21 Anti –Dilutive                            |

Since diluted earnings per share is increased when taking the convertible preference shares into account (from Rs. 4.995 to Rs. 5.21), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, adjusted diluted earnings per share for year ended 31.3.2002 is Rs. 4.995.

Adjusted diluted earnings per share                      Rs. 4.995

### Working Notes:

#### 1. Weighted average number of equity shares

|                                                                | 31.3.2003<br>No. of Shares | 31.3.2002<br>No. of Shares |
|----------------------------------------------------------------|----------------------------|----------------------------|
| (a) Fully paid equity shares                                   | 1,00,000                   | 1,00,000                   |
| (b) Partly paid equity shares*                                 |                            | 50,000                     |
| Partly paid equity shares                                      | 25,000                     |                            |
| Fully paid equity shares                                       | 50,000                     |                            |
| (Partly paid shares converted into fully paid up on 1.10.2002) |                            |                            |
| (c) Bonus Shares**                                             | <u>25,000</u>              | <u>          </u>          |
| Weighted average number of equity shares                       | <u>2,00,000</u>            | <u>1,50,000</u>            |
| (without considering bonus issue for year ended 31.3.2002)     |                            |                            |
| Bonus Shares                                                   |                            | <u>25,000</u>              |
| Weighted average number of equity shares                       |                            | <u>1,75,000</u>            |
| (after considering bonus issue for year ended 31.3.2002)       |                            |                            |

\*Since partly paid equity shares are entitled to participate in dividend to the extent of amount paid, 1,00,000 equity shares of Rs. 10 each, Rs. 5 paid up will be considered as 50,000 equity shares for the year ended 31st March, 2002.

## Advanced Accounting

On 1st October, 2002 the partly paid shares were converted into fully paid up. Thus, the weighted average equity shares (for six months ended 30th September, 2002) will be calculated as

$$50,000 \times \frac{6}{12} = 25,000 \text{ shares}$$

Weighted average shares (for six months ended 31st March, 2003) will be calculated as

$$1,00,000 \times \frac{6}{12} = 50,000 \text{ shares}$$

\*\* Total number of fully paid shares on 1st January, 2003

|                                                                  |                 |
|------------------------------------------------------------------|-----------------|
| Fully paid shares on 1st April, 2002                             | 1,00,000        |
| Partly paid shares being made fully paid up on 1st October, 2002 | <u>1,00,000</u> |
|                                                                  | <u>2,00,000</u> |

The company issued 1 bonus share for 8 shares held on 1st January, 2003.

Thus  $2,00,000/8 = 25,000$  bonus shares will be issued.

Bonus is an issue without consideration, thus it will be treated as if it had occurred prior to the beginning of 1st April, 2001, the earliest period reported.

- Increase in earnings attributable to equity shareholders on conversion of potential equity shares

|                                                                                                                                                                             | Increase in<br>earnings<br><br>(1)<br>Rs. | Increase in<br>number of<br>equity shares<br><br>(2) | Earnings per<br>incremental<br>share<br><br>(3) = (1) ÷ (2)<br>Rs. |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------------------------------|--------------------------------------------------------------------|
| Options                                                                                                                                                                     |                                           |                                                      |                                                                    |
| Increase in earnings                                                                                                                                                        | Nil                                       |                                                      |                                                                    |
| No. of incremental shares issued for<br>no consideration<br>[ $10,000 \times (75 - 60)/75$ ]                                                                                |                                           | 2,000                                                | Nil                                                                |
| Convertible Preference Shares                                                                                                                                               |                                           |                                                      |                                                                    |
| Increase in net profit attributable to<br>equity shareholders as adjusted by<br>attributable dividend tax<br>[(Rs. $10 \times 80,000$ ) + 10%<br>(Rs. $10 \times 80,000$ )] | 8,80,000                                  |                                                      |                                                                    |
| No. of incremental shares<br>( $2 \times 80,000$ )                                                                                                                          |                                           | 1,60,000                                             | 5.50                                                               |
| 12% Convertible Debentures                                                                                                                                                  |                                           |                                                      |                                                                    |

## Accounting Theory

|                                       |        |      |
|---------------------------------------|--------|------|
| Increase in net profit                | 84,000 |      |
| [(Rs.10,00,000 × 0.12 × (1 – 0.30))*] |        |      |
| No. of incremental shares             |        |      |
| (10,000 × 4)                          | 40,000 | 2.10 |

\* Tax rate has been taken at 30% in the absence of any information in the question.

### Question 16

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2002 for Rs. 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.2002 is given below:

|                      |                  |
|----------------------|------------------|
|                      | Rs.              |
| Share Capital        | 5,00,000         |
| Reserves and Surplus | <u>5,00,000</u>  |
|                      | <u>10,00,000</u> |
| Fixed Assets         | 5,00,000         |
| Investments          | 2,00,000         |
| Current Assets       | <u>3,00,000</u>  |
|                      | <u>10,00,000</u> |

During the year ended 31.3.2003 the following are the additional information available:

- (i) A Ltd. received dividend from B Ltd., for the year ended 31.3.2002 at 40% from the Reserves.
- (ii) B Ltd., made a profit after tax of Rs. 7 lakhs for the year ended 31.3.2003.
- (iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.2003 on 30.4.2003.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS – 21 for its various subsidiaries. Calculate:

- (i) Goodwill if any on acquisition of B Ltd.'s shares.
- (ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?
- (iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements? (6 marks)(May, 2003)

### Answer

In terms of AS 23 B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

|                             |             |
|-----------------------------|-------------|
| (i) Calculation of Goodwill | Rs.in lakhs |
| Cost of investment          | 3.00        |

## Advanced Accounting

Less: Share in the value of Equity of B.Ltd.

as at the date of investment

[25% of Rs.10 lakhs (Rs.5 lakhs + Rs. 5 lakhs)] 2.50

Goodwill 0.50

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 2003

|                                  | Rs. in lakhs    |
|----------------------------------|-----------------|
| By Share of profits in B Ltd.    | 1.75            |
| By Dividend received from B Ltd. | 0.50            |
| Transfer to investment A/c       | <u>0.50</u> Nil |

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.2003

|                                      | Rs. in lakhs     |
|--------------------------------------|------------------|
| Investment in B Ltd.                 |                  |
| Share in B Ltd.'s Equity             | 2.50             |
| Less: Dividend received              | <u>0.50</u>      |
|                                      | 2.00             |
| Share of Profit for year 2002 – 2003 | <u>1.75</u>      |
|                                      | 3.75             |
| Add: Goodwill                        | <u>0.50</u> 4.25 |

### Working Notes:

1. Dividend received from B Ltd. amounting to Rs. 0.50 lakhs will be reduced from investment value in the books of A Ltd. However goodwill will not change.
2. B Ltd. made a profit of Rs. 7 lakhs for the year ended 31st March, 2003. A Ltd.'s share in the profits of Rs. 7 lakhs is Rs. 1.75 lakhs. Investment in B Ltd. will be increased by Rs. 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with Rs. 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 2003 will not be recognised in the consolidated financial statements of A Ltd.



**Question 17**

XYZ Ltd., has undertaken a project for expansion of capacity as per the following details:

|                 | Plan      | Actual   |
|-----------------|-----------|----------|
|                 | Rs.       | Rs.      |
| April, 2002     | 2,00,000  | 2,00,000 |
| May, 2002       | 2,00,000  | 3,00,000 |
| June, 2002      | 10,00,000 | —        |
| July, 2002      | 1,00,000  | —        |
| August, 2002    | 2,00,000  | 1,00,000 |
| September, 2002 | 5,00,000  | 7,00,000 |

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had Rs. 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over Rs. 10 lakhs from 1.9.2002. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure were incurred on 1st day of each month. Calculate:

- (i) Interest to be capitalised.
- (ii) Give reasons wherever necessary.

Assume:

- (a) Overdraft will be less, if there is no capital expenditure.
- (b) The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time.

(8 marks) (May, 2003)

**Answer**

| (a) XYZ Ltd.    |                    |                      |                   |
|-----------------|--------------------|----------------------|-------------------|
| Month           | Actual Expenditure | Interest Capitalised | Cumulative Amount |
|                 | Rs.                | Rs.                  | Rs.               |
| April, 2002     | 2,00,000           | 2,000                | 2,02,000          |
| May, 2002       | 3,00,000           | 5,020                | 5,07,020          |
| June, 2002      | —                  | 5,070                | 5,12,090          |
| July, 2002      | —                  | 5,120                | 5,17,210          |
| August, 2002    | 1,00,000           | —                    | 6,17,210          |
| September, 2002 | <u>7,00,000</u>    | <u>10,000</u>        | <u>13,27,210</u>  |
|                 | <u>13,00,000</u>   | <u>27,210</u>        | <u>13,27,210</u>  |

Note 2

Note 3

Note 4

## Advanced Accounting

Note:

1. There would not have been overdraft, if there is no capital expenditure. Hence, it is a case of specific borrowing as per AS 16 on Borrowing Costs.
2. The company had a strike in June and hence could not continue the work during June. As per para 14 (c) of AS 16, the activities that are necessary to prepare the asset for its intended use or sale are in progress. The strike is not during extended period. Thus during strike period, interest need to be capitalised.
3. During August, the company did not incur any interest as there was surplus cash in August. Therefore, no amount should be capitalised during August as per para 14(b) of AS 16.
4. During September, it has been taken that actual overdraft is Rs. 10 lakhs only. Hence, only Rs. 10,000 interest has been capitalised even though actual expenditure exceeds Rs. 10 lakhs.

Alternatively, interest may be charged on total amount of (Rs. 6,17,210 + Rs. 7,00,000 = 13,17,210) for the month of September, 2002 as it is given in the question that overdraft was over Rs. 10 lakhs from 1.9.2002 and not exactly Rs. 10 lakhs. In that case, interest amount Rs. 13,172 will be capitalised for the month of September.

### Question 18

Briefly explain, as per relevant Accounting Standard:

- (a) TVSM company has taken a Transit Insurance Policy. Suddenly in the year 2002-2003 the percentage of accident has gone up to 7% and the company wants to recognise insurance claim as revenue in 2002-2003 in accordance with relevant Accounting Standards. Do you agree?
- (b) 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 2002-2003 the company wants to recognise the entire interest receivable. Do you agree?
- (c) ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months upto 31.3.2002.

The company wants to provide during the year ending 31.3.2003 based on technical evaluation:

|                                                  |               |
|--------------------------------------------------|---------------|
| Total value of stock                             | Rs. 100 lakhs |
| Provision required based on 12 months issue      | Rs. 3.5 lakhs |
| Provision required based on technical evaluation | Rs. 2.5 lakhs |

Does this amount to change in Accounting Policy? Can the company change the method of provision?

- (d) XYZ is an export oriented unit and was enjoying tax holiday upto 31.3.2002. No provision for deferred tax liability was made in accounts for the year ended 31.3.2002. While finalising the accounts for the year ended 31.3.2003, the Accountant says that the entire deferred tax liability upto 31.3.2002 and current year deferred tax liability should be routed through Profit and Loss Account as the relevant Accounting Standard has already become mandatory from 1.4.2001. Do you agree? (16 marks)(May, 2003)

Answer

- (a) AS 9 on Revenue Recognition defines revenue as 'gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of the enterprise from the sale of goods, from the rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends'.

To recognise revenue AS 9 requires that revenue arises from ordinary activities and that it is measurable and there should be no uncertainty. As per para 9.2 of the Standard, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

In the given case, TVSM company wants to suddenly recognise Insurance claim because it has increased over the previous year. But, there are uncertainties involved in the settlement of the claim. Also, the claim does not seem to be in the course of ordinary activity of the company.

Hence, TVSM company is not advised to recognise the Insurance claim as revenue.

- (b) 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.

- (c) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from Rs.3.5 lakhs to Rs.2.5 lakhs is also not

## Advanced Accounting

material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2002-03:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by Rs.1 lakh."

- (d) Paragraph 33 of AS 22 on "Accounting For Taxes on Income" relates to the transitional provisions. It says, "On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets.

Further Paragraph 34 lays down, "For the purpose of determining accumulated deferred tax in the period in which this statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences."

Therefore, in the case of XYZ, even though AS 22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves.

Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

### Question 19

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of Rs. 2,00,000 for the year ending 31.3.2001. For the years ending 31.3.2002 and 31.3.2003, it made profits of Rs. 1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2001, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 2002 and 2003 for tax purposes. Prepare a statement of Profit and Loss for the years ending 2001, 2002 and 2003.

(4 marks) (November, 2003)

Answer

## Statement of Profit and Loss

|                                                                    | 31.3.2001         | 31.3.2002     | 31.3.2003     |
|--------------------------------------------------------------------|-------------------|---------------|---------------|
|                                                                    | Rs.               | Rs.           | Rs.           |
| Profit (Loss)                                                      | (2,00,000)        | 1,00,000      | 1,20,000      |
| Less: Current tax                                                  |                   |               | (8,000)       |
| Deferred tax:                                                      |                   |               |               |
| Tax effect of timing differences originating during the year       | 80,000            |               |               |
| Tax effect of timing differences reversed/adjusted during the year |                   | (40,000)      | (40,000)      |
| Profit (loss) after tax effect                                     | <u>(1,20,000)</u> | <u>60,000</u> | <u>72,000</u> |

## Question 20

- (a) J Ltd. purchased machinery from K Ltd. on 30.09.2001. The price was Rs. 370.44 lakhs after charging 8% Sales-tax and giving a trade discount of 2% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price.

A loan of Rs. 300 lakhs was taken from the bank on which interest at 15% per annum was to be paid.

Expenditure incurred on the trial run was Materials Rs. 35,000, Wages Rs. 25,000 and Overheads Rs. 15,000.

Machinery was ready for use on 1.12.2001. However, it was actually put to use only on 1.5.2002. Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 1.12.2001 to 1.5.2002. The entire loan amount remained unpaid on 1.5.2002.

- (b) State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 2003 with reference to Accounting Standards:
- The company finds that the stock sheets of 31.3.2002 did not include two pages containing details of inventory worth Rs. 14.5 lakhs.
  - The company had spent Rs. 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 2002-2003, but proved to be a failure. (7 + 8 = 15 marks)(November, 2003)

Answer

|                                      |                |                |
|--------------------------------------|----------------|----------------|
| (a)                                  | Rs. (in Lakhs) | (Rs. in Lakhs) |
| Quoted price (refer to working note) | 350.00         |                |
| Less: 2% Trade Discount              | <u>7.00</u>    |                |
|                                      | 343.00         |                |

### Advanced Accounting

|                                                                            |              |                |
|----------------------------------------------------------------------------|--------------|----------------|
| Add: 8% Sales tax (8% × Rs. 343 lakhs)                                     | <u>27.44</u> | 370.44         |
| Transport charges (0.25% × Rs. 350 lakhs)                                  |              | 0.88 (approx.) |
| Installation charges (1% × Rs. 350 lakhs)                                  |              | 3.50           |
| Financing cost (15% on Rs.300 Lakhs) for the period 30.9.2001 to 1.12.2001 |              | 7.50           |
| Trial Run Expenses                                                         |              |                |
| Material                                                                   | 0.35         |                |
| Wages                                                                      | 0.25         |                |
| Overheads                                                                  | <u>0.15</u>  | <u>0.75</u>    |
| Total cost                                                                 |              | <u>383.07</u>  |

Interest on loan for the period 1.12.2001 to 1.05.2002 is Rs. 300 lakhs  $\times \frac{15}{100} \times \frac{5}{12}$

= Rs.18.75 lakhs

This expenditure may be charged to Profit and Loss Account or deferred for amortization between say three to five years. Assumed that no other expenses are incurred on the machine during this period.

Working Note:

Let the quoted price 'X'

Less: Trade Discount 0.02X.

Actual Price = 0.98X.

Sale Tax @8% = 1.08 × 0.98X

or  $X = \frac{\text{Rs. 370.44 lakhs}}{1.08 \times 0.98} = \text{Rs. 350 lakhs}$

- (b) (i) Paragraph 4 of Accounting Standard 5 on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in stock valuation is a prior period item vide Para 4 of AS 5. Rs.14.5 lakhs must be added to the opening stock of 1/4/2002. It is also necessary to show Rs. 14.5 lakhs as a prior period adjustment in the Profit and loss Account below the line. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.

## Accounting Theory

- (ii) In the given case, the company spent Rs. 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to paras 41 to 43 of AS 26 'Intangible Assets', the company should charge the total amount of Rs. 45 lakhs as an expense in the profit and loss account.

### Question 21

- (a) On 1st December, 2002, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for Rs. 85 lakhs. On 31st March, 2003 the company found that it had already spent Rs. 64,99,000 on the construction. Prudent estimate of additional cost for completion was Rs. 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2003 as per provisions of Accounting Standard 7 (Revised)?
- (b) While preparing its final accounts for the year ended 31st March, 2003 a company made a provision for bad debts @ 5% of its total debtors. In the last week of February, 2003 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2003 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2003? (5+ 5 = 10 marks)(November, 2003)

### Answer

|                                                    |                  |
|----------------------------------------------------|------------------|
| (a)                                                | Rs.              |
| Cost incurred till 31 <sup>st</sup> March, 2003    | 64,99,000        |
| Prudent estimate of additional cost for completion | <u>32,01,000</u> |
| Total cost of construction                         | 97,00,000        |
| Less: Contract price                               | <u>85,00,000</u> |
| Total foreseeable loss                             | <u>12,00,000</u> |

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

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

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

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

- (b) As per paras 8.2 and 13 of Accounting Standard 4 on Contingencies and Events Occurring after the Balance Sheet Date, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

## Advanced Accounting

So full provision for bad debt amounting to Rs. 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31<sup>st</sup> March, 2003. It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31<sup>st</sup> March, 2003, then mere disclosure required as per para 15, would have been sufficient.

### Question 22

- (a) At the end of the financial year ending on 31<sup>st</sup> December, 2003, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

|                                | Probability | Loss (Rs.) |
|--------------------------------|-------------|------------|
| In respect of five cases (Win) | 100%        | —          |
| Next ten cases (Win)           | 60%         | —          |
| Lose (Low damages)             | 30%         | 1,20,000   |
| Lose (High damages)            | 10%         | 2,00,000   |
| Remaining five cases           |             |            |
| Win                            | 50%         | —          |
| Lose (Low damages)             | 30%         | 1,00,000   |
| Lose (High damages)            | 20%         | 2,10,000   |

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

- (b) Z Ltd. presents the following information for the year ending 31.03.2002 and 31.03.2003 from which you are required to calculate the Deferred Tax Asset/Liability assuming tax rate of 30% and state how the same should be dealt with as per relevant accounting standard.

|                                                                   | 31.03.2002  | 31.03.2003  |
|-------------------------------------------------------------------|-------------|-------------|
|                                                                   | Rs. (lakhs) | Rs. (lakhs) |
| Depreciation as per books                                         | 4,010.10    | 4,023.54    |
| Unabsorbed carry forward business loss and depreciation allowance | 2,016.60    | 4,110.00    |
| Disallowance under Section 43B of Income tax Act, 1961            | 518.35      | 611.45      |
| Deferred Revenue Expenses                                         | 4.88        | —           |
| Provision for Doubtful Debts                                      | 282.51      | 294.35      |



## Accounting Theory

Z Ltd. had incurred a loss of Rs. 504 lakhs for the year ending 31.03.2003 before providing for Current Tax of Rs. 26.00 lakhs. (4 + 6 = 10 marks)(May, 2004)

Answer

(a) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

- (i) There is a present obligation arising out of past events but not recognized as provision.
- (ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- (iii) The possibility of an outflow of resources embodying economic benefits is also remote.
- (iv) 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 five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 30% of Rs. 1,20,000 + 10% of Rs. 2,00,000  
= Rs. 36,000 + Rs. 20,000  
= Rs. 56,000

Expected loss in remaining five cases = 30% of Rs. 1,00,000 + 20% of Rs. 2,10,000  
= Rs. 30,000 + Rs. 42,000  
= Rs. 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of Rs. 9,20,000 (Rs. 56,000 × 10 + Rs. 72,000 × 5) as contingent liability.

| (b)                                                          | Rs. in lakhs |           |
|--------------------------------------------------------------|--------------|-----------|
|                                                              | 31.3.2002    | 31.3.2003 |
| Carried Forward Business Loss and Depreciation Allowance     | 2,016.60     | 4,110.00  |
| Add: Disallowance under Section 43 B of Income Tax Act, 1961 | 518.35       | 611.45    |

## Advanced Accounting

|                                     |                     |                 |
|-------------------------------------|---------------------|-----------------|
| Provision for Doubtful Debts        | <u>282.51</u>       | <u>294.35</u>   |
|                                     | 2,817.46            | 5,015.80        |
| Less: Depreciation                  | <u>4,010.10</u>     | <u>4,023.54</u> |
|                                     | (–) 1,192.64        | 992.26          |
| Less: Deferred Revenue Expenditure* | <u>4.88</u>         | <u>—</u>        |
| Timing Differences                  | (–) <u>1,197.52</u> | <u>992.26</u>   |
| Deferred Tax Liability              | 359.26              |                 |
| Deferred Tax Asset                  |                     | 297.68          |

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that future taxable income will be available against which such deferred tax assets can be realized. The existence of unabsorbed depreciation or carry forward of losses is strong evidence that future taxable income may not be available. Deferred Tax Asset of Rs. 297.68 lakhs should not be recognized as an asset as per para 17 of AS 22 on 'Accounting for Taxes on Income'. Deferred Tax Liability of Rs. 359.26 lakhs should be disclosed under a separate heading in the balance sheet of Z Ltd., separately from current assets and current liabilities.

### Question 23

- (a) X Co. Ltd. supplied the following information. You are required to compute the basic earning per share:

(Accounting year 1.1.2002 – 31.12.2002)

|                                                                                       |   |                                                                      |
|---------------------------------------------------------------------------------------|---|----------------------------------------------------------------------|
| Net Profit                                                                            | : | Year 2002 : Rs. 20,00,000                                            |
|                                                                                       | : | Year 2003 : Rs. 30,00,000                                            |
| No. of shares outstanding prior to Right Issue                                        | : | 10,00,000 shares                                                     |
| Right Issue                                                                           | : | One new share for each four<br>outstanding i.e., 2,50,000<br>shares. |
|                                                                                       |   | Right Issue price – Rs. 20                                           |
|                                                                                       |   | Last date of exercise rights –<br>31.3.2003.                         |
| Fair rate of one Equity share immediately prior<br>to exercise of rights on 31.3.2003 | : | Rs. 25                                                               |

---

\* It is assumed that the deferred revenue expenditure is actually incurred during the year ended 31<sup>st</sup> March, 2002 and it is fully allowed under the Income Tax Act.

## Accounting Theory

- (b) A Ltd. Leased a machinery to B Ltd. on the following terms:

|                             | (Rs. in Lakhs) |
|-----------------------------|----------------|
| Fair value of the machinery | 20.00          |
| Lease term                  | 5 years        |
| Lease Rental per annum      | 5.00           |
| Guaranteed Residual value   | 1.00           |
| Expected Residual value     | 2.00           |
| Internal Rate of Return     | 15%            |

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

- (c) The following particulars are stated in the Balance Sheet of M/s Exe Ltd. as on 31.03.2003:

|                              | (Rs. in Lakhs) |
|------------------------------|----------------|
| Deferred Tax Liability (Cr.) | 20.00          |
| Deferred Tax Assets (Dr.)    | 10.00          |

The following transactions were reported during the year 2003-04:

- |       |                                                                                                                                                                                           |       |
|-------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| (i)   | Tax Rate                                                                                                                                                                                  | 50%   |
| (ii)  | Depreciation – As per Books                                                                                                                                                               | 50.00 |
|       | Depreciation – for Tax purposes                                                                                                                                                           | 30.00 |
|       | There were no addition to Fixed Assets during the year.                                                                                                                                   |       |
| (iii) | Items disallowed in 2002-03 and allowed for Tax purposes in 2003-04                                                                                                                       | 10.00 |
| (iv)  | Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2004                                                                     | 20.00 |
| (v)   | Donations to Private Trusts made in 2003-04                                                                                                                                               | 10.00 |
| (vi)  | Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2003-04 (1/10th of Rs. 50.00 lakhs incurred in 1999-2000)                                                     | 5.00  |
| (vii) | Repairs to Plant and Machinery Rs. 100.00 lakhs was spread over the period 2003-04 and 2004-05 equally in the books. However, the entire expenditure was allowed for Income-tax purposes. |       |

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets and the balances of Deferred Tax Liability/Deferred Tax Asset as on 31.03.2004.

(8 + 8 + 4 = 20 marks)(November, 2004)

## Advanced Accounting

Answer

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

|                                                                                                                                                           | Year<br>2002 | Year<br>2003 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
|                                                                                                                                                           | Rs.          | Rs.          |
| EPS for the year 2002 as originally reported                                                                                                              |              |              |
| = $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ |              |              |
| = (Rs. 20,00,000 / 10,00,000 shares)                                                                                                                      | 2.00         |              |
| EPS for the year 2002 restated for rights issue                                                                                                           |              |              |
| = [Rs. 20,00,000 / (10,00,000 shares × 1.04*)]                                                                                                            | 1.92         |              |
|                                                                                                                                                           | (approx.)    |              |
| EPS for the year 2003 including effects of rights issue                                                                                                   |              |              |
| $\frac{\text{Rs. 30,00,000}}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$                                |              |              |
| $\frac{\text{Rs. 30,00,000}}{11,97,500 \text{ shares}}$                                                                                                   |              | 2.51         |
|                                                                                                                                                           |              | (approx.)    |

Working Notes:

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

$$\begin{aligned} & \frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}} \\ &= \frac{(\text{Rs. } 25 \times 10,00,000 \text{ shares}) + (\text{Rs. } 20 \times 2,50,000 \text{ shares})}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}} \\ &= \frac{\text{Rs. } 3,00,00,000}{12,50,000 \text{ shares}} = \text{Rs. } 24 \end{aligned}$$

2. Computation of adjustment factor

$$\begin{aligned} &= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} \\ &= \frac{\text{Rs. } 25}{\text{Rs. } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)} \end{aligned}$$

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\* Refer working note 2.

## (b) Computation of Unearned Finance Income

As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where :

- (a) Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

$$\begin{aligned}
 \text{Gross investment} &= \text{Minimum lease payments} + \text{Unguaranteed residual value} \\
 &= (\text{Total lease rent} + \text{Guaranteed residual value}) + \text{Unguaranteed residual value} \\
 &= [(\text{Rs. } 5,00,000 \times 5 \text{ years}) + \text{Rs. } 1,00,000] + \text{Rs. } 1,00,000 \\
 &= \text{Rs. } 27,00,000
 \end{aligned}$$

- (b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

| Year | MLP inclusive of<br>URV       | Internal rate of<br>return (Discount<br>factor 15%) | Present<br>Value |      |
|------|-------------------------------|-----------------------------------------------------|------------------|------|
|      | Rs.                           |                                                     | Rs.              |      |
| 1    | 5,00,000                      | .8696                                               | 4,34,800         |      |
| 2    | 5,00,000                      | .7561                                               | 3,78,050         |      |
| 3    | 5,00,000                      | .6575                                               | 3,28,750         |      |
| 4    | 5,00,000                      | .5718                                               | 2,85,900         |      |
| 5    | 5,00,000                      | .4972                                               | 2,48,600         |      |
|      | 1,00,000                      | .4972                                               | 49,720           |      |
|      | (guaranteed residual value)   |                                                     | <hr/>            |      |
|      |                               |                                                     | 17,25,820        | (i)  |
|      | 1,00,000                      | .4972                                               | 49,720           | (ii) |
|      | (unguaranteed residual value) |                                                     | <hr/>            |      |
|      |                               | (i) + (ii)                                          | <u>17,75,540</u> | (b)  |

$$\begin{aligned}
 \text{Unearned Finance Income} &= (a) - (b) \\
 &= \text{Rs. } 27,00,000 - \text{Rs. } 17,75,540 \\
 &= \text{Rs. } 9,24,460
 \end{aligned}$$

## Advanced Accounting

### Journal Entries in the books of B Ltd.

|                                                                                                                                   |     | Rs.        | Rs.        |
|-----------------------------------------------------------------------------------------------------------------------------------|-----|------------|------------|
| At the inception of lease                                                                                                         |     |            |            |
| Machinery account                                                                                                                 | Dr. | 17,25,820* |            |
| To A Ltd.'s account                                                                                                               |     |            | 17,25,820* |
| (Being lease of machinery recorded at present value of MLP)                                                                       |     |            |            |
| At the end of the first year of lease                                                                                             |     |            |            |
| Finance charges account (Refer Working Note)                                                                                      | Dr. | 2,58,873   |            |
| To A Ltd.'s account                                                                                                               |     |            | 2,58,873   |
| (Being the finance charges for first year due)                                                                                    |     |            |            |
| A Ltd.'s account                                                                                                                  | Dr. | 5,00,000   |            |
| To Bank account                                                                                                                   |     |            | 5,00,000   |
| (Being the lease rent paid to the lessor which includes outstanding liability of Rs. 2,41,127 and finance charge of Rs. 2,58,873) |     |            |            |
| Depreciation account                                                                                                              | Dr. | 1,72,582   |            |
| To Machinery account                                                                                                              |     |            | 1,72,582   |
| (Being the depreciation provided @ 10% p.a. on straight line method)                                                              |     |            |            |
| Profit and loss account                                                                                                           | Dr. | 4,31,455   |            |
| To Depreciation account                                                                                                           |     |            | 1,72,582   |
| To Finance charges account                                                                                                        |     |            | 2,58,873   |
| (Being the depreciation and finance charges transferred to profit and loss account)                                               |     |            |            |

\* As per para 11 of AS 19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 20,00,000 is more than the present value amounting Rs. 17,25,820, the machinery has been recorded at Rs. 17,25,820 in the books of B Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

## Accounting Theory

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

| Year | Outstanding liability<br>(opening balance) | Lease rent | Finance charge  | Reduction in outstanding liability | Outstanding liability<br>(closing balance) |
|------|--------------------------------------------|------------|-----------------|------------------------------------|--------------------------------------------|
|      | Rs.                                        | Rs.        | Rs.             | Rs.                                | Rs.                                        |
| 1    | 17,25,820                                  | 5,00,000   | 2,58,873        | 2,41,127                           | 14,84,693                                  |
| 2    | 14,84,693                                  | 5,00,000   | 2,22,704        | 2,77,296                           | 12,07,397                                  |
| 3    | 12,07,397                                  | 5,00,000   | 1,81,110        | 3,18,890                           | 8,88,507                                   |
| 4    | 8,88,507                                   | 5,00,000   | 1,33,276        | 3,66,724                           | 5,21,783                                   |
| 5    | 5,21,783                                   | 5,00,000   | <u>78,267</u>   | <u>5,21,783</u>                    | 1,00,050*                                  |
|      |                                            |            | <u>8,74,230</u> | <u>17,25,820</u>                   |                                            |

\* The difference between this figure and guaranteed residual value (Rs. 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

(c) Impact of various items in terms of deferred tax liability/deferred tax asset.

| Transactions                                   | Analysis                                                                                                                                                                                   | Nature of difference         | Effect          | Amount                            |
|------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|-----------------|-----------------------------------|
| Difference in depreciation                     | Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. | Responding timing difference | Reversal of DTL | Rs. 20 lakhs × 50% = Rs. 10 lakhs |
| Disallowances, as per IT Act, of earlier years | Tax payable for the earlier year was higher on this account.                                                                                                                               | Responding timing difference | Reversal of DTA | Rs. 10 lakhs × 50% = Rs. 5 lakhs  |
| Interest to financial institutions             | It is allowed as deduction under section 43B of the IT Act, if the payment is made before the due date of filing the return of income (i.e. 31st October, 2004).                           | No timing difference         | Not applicable  | Not applicable                    |

## Advanced Accounting

|                                |                                                                                                    |                               |                 |                                   |
|--------------------------------|----------------------------------------------------------------------------------------------------|-------------------------------|-----------------|-----------------------------------|
| Donation to private trusts     | Not an allowable expenditure under IT Act.                                                         | Permanent difference          | Not applicable  | Not applicable                    |
| Share issue expenses           | Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher. | Responding timing difference  | Reversal of DTA | Rs. 5 lakhs × 50% = Rs. 2.5 lakhs |
| Repairs to plant and machinery | Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.   | Originating timing difference | Increase in DTL | Rs. 50 lakhs × 50% = Rs. 25 lakhs |

### Deferred Tax Liability Account

| Dr.       |    |                                        |                 |          |    |                                            | Cr.             |
|-----------|----|----------------------------------------|-----------------|----------|----|--------------------------------------------|-----------------|
|           |    |                                        | Rs.<br>in lakhs |          |    |                                            | Rs.<br>in lakhs |
| 31.3.2004 | To | Profit and Loss account (Depreciation) | 10.00           | 1.4.2003 | By | Balance b/d                                | 20.00           |
|           |    |                                        |                 |          | By | Profit and Loss Account (Repairs to plant) | 25.00           |
|           | To | Balance c/d                            | <u>35.00</u>    |          |    |                                            | <u>45.00</u>    |
|           |    |                                        | <u>45.00</u>    |          |    |                                            |                 |
|           |    |                                        |                 | 1.4.2004 | By | Balance b/d                                | 35.00           |

### Deferred Tax Asset Account

| Dr.      |    |             |              |           |    |                                                                                                | Cr.          |
|----------|----|-------------|--------------|-----------|----|------------------------------------------------------------------------------------------------|--------------|
|          |    |             | Rs. in lakhs |           |    |                                                                                                | Rs. in lakhs |
| 1.4.2003 | To | Balance b/d | 10.00        | 31.3.2004 | By | Profit and Loss Account:<br>Items disallowed in 2002-03 and allowed as per I.T. Act in 2003-04 | 5.00         |
|          |    |             |              |           |    | Share issue expenses                                                                           | 2.50         |
|          |    |             |              |           | By | Balance c/d                                                                                    | <u>2.50</u>  |
|          |    |             | <u>10.00</u> |           |    |                                                                                                | <u>10.00</u> |
| 1.4.2004 | To | Balance b/d | 2.50         |           |    |                                                                                                |              |



## Question 24

- (a) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are Rs. 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is Rs. 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.
- (i) State with reason whether the lease constitutes finance lease.
- (ii) Calculate unearned finance income.
- (b) Intelligent Corporation (I–Corp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

| Quarter I<br>Ending 31st March | II<br>30th June | III<br>30th September | IV<br>31st December |
|--------------------------------|-----------------|-----------------------|---------------------|
| -                              | -               | -                     | -*                  |

For the First quarter ending 31st March, 2005, I–Corp. gives you the following information:

|                                     | Rs. crores |
|-------------------------------------|------------|
| Sales                               | 50         |
| Salary and other expenses           | 30         |
| Advertisement expenses (routine)    | 02         |
| Administrative and selling expenses | 08         |

While preparing interim financial report for the first quarter 'I–Corp.' wants to defer Rs. 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

- (c) Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crore in capital assets, received Rs. 10 crore from the Government in January, 2005 (accounting period being 2004-2005). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2005.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

( 4 + 4 + 4 = 12 marks)(May, 2005)

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\* There may be some percentage of sales given herein.

## Advanced Accounting

Answer

- (a) (i) Present value of residual value = Rs. 40,000 × 0.7513 = Rs. 30,052  
Present value of lease payments = Rs. 3,00,000 – Rs. 30,052 = Rs. 2,69,948.

The present value of lease payments being 89.98%  $\left( \frac{2,69,948}{3,00,000} \times 100 \right)$  of the fair value, i.e. being a substantial portion thereof, the lease constitutes a finance lease.

- (ii) Calculation of unearned finance income

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

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

- (b) Result of the first quarter  
ended 31st March, 2005

|                                             |                 |
|---------------------------------------------|-----------------|
|                                             | (Rs. in crores) |
| Turnover                                    | 50              |
| Add: Other Income                           | <u>Nil</u>      |
| Total                                       | 50              |
| Less: Change in inventories                 | Nil             |
| Salaries and other cost                     | 30              |
| Administrative and selling expenses (8 + 2) | <u>10</u>       |
| Profit                                      | <u>10</u>       |

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per para 38 of AS 25, the costs should be anticipated or deferred only when

- (i) it is appropriate to anticipate that type of cost at the end of the financial year, and  
(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of Rs. 21 crores is not tenable as expenditures are uniform through out all quarters.

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

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

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

**Question 25**

- (a) Venus Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2005 at Rs. 500 lakhs. As at that date the value in use is Rs. 400 lakhs and the net selling price is Rs. 375 lakhs.

From the above data:

- (i) Calculate impairment loss.
  - (ii) Prepare journal entries for adjustment of impairment loss.
  - (iii) Show, how impairment loss will be shown in the Balance Sheet.
- (b) Himalaya Ltd. in the past three years spent Rs. 75,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS 8 criteria for capitalization. In the current year approval of the concerned Government Authority has been received. The Company wishes to capitalize Rs. 75,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views.
- (c) Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with registrar subsequent to Balance Sheet date. But before finalisation, is it possible to recognise the sale and the gain at the Balance Sheet date? Give your view with reasons.
- (d) In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees?

(6 + 5 + 5+5 = 21Marks)(Nov.2005)

**Answer**

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

∴ Recoverable amount = Rs. 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

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

## Advanced Accounting

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

### (iii) Balance Sheet of Venus Ltd. as on 31.3.2005

|                         | Rs. in lakhs |
|-------------------------|--------------|
| Asset less depreciation | 500          |
| Less: Impairment loss   | <u>100</u>   |
|                         | <u>400</u>   |

- (b) AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. In any case, under either standard, the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account. Once the amount is charged to the Profit and Loss account, such amount cannot be restated later as a Research and Development Asset when the condition for recognition get fulfilled. The Company therefore cannot capitalize Rs. 75,00,000 even as a prior period item.
- (c) Yes, both sales and gain of Bottom Ltd. should be recognized. In accordance with AS 9 at the Balance Sheet date and what was pending was merely a formality to register the deed. It is clear that significant risk and rewards of ownership had passed before the balance sheet date. Further the registration post the balance sheet date confirms the condition of sale at the balance sheet date as per AS 4.
- (d) Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Question 26

- (a) 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?

- (b) Distinguish between "Timing differences" and "Permanent differences" referred to in AS 22 on Accounting for Taxes, giving 2 examples of each. (4 + 4 = 8Marks)( Nov. 2005)

Answer

- (a) AS 16 clearly states 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.
- (b) 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:

- (i) Unabsorbed depreciation and, carry forward of losses which can be set-off against future taxable income.
- (ii) 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:

- (i) Agricultural income.
- (ii) Donations/contributions disallowed for tax purposes

Question 27

- (a) Global Ltd. has initiated a lease for three years in respect of an equipment costing Rs.1,50,000 with expected useful life of 4 years. The asset would revert to Global Limited under the lease agreement. The other information available in respect of lease agreement is:
- (i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs.20,000.
  - (ii) The implicit rate of interest is 10%.

## Advanced Accounting

- (iii) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Global Ltd.

- (i) The annual lease payment.  
(ii) The unearned finance income.  
(iii) The segregation of finance income, and also,  
(iv) Show how necessary items will appear in its profit and loss account and balance sheet for the various years. (8 marks)
- (b) Swift Ltd. acquired a patent at a cost of Rs.80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at Rs.10,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs.36,00,000, Rs.46,00,000, Rs.44,00,000, Rs.40,00,000 and Rs.34,00,000. Find out the amortization cost of the patent for each of the years. (4 marks)
- (c) The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

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

The Chief accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss. (4 marks)

(May, 2006)

### Answer

- (a) (i) Calculation of Annual Lease Payment\*

|                                                                         | Rs.      |
|-------------------------------------------------------------------------|----------|
| Cost of the equipment                                                   | 1,50,000 |
| Unguaranteed Residual Value                                             | 20,000   |
| PV of residual value for 3 years @ 10% (Rs.20,000 x 0.751)              | 15,020   |
| Fair value to be recovered from Lease Payment (Rs.1,50,000 – Rs.15,020) | 1,34,980 |
| PV Factor for 3 years @ 10%                                             | 2.487    |
| Annual Lease Payment (Rs. 1,34,980 / PV Factor for 3 years @ 10% i.e.   |          |

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\* Annual lease payments are considered to be made at the end of each accounting year.

## Accounting Theory

2.487) 54,275

(ii) Unearned Financial Income

|                                                              |                 |
|--------------------------------------------------------------|-----------------|
| Total lease payments [Rs. 54,275 x 3]                        | 1,62,825        |
| Add: Residual value                                          | <u>20,000</u>   |
| Gross Investments                                            | 1,82,825        |
| Less: Present value of Investments (Rs.1,34,980 + Rs.15,020) | <u>1,50,000</u> |
| Unearned Financial Income                                    | <u>32,825</u>   |

(iii) Segregation of Finance Income

| Year | Lease Rentals   | Finance Charges @<br>10% on outstanding<br>amount of the year | Repayment       | Outstanding<br>Amount |
|------|-----------------|---------------------------------------------------------------|-----------------|-----------------------|
|      | Rs.             | Rs.                                                           | Rs.             | Rs.                   |
| 0    | -               | -                                                             | -               | 1,50,000              |
| I    | 54,275          | 15,000                                                        | 39,275          | 1,10,725              |
| II   | 54,275          | 11,073                                                        | 43,202          | 67,523                |
| III  | <u>74,275**</u> | <u>6,752</u>                                                  | <u>67,523</u>   | --                    |
|      | <u>1,82,825</u> | <u>32,825</u>                                                 | <u>1,50,000</u> |                       |

(iv) Profit and Loss Account ( Relevant Extracts)

| Credit side |                   | Rs.           |
|-------------|-------------------|---------------|
| I Year      | By Finance Income | <u>15,000</u> |
| II year     | By Finance Income | <u>11,073</u> |
| III year    | By Finance Income | <u>6,752</u>  |

Balance Sheet ( Relevant Extracts)

| Assets side                       | Rs.           | Rs.             |
|-----------------------------------|---------------|-----------------|
| I year Lease Receivable           | 1,50,000      |                 |
| Less: Amount Received             | <u>39,275</u> | <u>1,10,725</u> |
| II year Lease Receivable          | 1,10,725      |                 |
| Less: Received                    | <u>43,202</u> | <u>67,523</u>   |
| III year :Lease Amount Receivable | 67,523        |                 |

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\*\* Rs. 74,275 includes unguaranteed residual value of equipment amounting Rs. 20,000.

## Advanced Accounting

|                                              |               |                 |
|----------------------------------------------|---------------|-----------------|
| Less: Amount received                        | 47,523        |                 |
| Residual value                               | <u>20,000</u> | <u>NIL</u>      |
| Notes to Balance Sheet                       |               |                 |
| Year 1                                       |               | Rs.             |
| Minimum Lease Payments (54,275 + 54,275)     |               | 1,08,550        |
| Residual Value                               |               | <u>20,000</u>   |
|                                              |               | 1,28,550        |
| Unearned Finance Income(11,073+ 6,752)       |               | <u>17,825</u>   |
| Lease Receivables                            |               | <u>1,10,725</u> |
| Classification:                              |               |                 |
| Not later than 1 year                        |               | 43,202          |
| Later than 1 year but not more than 5 years  |               | <u>67,523</u>   |
| Total                                        |               | <u>1,10,725</u> |
| Year II:                                     |               |                 |
| Minimum Lease Payments                       |               | 54,275          |
| Residual Value (Estimated)                   |               | <u>20,000</u>   |
|                                              |               | 74,275          |
| Unearned Finance Income                      |               | <u>6,752</u>    |
| Lease Receivables (not later than 1year)     |               | 67,523          |
| III Year:                                    |               |                 |
| Lease Receivables (including residual value) |               | 67,523          |
| Amount Received                              |               | <u>67,523</u>   |
|                                              |               | <u>NIL</u>      |

- (b) Swift Limited amortised Rs.10,00,000 per annum for the first two years i.e. Rs.20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

| Year | Net cash flows<br>Rs | Amortization Ratio | Amortization Amount<br>Rs. |
|------|----------------------|--------------------|----------------------------|
| I    | -                    | 0.125              | 10,00,000 <sup>1</sup>     |
| II   | -                    | <u>0.125</u>       | 10,00,000                  |
| III  | 36,00,000            | 0.180              | 10,80,000                  |
| IV   | 46,00,000            | 0.230              | 13,80,000                  |

<sup>1</sup> It has been assumed that the company had amortized the patent at Rs. 10,00,000 per annum in the first two years on the basis of economic benefits derived from the product manufactured under the patent.



## Accounting Theory

|       |                    |              |                  |
|-------|--------------------|--------------|------------------|
| V     | 44,00,000          | 0.220        | 13,20,000        |
| VI    | 40,00,000          | 0.200        | 12,00,000        |
| VII   | <u>34,00,000</u>   | <u>0.170</u> | <u>10,20,000</u> |
| Total | <u>2,00,00,000</u> | <u>1.000</u> | <u>80,00,000</u> |

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs.60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

- (c) As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:
- (i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or
  - (ii) Its segment result whether profit or loss is 10% or more of:
    - (1) The combined result of all segments in profit; or
    - (2) The combined result of all segments in loss, whichever is greater in absolute amount; or
  - (iii) Its segment assets are 10% or more of the total assets of all segments.

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

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

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

### Question 28

- (a) Narmada Ltd. sold goods for Rs.90 lakhs to Ganga Ltd. during financial year ended 31-3-2006. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

### Advanced Accounting

- (b) Milton Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is Rs.200 lakhs and 400 lakhs respectively. From the 3<sup>rd</sup> year onwards, it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate @35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.
- (c) Victory Ltd. purchased goods on credit from Lucky Ltd. for Rs.250 crores for export. The export order was cancelled. Victory Ltd. decided to sell the same goods in the local market with a price discount. Lucky Ltd. was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified.
- (d) Accountants of Poornima Ltd. show a net profit of Rs.7,20,000 for the third quarter of 2005 after incorporating the following:
- (i) Bad debts of Rs.40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
  - (ii) Extra ordinary loss of Rs.35,000 incurred during the quarter has been fully recognized in this quarter.
  - (iii) Additional depreciation of Rs.45,000 resulting from the change in the method of charge of depreciation.

Ascertain the correct quarterly income.

(4x4=16 Marks)(May, 2006)

#### Answer

- (a) As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise.

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

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

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

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

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

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

- (c) Lucky Ltd. had sold goods to Victory Ltd on credit worth for Rs.250 crores and the sale was completed in all respects. Victory Ltd's decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. The price discount of 15% offered by Lucky Ltd. after request of Victory Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. Now, as far Lucky Ltd is concerned, there appears to be an uncertainty relating to the collectability of the debt, which has arisen subsequent to the time of sale therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be written off to the profit and loss account and not shown as deduction from the sales figure.

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

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

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

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

#### Question 29

- (a) A company had imported raw materials worth US Dollars 6,00,000 on 5<sup>th</sup> January, 2005, when the exchange rate was Rs.43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5<sup>th</sup> April, 2005 when the exchange rate was Rs.47 per US Dollar. However, on 31<sup>st</sup> March, 2005, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31<sup>st</sup> March, 2005 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

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

Comment on the valuation of the stocks by the company.

- (c) A company with a turnover of Rs.250 crores and an annual advertising budget of Rs.2 crore had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs. 25 crores from the new product. The company had debited

### Advanced Accounting

to its Profit and Loss account the total expenditure of Rs.2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

- (d) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.
- (e) Mohur Ltd. has equity capital of Rs.40,00,000 consisting of fully paid equity shares of Rs.10 each. The net profit for the year 2004-05 was Rs.60,00,000. It has also issued 36,000, 10% convertible debentures of Rs.50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings.

(4 Marks each)(Nov. 2006)

### Answer

- (a) As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e, Rs.48 at 31<sup>st</sup> March, 2005 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs.5 (48-43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31<sup>st</sup> March, 2005 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs.48 and Rs.47 per Us dollar. Hence, the accounting treatment adopted by the company is incorrect.
- (b) Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

- (c) According to paras 55 and 56 of AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs.25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs.2 crores to the Profit and Loss account of the year is correct.

- (d) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

- |                                               |                                          |
|-----------------------------------------------|------------------------------------------|
| (e) Interest on Debentures @ 10% for the year | $36,000 \times 50 \times \frac{10}{100}$ |
|                                               | = Rs.1,80,000                            |
| Tax on interest @ 30%                         | = Rs.54,000                              |
| Diluted Earnings (Adjusted net profit)        | = (60,00,000 + 1,80,000-54,000)          |
|                                               | = Rs. 61,26,000                          |

**Question 30**

- (a) During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company Accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss account as a prior period item.

Is the Company's proposed accounting treatment correct? Discuss.

- (b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs.2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal? Discuss.

- (c) A Company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company, it was noticed that the

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production lines output was not of the desired quality. However, company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.

In the background of the relevant accounting standard, advise the company on the cut-off date for capitalization of the project cost.

- (d) A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct? (4+4+4+4 = 16 Marks)(May, 2007)

Answer

- (a) The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes In Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. As per paragraph 8 of AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. The amount so written-back (If material) should be disclosed as an extraordinary item as per AS 5.
- (b) According to para 14 of AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.
- (c) As per provisions of AS 10 'Accounting for Fixed Assets', expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period. In the present case, the company did stop production even if the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalization should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

- (d) AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

**Question 31**

Write short notes on:

- (a) Impairment of asset and its application to inventory.
- (b) Treatment of borrowing costs.
- (c) Accounting for investment by a holding company in subsidiaries.

(4 marks each) (May, 2007)

- (d) Concept of Materiality.

(6 Marks) (Nov. 2007)

**Answer**

- (a) The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.
- (b) According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production

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of a qualifying asset\* should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.

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

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) is carried normally at cost.

- (d) Para 17 of AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective, materiality has to do with the significance of an item or event to warrant attention in the accounting process. From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Individual judgements are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organisation, may not be material for another organisation.

The relevance of information is affected by its materiality. Information is material if its misstatements (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

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\* A qualifying asset is an asset that necessarily takes a substantial period of time<sup>1</sup> to get ready for its intended use or sale.



## Question 32

- (a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

|                                       | Rs. (in lacs) | Rs.(in lacs)       |
|---------------------------------------|---------------|--------------------|
| Net Profit                            |               | 60,000             |
| Add: Sale of Investments              |               | 70,000             |
| Depreciation on Assets                |               | 11,000             |
| Issue of Preference Shares            |               | 9,000              |
| Loan raised                           |               | 4,500              |
| Decrease in Stock                     |               | 12,000             |
|                                       |               | <hr/> 1,66,500     |
| Less: Purchase of Fixed Assets        | 65,000        |                    |
| Decrease in Creditors                 | 6,000         |                    |
| Increase in Debtors                   | 8,000         |                    |
| Exchange gain                         | 8,000         |                    |
| Profit on sale of investments         | 12,000        |                    |
| Redemption of Debenture               | 5,700         |                    |
| Dividend paid                         | 1,400         |                    |
| Interest paid                         | <u>945</u>    | <u>1,07,045</u>    |
|                                       |               | 59,455             |
| Add: Opening cash and cash equivalent |               | 12,341             |
| Closing cash and cash equivalent      |               | <hr/> 71,796 <hr/> |

- (b) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

- (c) Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being Rs.7,00,000. The economic life of the machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays Rs.3,00,000. Guaranteed Residual Value (GRV) is Rs.22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

### Advanced Accounting

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance charges) in each year. (6+4+6 = 16 Marks)(Nov. 2007)

Answer

| (a) Cash Flow Statement                          |                 | (Rs. in lacs)   |
|--------------------------------------------------|-----------------|-----------------|
| Cash flows from operating activities             |                 |                 |
| Net profit                                       |                 | 60,000          |
| Less: Exchange gain                              |                 | (8,000)         |
| Less: Profit on sale of investments              |                 | <u>(12,000)</u> |
|                                                  |                 | 40,000          |
| Add: Depreciation on assets                      |                 | <u>11,000</u>   |
| Change in current assets and current liabilities |                 | 51,000          |
| (-) Increase in debtors                          | (8,000)         |                 |
| (+) Decrease in stock                            | 12,000          |                 |
| (-) Decrease in creditors                        | <u>(6,000)</u>  | <u>(2,000)</u>  |
| Net cash from operating activities               |                 | 49,000          |
| Cash flows from investing activities             |                 |                 |
| Sale of investments                              | 70,000          |                 |
| Purchase of fixed assets                         | <u>(65,000)</u> |                 |
| Net cash from Investing activities               |                 | 5,000           |
| Cash flows from financing activities             |                 |                 |
| Issue of preference shares                       | 9,000           |                 |
| Loan raised                                      | 4,500           |                 |
| Redemption of Debentures                         | (5,700)         |                 |
| Interest paid                                    | (945)           |                 |
| Dividend paid                                    | <u>(1,400)</u>  |                 |
| Net cash from financing activities               |                 | <u>5,455</u>    |
| Net increase in cash & cash equivalents          |                 | 59,455          |
| Add: Opening cash and cash equivalents           |                 | <u>12,341</u>   |
| Closing cash and cash equivalents                |                 | <u>71,796</u>   |

- (b) P Ltd. has direct economic interest in R Ltd to the extent of 14%, and through Q Ltd. in which it is the majority shareholders, it has further control of 12% in R Ltd. (60% of Q Ltd's 20%). These two taken together (14% + 12%) make the total control of 26%.

Para 10 of AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Here, Control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

In the present case, control of P Ltd. in R Ltd. directly and through Q Ltd., does not go beyond 26%. However, as per para 12 of AS 18, significant influence may be exercised as an investing party (P Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd. As R Ltd. is a listed company and regularly supplies goods to P Ltd. therefore, related party disclosure, as per AS 18, is required.

- (c) Value of machine will be lower of the fair value or present value (PV) of Minimum Lease Payments (MLP).

Present value (PV) of Minimum Lease Payments (MLP)

| Year | MLP                                   | PV at 15%<br>Rs. | PV Amount<br>Rs. |
|------|---------------------------------------|------------------|------------------|
| 1    | 3,00,000                              | 0.869            | 2,60,700         |
| 2    | 3,00,000                              | 0.756            | 2,26,800         |
| 3    | 3,22,000 (considering residual value) | 0.657            | <u>2,11,554</u>  |
|      |                                       |                  | <u>6,99,054</u>  |

Since PV of MLP Rs. 6,99,054 being lower than the fair value Rs. 7,00,000, therefore, value of machine will be taken as Rs.6,99,054.

Calculation of interest (finance charges)

| Year            |                 | Liability<br>Rs. | Interest at 15%<br>Rs. | Principal<br>Rs.    | Lease rental<br>Rs. |
|-----------------|-----------------|------------------|------------------------|---------------------|---------------------|
|                 |                 | 6,99,054         | 1,04,858               | 1,95,142            | 3,00,000            |
| 1 <sup>st</sup> | Less: Principal | <u>1,95,142</u>  |                        | (Rental – Interest) |                     |
|                 |                 | 5,03,912         | 75,587                 | 2,24,413            | 3,00,000            |
| 2 <sup>nd</sup> | Less: Principal | <u>2,24,413</u>  |                        | (Rental – Interest) |                     |
|                 |                 | 2,79,499         | 41,925                 | 2,58,075            | 3,00,000            |
| 3 <sup>rd</sup> | Less: Principal | <u>2,58,075</u>  |                        | (Rental – Interest) |                     |
|                 | Residual value  | <u>21,424*</u>   |                        |                     |                     |

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\* The difference between this figure and guaranteed residual value (Rs. 22,000) is due to approximation in computing the interest rate implicit in the lease.

## Advanced Accounting

### Question 33

X Ltd. began construction of a new building on 1<sup>st</sup> January, 2007. It obtained Rs.1 lakh special loan to finance the construction of the building on 1<sup>st</sup> January, 2007 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

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

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

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

Building was completed by 31<sup>st</sup> December, 2007. Following the principles prescribed in AS-16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building. (10 Marks) (May, 2008)

Answer

|                                                 |                 |
|-------------------------------------------------|-----------------|
| (i) Computation of average accumulated expenses | Rs.             |
| Rs. 2,00,000 x 12 / 12                          | = 2,00,000      |
| Rs. 2,50,000 x 9 / 12                           | = 1,87,500      |
| Rs. 4,50,000 x 6 / 12                           | = 2,25,000      |
| Rs. 1,20,000 x 1 / 12                           | = <u>10,000</u> |
|                                                 | <u>6,22,500</u> |

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

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

## (iii) Interest on average accumulated expenses

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

## (iv) Total expenses to be capitalized for building

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

## (v) Journal Entry

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

## Question 34

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

You are required to calculate:

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

Ignore depreciation.

- (b) Mini Ltd. took a factory premises on lease on 1.4.07 for Rs.2,00,000 per month. The lease is operating lease. During March, 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto

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\* (Rs. 6,22,500 – Rs. 1,00,000)

### Advanced Accounting

31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.

- (c) A Cosmetic articles producing company provides the following information:

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

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

(5+5+5 =15 Marks) (May, 2008)

#### Answer

- (a) As per AS 26 'Intangible Assets'

- (i) For the year ending 31.03.2007

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

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

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

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

- (ii) For the year ending 31.03.2008

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

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

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

(2) Carrying value of intangible as on 31.03.2008:

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

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

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

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

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

### Question 35

From the following information of Beta Ltd. calculate Earning Per Share (EPS) in accordance with AS-20:

|                               |                 | (Rs.)         |
|-------------------------------|-----------------|---------------|
|                               | Year 31.3.08    | Year 31.3.07  |
| 1. Net profit before tax      | 3,00,000        | 1,00,000      |
| 2. Current tax                | 40,000          | 30,000        |
| Tax relating to earlier years | 24,000          | (13,000)      |
| Deferred tax                  | 30,000          | 10,000        |
| 3. Profit after tax           | <u>2,06,000</u> | <u>73,000</u> |

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

## Advanced Accounting

### 4. Other information:

- (a) Profit includes compensation from Central Government towards loss on account of earthquake in 2005 (non-taxable) 1,00,000 NIL
- (b) Outstanding convertible 6% Preference shares 1,000 issued and paid on 30.9.2006. Face value Rs.100, Conversion ratio 15 equity shares for every preference share.
- (c) 15% convertible debentures of Rs.1,000 each total face value Rs.1,00,000 to be converted into 10 Equity shares per debenture issued and paid on 30.6.2006.
- (d) Total no. of Equity shares outstanding as on 31.3.2008, 20,000 including 10,000 bonus shares issued on 1.1.08, face value Rs.100.

Administrative and Collection costs

25,000

(8 Marks) (Nov. 2008)

### Answer

#### (a) Calculation of Earning Per Share (EPS) of Beta Ltd.

|                                                                                | Rs.                   | Rs.                   |
|--------------------------------------------------------------------------------|-----------------------|-----------------------|
|                                                                                | Year ended<br>31.3.08 | Year ended<br>31.3.07 |
| 1. A Earning after extra ordinary items<br>(2,06,000 – 6,000) (73,000 – 3,000) | 2,00,000              | 70,000                |
| B. No. of Equity Shares                                                        | 20,000                | 20,000                |
| C. Basic Earnings Per share [A/B]                                              | 10.00                 | 3.50                  |
| A. Earning before extra ordinary items                                         | 1,00,000              | 70,000                |
| B. No. of Equity Shares                                                        | 20,000                | 20,000*               |
| C. Basic Earnings Per share [A/B]                                              | 5.00                  | 3.50                  |
| 2. Tax Rate applicable                                                         |                       |                       |
| 40,000 + 30,000/2,00,000                                                       | 35%                   |                       |
| 30,000 + 10,000/1,00,000                                                       |                       | 40%                   |

\* Since the bonus issue is without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2007.



## Accounting Theory

|    |    |                                                                |                 |                 |
|----|----|----------------------------------------------------------------|-----------------|-----------------|
| 3. | A. | Dividend on Weighted Average Preference Shares                 | 6,000           | 3,000           |
|    | B. | Incremental shares                                             | 15,000          | 7,500           |
|    | C. | EPS on Incremental Shares [A/B]                                | 0.40            | 0.40            |
|    |    |                                                                | (dilutive)      | (dilutive)      |
| 4. |    | Convertible Debentures                                         |                 |                 |
|    | A. | Increase in earnings                                           |                 |                 |
|    |    | $(1,00,000 \times \frac{15}{100} \times .65)$                  | 9,750           |                 |
|    |    | $100,000 \times \frac{15}{100} \times .60 \times \frac{9}{12}$ |                 | 6,750           |
|    | B. | Increase in shares                                             | 1,000           | 750             |
|    | C. | Increase in EPS [A/B]                                          | 9.75            | 9.00            |
|    |    |                                                                | (Anti dilutive) | (Anti dilutive) |

It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

|                                                                       |                       |                       |
|-----------------------------------------------------------------------|-----------------------|-----------------------|
| Calculation of Diluted EPS                                            | Year ended<br>31.3.08 | Year ended<br>31.3.07 |
|                                                                       | Rs.                   | Rs.                   |
| A.                                                                    |                       |                       |
| Profit from continuing ordinary activities before Preference Dividend | 1,06,000              | 73,000                |
| No. of ordinary equity shares                                         | 20,000                | 20,000                |
| Adjustment for dilutive potential of 6% convertible pref. shares      | 15,000                | 7,500                 |
| B.                                                                    |                       |                       |
| Total no. of shares                                                   | 35,000                | 27,500                |
| C.                                                                    |                       |                       |
| Diluted EPS from continuing ordinary operations [A/B]                 | 3.02                  | 2.65                  |
| D.                                                                    |                       |                       |
| Profit including extra ordinary items                                 | 2,06,000              | 73,000                |
| E.                                                                    |                       |                       |
| Adjusted No. of shares                                                | 35,000                | 27,500                |
| F.                                                                    |                       |                       |
| Diluted EPS including extra ordinary items [D/E]                      | 5.88                  | 2.65                  |

## Advanced Accounting

Disclosure of EPS in accordance with AS 20 in the Profit and Loss Account

|                                                 |                |               |
|-------------------------------------------------|----------------|---------------|
| Earning per share (Face value Rs.100)           | 31.3.08 (Rs. ) | 31.3.07 (Rs.) |
| Basic EPS from continuing ordinary operations   | 5.00           | 3.50          |
| Diluted EPS from continuing ordinary operations | 3.02           | 2.65          |

### Question 36

- (a) Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with references to AS-9.
- (b) Discuss the concept of Cost v/s Fair value with reference to Indian Accounting Standards.
- (c) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

- (i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.
- (ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (4 marks each) (Nov. 2008)

### Answer

- (a) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

In the case of the Jewellery Business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The

company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

**(b) Cost vs. Fair value**

**Cost basis:** The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

**Fair value:** Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm's length transaction.

Indian Accounting Standards are generally based on historical cost with a very few exceptions:

AS 2 "Valuation of Inventories" – Inventories are valued at net realizable value (NRV) if cost of inventories is more than NRV.

AS 10 "Accounting for Fixed Assets" – Items of fixed assets that have been retired from active use and are held for disposal are stated at net realizable value if their net book value is more than NRV.

AS 13 "Accounting for Investments" – Current investments are carried at lower of cost and fair value. The carrying amount of long term investments is reduced to recognise the permanent decline in value.

AS 15 "Employee Benefits" – The provision for defined benefits is made at fair value of the obligations.

AS 26 "Intangible Assets" – If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

AS 28 "Impairment of Assets" – Provision is made for impairment of assets.

On the other hand IFRS and US GAAPs are more towards fair value. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

- (c)** The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made

### Advanced Accounting

regarding future conditions and events, which are largely outside the company's control. Thus,

- (1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).
- (2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
- (3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

#### Question 37

- (a) XYZ Ltd., with a turnover of Rs.35 lakhs and borrowings of Rs.10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2008. Advise the management the exemptions that are available as per Companies (AS) Rules, 2006.

If XYZ is a partnership firm is there any other exemptions additionally available.

- (b) Write short note on NACAS. (8 + 4 = 12marks)(Nov. 2008)

#### Answer

- (a) XYZ Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

1. AS 3 "Cash Flow Statements" is not mandatory.
2. AS 17 "Segment Reporting" is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 "Leases".
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 "Impairment of Assets".
6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets".
7. SMEs are exempt from certain requirements of AS 15 "Employee Benefits".
8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

If XYZ is not a company, it will be treated as a level III enterprise instead of level II enterprise; XYZ Ltd. will be exempt from requirements of AS 18 "Related Party Disclosures" and AS 24 "Discontinuing Operations".

- (b) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006.

**Question 38**

- (a) Summarise the recommendations of the Institute of Chartered Accountants of India regarding accounting treatment of excise duty. (10 marks)
- (b) Write a short note on accounting of income during construction period. (5 marks)
- (c) 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. (3 marks) (November, 1996)

**Answer**

- (a) As per the Guidance Note on Accounting Treatment for Excise Duty issued by the Institute, the summary of recommendations is given as below:
- (i) Excise duty should be considered as a manufacturing expense and like other manufacturing expense be considered as an element of cost for inventory valuation.
  - (ii) Where excise duty is paid on excisable goods and such goods are subsequently utilised in the manufacturing process the duty paid on such goods becomes a manufacturing cost and must be included in the valuation of work-in-progress or finished goods arising from the subsequent processing of such goods.
  - (iii) Where the liability for excise duty has been incurred but its collection is deferred, provision for the unpaid liability should be made. The estimate of such liability can be made at the rates in force on the balance sheet date. If provision is not made, the liability should be quantified and the fact about the non-provision of such liability should be disclosed in the accounts.
  - (iv) The excise duty cannot be treated as a period cost.
  - (v) If the method of accounting for excise duty or the method of inventory valuation is not in accordance with the principles explained in this guidance note, the auditor should qualify his report.

Note: The ICAI has issued a separate Guidance Note on Accounting Treatment for MODVAT which sets out principles of accounting for MODVAT (now renamed as CENVAT). The Guidance Note 'Accounting Treatment for MODVAT/CENVAT' is, currently under revision.

- (b) The treatment and accounting of, income during the construction or pre-production period

## Advanced Accounting

has been explained in para 8.1 of the Guidance Note on Treatment of Expenditure During Construction Period. According to it, it is possible that a new project may earn some income from miscellaneous sources during its construction or pre-production period. Such income may be earned by way of interest from the temporary investment of surplus funds prior to their utilisation for capital or other expenditure or from sale of products manufactured during the period of test runs and experimental production. Such items of income should be disclosed separately either in the profit and loss account, where this account is prepared during construction period, or in the account/statement prepared in lieu of the profit and loss account, i.e., Development Account/Incidental Expenditure During Construction Period Account/Statement on Incidental Expenditure During Construction.

The treatment of such incomes for arriving at the amount of expenditure to be capitalised/deferred, has been dealt with in para 15.2. According to para 15.2, from the total of the items of indirect expenditure (mentioned in para 15.1 e.g. preliminary project expenditure, financial expenses, depreciation on fixed assets used during the period of construction etc.), would be deducted the income, if any, earned during the period of construction, provided it can be identified with the project.

Note: Currently, Guidance Note 'Accounting Treatment of Expenditure during Construction Period' is under revision.

- (c) 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.

### Question 39

A factory went into commercial production on 1st April, 1997. It uses as its raw materials product X on which excise duty of Rs. 30 per Kg. is paid and product Y on which excise duty of Rs. 20 per kg. is paid. On 31st March, 1997 it had stock of 20,000 kgs. of X and 15,000 kgs. of Y which it had purchased at an all inclusive price of Rs. 150 per kg. for X and Rs. 120 per kg. for Y. The suppliers of X and Y are to receive payment on 15th May, 1997.

During April 1997, the factory manufactured 40,000 units of the end product for which the

## Accounting Theory

consumption of material X was 60,000 kgs. and material Y was 45,000 kgs. The excise duty on the end product is Rs. 60 per unit. 30,000 units of the end product were dispatched, 8,000 units were kept in warehouse and balance 2,000 kgs. were kept in finished goods godown.

During the month the factory purchased 50,000 kgs. of X at Rs. 145 per kg. (inclusive of excise duty of Rs. 30 per kg.) on credit of 60 days and 50,000 kgs. of Y at Rs. 110 per kg. (inclusive of excise duty of Rs. 20 per kg.) on credit of 45 days.

The cost of "converting" the raw materials into finished product amounts to Rs. 150 per unit of end product of which Rs. 100 is "cash cost" paid immediately and Rs. 50 represents non-cash charge for depreciation. There is no work in process.

Sales are effected at Rs. 750 per unit in respect of credit transactions and at Rs. 700 per unit in respect of cash transactions. 20% of despatches were in respect of cash transactions while the balance 80% were in respect of credit transactions (one month credit).

You are required to:

- (a) (i) Calculate modvat credit available, modvat credit availed of and balance in modvat credit as on 30th April, 1997.
  - (ii) Show the necessary ledger accounts in respect of modvat. (3 + 2 = 5 marks)
  - (b) Value the inventory of:
    - (i) raw material
    - (ii) finished goods in warehouse
    - (iii) finished goods in finished goods godown on "first in first out" principle. (3 marks)
  - (c) Show the ledger accounts of customers, suppliers and bank, assuming that the necessary bank balance is available at the start of the month to meet "cash" expenses of that month. (3 marks)
  - (d) Calculate the working capital as on 30th April, 1997. (2 marks)
  - (e) State the impact of 'modvat' on working capital requirement of the factory as on 30th April, 1997. (2 marks)
- (May, 1997)

Answer

- (a) (i) Excise duty paid on raw materials:

|               |        | X   |                  | Y      |     | Total            |                  |
|---------------|--------|-----|------------------|--------|-----|------------------|------------------|
|               | Kgs.   | @   | Amount           | Kgs.   | @   | Amount           | Amount           |
|               |        | Rs. | Rs.              |        | Rs. | Rs.              | Rs.              |
| Stock on 31st |        |     |                  |        |     |                  |                  |
| March, 1997   | 20,000 | 30  | 6,00,000         | 15,000 | 20  | 3,00,000         | 9,00,000         |
| Purchases     | 50,000 | 30  | <u>15,00,000</u> | 50,000 | 20  | <u>10,00,000</u> | <u>25,00,000</u> |
|               |        |     | <u>21,00,000</u> |        |     | <u>13,00,000</u> | <u>34,00,000</u> |

## Advanced Accounting

Modvat credit available:

$$\text{Rs. } 21,00,000 + 13,00,000 = \text{Rs. } 34,00,000$$

Modvat credit available of:

$$\text{Production} = 40,000 \text{ units}$$

$$\text{Excise duty on the end product} = \text{Rs. } 60 \text{ per unit}$$

$$\text{Modvat credit availed of} = 40,000 \times 60 = \text{Rs. } 24,00,000$$

$$\text{Balance in Modvat credit } 34,00,000 - 24,00,000 = \text{Rs. } 10,00,000$$

Note: Normally goods are removed from factory on payment of excise duty. However, in respect of certain goods, provision has been made to store the goods in warehouses without payment of duty (Rule 20 of Central Excise Rules, 2002). These provisions are also applicable to goods transferred to customs warehouse.

It is to be noted that as per para 33 of The Guidance Note on Accounting Treatment for Excise Duty, it is necessary that a provision for liability in respect of unpaid excise duty should be made in the accounts in respect of stocks lying in the factory or warehouse since the liability for excise duty arises when the manufacture of the goods is completed.

| (ii)    |    | Modvat Credit Receivable Account |                  |          |    |                 |                  |
|---------|----|----------------------------------|------------------|----------|----|-----------------|------------------|
| Dr.     |    |                                  |                  |          |    | Cr.             |                  |
| 1997    |    |                                  |                  |          |    | 1997            |                  |
|         |    |                                  |                  |          |    | Cr.             |                  |
| April 1 | To | Balance b/d                      |                  | April    | By | Excise Duty A/c | 24,00,000        |
|         |    | X                                | 6,00,000         |          |    |                 |                  |
|         |    | Y                                | <u>3,00,000</u>  |          |    |                 |                  |
|         |    |                                  | 9,00,000         | April 31 | By | Balance c/d     | 10,00,000        |
| April   | To | Suppliers A/c                    |                  |          |    |                 |                  |
|         |    | X                                | 15,00,000        |          |    |                 |                  |
|         |    | Y                                | <u>10,00,000</u> |          |    |                 |                  |
|         |    |                                  | <u>25,00,000</u> |          |    |                 |                  |
|         |    |                                  | <u>34,00,000</u> |          |    |                 | <u>34,00,000</u> |

|       |    | Purchases Account        |                    |          |    |             |                    |
|-------|----|--------------------------|--------------------|----------|----|-------------|--------------------|
| Dr.   |    |                          |                    |          |    | Cr.         |                    |
| 1997  |    |                          |                    |          |    | 1997        |                    |
|       |    |                          |                    |          |    | Cr.         |                    |
| April | To | Suppliers A/c            |                    | April 31 | By | Balance c/d | 1,02,50,000        |
|       |    | X: [50,000 × (145 – 30)] | 57,50,000          |          |    |             |                    |
|       |    | Y: [50,000 × (110 – 20)] | <u>45,00,000</u>   |          |    |             |                    |
|       |    |                          | <u>1,02,50,000</u> |          |    |             | <u>1,02,50,000</u> |



## (b) Valuation of Inventory

## (i) Raw material:

|               | X<br>(Kgs.)   | Y<br>(Kgs.)   |
|---------------|---------------|---------------|
| Opening stock | 20,000        | 15,000        |
| Purchases     | <u>50,000</u> | <u>50,000</u> |
|               | 70,000        | 65,000        |
| Consumption   | <u>60,000</u> | <u>45,000</u> |
| Closing stock | <u>10,000</u> | <u>20,000</u> |

Inventory:

X : 10,000 × (145 – 30)

Rs.  
11,50,000

Y : 20,000 × (110 – 20)

18,00,00029,50,000

## (ii) Finished goods in warehouse

|                                             |                 | Rs.              |
|---------------------------------------------|-----------------|------------------|
| Raw material cost of 80,000 units of output |                 |                  |
| X : 12,000* × (145 – 30)                    | 13,80,000       |                  |
| Y : 9,000* × (110 – 20)                     | <u>8,10,000</u> | 21,90,000        |
| Conversion cost                             |                 |                  |
| Cash cost : 8,000 × Rs. 100                 | 8,00,000        |                  |
| Non-cash : 8,000 × Rs. 50                   | <u>4,00,000</u> | 12,00,000        |
| Excise duty                                 |                 |                  |
| 8,000 × Rs. 60                              |                 | <u>4,80,000</u>  |
|                                             |                 | <u>38,70,000</u> |

\* For 40,000 units of output,

input of X = 60,000 Kgs.

input of Y = 45,000 Kgs.

Therefore, for 8,000 units of finished goods in warehouse:

$$\text{Input of X} = \frac{60,000}{40,000} \times 8,000 = 12,000 \text{ Kgs.}$$

$$\text{Input of Y} = \frac{45,000}{40,000} \times 8,000 = 9,000 \text{ Kgs.}$$

## (iii) Finished goods in finished goods godown

|                                                                                                           |           |
|-----------------------------------------------------------------------------------------------------------|-----------|
|                                                                                                           | Rs.       |
| Cost of 8,000 units of finished goods in warehouse                                                        | 38,70,000 |
| Cost of 2,000 units of finished goods in finished goods godown = $\frac{38,70,000}{8,000} \times 2,000 =$ | 9,67,500  |

## Advanced Accounting

|     |                                                                    |                                                        |                    |                              |                    |
|-----|--------------------------------------------------------------------|--------------------------------------------------------|--------------------|------------------------------|--------------------|
| (c) |                                                                    |                                                        |                    | Customers Account            |                    |
| Dr. |                                                                    |                                                        |                    |                              | Cr.                |
|     |                                                                    |                                                        |                    | Rs.                          | Rs.                |
| To  | Sales A/c                                                          | $\left(\frac{80}{100} \times 30,000 \times 750\right)$ |                    | By                           | Balance c/d        |
|     |                                                                    |                                                        | 1,80,00,000        |                              | 1,80,00,000        |
|     |                                                                    |                                                        | <u>1,80,00,000</u> |                              | <u>1,80,00,000</u> |
|     |                                                                    |                                                        |                    | Suppliers Account            |                    |
|     |                                                                    |                                                        |                    | Rs.                          | Rs.                |
| To  | Balance c/d                                                        | 1,75,50,000                                            | By                 | Balance b/d                  |                    |
|     |                                                                    |                                                        |                    | X : 20,000 × Rs. 150 =       | 30,00,000          |
|     |                                                                    |                                                        |                    | Y : 15,000 × Rs. 120 =       | <u>18,00,000</u>   |
|     |                                                                    |                                                        |                    |                              | 48,00,000          |
|     |                                                                    |                                                        | By                 | Purchases A/c                | 1,02,50,000        |
|     |                                                                    |                                                        | By                 | Modvat Credit Receivable A/c |                    |
|     |                                                                    |                                                        |                    | X : 50,000 × 30 =            | 15,00,000          |
|     |                                                                    |                                                        |                    | Y : 50,000 × 20 =            | <u>10,00,000</u>   |
|     |                                                                    |                                                        |                    |                              | 25,00,000          |
|     |                                                                    | <u>1,75,50,000</u>                                     |                    |                              | <u>1,75,50,000</u> |
|     |                                                                    |                                                        |                    | Bank Account                 |                    |
|     |                                                                    |                                                        |                    | Rs.                          | Rs.                |
| To  | Balance b/d                                                        | 40,00,000                                              | By                 | Cash Expenses (40,000 × 100) | 40,00,000          |
| To  | Sales (cash sales) A/c                                             | 42,00,000                                              | By                 | Balance c/d                  | 42,00,000          |
|     | $\left(\frac{20}{100} \times 30,000 \times \text{Rs. } 700\right)$ |                                                        |                    |                              |                    |
|     |                                                                    | <u>82,00,000</u>                                       |                    |                              | <u>82,00,000</u>   |

(d) Working Capital as on 30th April, 1997

Current Assets:

Inventory

|      |                             |                  |             |
|------|-----------------------------|------------------|-------------|
| (i)  | Raw materials               |                  |             |
|      | X                           | 11,50,000        |             |
|      | Y                           | <u>18,00,000</u> | 29,50,000   |
| (ii) | Finished goods in warehouse | 38,70,000        |             |
|      | in finished goods godown    | <u>9,67,500</u>  | 48,37,500   |
|      | Customers                   |                  | 1,80,00,000 |

### Accounting Theory

|                           |                    |
|---------------------------|--------------------|
| Bank balance              | 42,00,000          |
| Modvat credit receivable  | <u>10,00,000</u>   |
|                           | 3,09,87,500        |
| Less: Current Liabilities |                    |
| Sundry creditors          | <u>1,75,50,000</u> |
|                           | <u>1,34,37,500</u> |

(e) Impact of Modvat on Working Capital Requirement

Modvat has enabled

- (i) dispatch on sale of 30,000 units of finished product,
  - (ii) removal of 10,000 units of finished product,
- without payment of a single rupee in cash. Cash outlay so saved at Rs. 60 per unit is Rs. 24,00,000.

It has also ensured creation of a current asset worth Rs. 10,00,000 in Modvat Credit Receivable Account.

Thus Modvat reduces the pressure on working capital.

#### Question 40

Briefly explain as per relevant Guidance Notes:

- (a) HSL Ltd. is manufacturing goods for local sale and exports. As on 31st March, 2003, it has the following finished stocks in the factory warehouse:

- (i) Goods meant for local sale Rs. 100 lakhs (cost Rs. 75 lakhs).
- (ii) Goods meant for exports Rs. 50 lakhs (cost Rs. 20 lakhs).

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

(4 marks) (May, 2003)

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

(4 marks) (May, 2003)

- (c) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2003-2004 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

(4 marks)(May, 2004)

- (d) A Company has its share capital divided into shares of Rs. 10 each. On 1st April, 2004 it granted 10,000 employees' stock options at Rs. 40, when the market price was Rs. 130.

### Advanced Accounting

The options were to be exercised between 16th December, 2004 and 15th March, 2005. The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year.

Show Journal Entries.

(6 marks) Nov. 2005)

#### Answer

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

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

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

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

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

- (b) The Guidance Note on Accounting for Investments in the Financial statements of Mutual Funds provides that the investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. Clause 2(i) of the Eleventh Schedule provides that "where the financial statements are prepared on a mark to market basis, there need not be a separate provision for depreciation." However keeping in view, 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the guidance note recommends that the gross value of depreciation on investments should be reflected in the Revenue Account rather than the same being netted off with the appreciation in the value of other investments. In other words, depreciation/appreciation on investments should be worked out on an individual investment basis or by category of investment basis, but not on an overall basis or by category of investment.

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

## Accounting Theory

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

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

(d) Journal Entries

|                               | Particulars                                                                                                                                      |     | Dr.<br>Rs. | Cr.<br>Rs. |
|-------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|-----|------------|------------|
| 2004                          |                                                                                                                                                  |     |            |            |
| April 1                       | Employee Compensation Expense                                                                                                                    | Dr. | 9,00,000   |            |
|                               | To Employee Stock Options Outstanding                                                                                                            |     |            | 9,00,000   |
|                               | (Being grant of 10,000 stock options to employees at Rs. 40 when market price is Rs. 130)                                                        |     |            |            |
| <hr/>                         |                                                                                                                                                  |     |            |            |
| 2005                          |                                                                                                                                                  |     |            |            |
| 16th Dec.<br>to 15th<br>March | Bank                                                                                                                                             | Dr. | 3,80,000   |            |
|                               | Employee stock options outstanding                                                                                                               | Dr. | 8,55,000   |            |
|                               | To Equity share capital                                                                                                                          |     |            | 95,000     |
|                               | To Securities premium                                                                                                                            |     |            | 11,40,000  |
|                               | (Being allotment to employees of 9,500 equity shares of Rs. 10 each at a premium of Rs. 120 per share in exercise of stock options by employees) |     |            |            |
| <hr/>                         |                                                                                                                                                  |     |            |            |
| March 16                      | Employee stock options outstanding                                                                                                               | Dr. | 45,000     |            |
|                               | To Employee compensation expense                                                                                                                 |     |            | 45,000     |
|                               | (Being entry for lapse of stock options for 500 shares)                                                                                          |     |            |            |
| March 31                      | Profit and Loss A/c                                                                                                                              | Dr. | 8,55,000   |            |
|                               | To Employee compensation expense                                                                                                                 |     |            | 8,55,000   |
|                               | (Being transfer of employee compensation expense to profit and loss account)                                                                     |     |            |            |
| <hr/>                         |                                                                                                                                                  |     |            |            |

### Question 41

A buyer buys a stock option of New Light Company Limited on 30<sup>th</sup> August, 2006 with a strike price of Rs.150 per unit to be expired on September 30, 2006. The premium is Rs.10 per unit and the market lot is of 100. The margin to be paid is Rs.60 per unit.

Show, how the transactions will appear in the books of the seller, when:

### Advanced Accounting

- (i) The option is settled by delivery of the Asset, and
- (ii) The option is settled in cash and the Index price is Rs.160 per unit.

(8 Marks) (May, 2007)

Answer

#### In the Books of Seller

|                                            |                                                                                   | Dr.        | Cr.    |
|--------------------------------------------|-----------------------------------------------------------------------------------|------------|--------|
|                                            |                                                                                   | Amount     | Amount |
|                                            |                                                                                   | Rs.        | Rs.    |
| At the time of inception:                  |                                                                                   |            |        |
| 30 <sup>th</sup> August                    | Equity Stock Option Margin A/c (100 x Rs.60)                                      | Dr. 6,000  |        |
|                                            | To Bank A/c                                                                       |            | 6,000  |
|                                            | (Being the initial Margin paid on option)                                         |            |        |
|                                            | Bank A/c (100 x Rs.10)                                                            | Dr. 1,000  |        |
|                                            | To Equity Stock Option Premium A/c                                                |            | 1,000  |
|                                            | (Being the premium on option collected)                                           |            |        |
| At the time of final settlement:           |                                                                                   |            |        |
|                                            | Bank A/c                                                                          | Dr. 6,000  |        |
|                                            | To Equity Stock Option Margin A/c                                                 |            | 6,000  |
|                                            | (Being margin on equity stock option received back on exercise/expiry of option). |            |        |
| (i) Option is settled by delivery of asset |                                                                                   |            |        |
| 30 <sup>th</sup> September                 | Bank A/c                                                                          | Dr. 15,000 |        |
|                                            | To Equity Shares of New Light Ltd A/c                                             |            | 15,000 |
|                                            | (Being shares delivered on exercise of option)                                    |            |        |
|                                            | Equity Stock Option Premium A/c                                                   | Dr. 1,000  |        |
|                                            | To Profit & Loss A/c                                                              |            | 1,000  |
|                                            | (Being premium on option recognized as income)                                    |            |        |

## Accounting Theory

(ii) Option is settled in cash

|                                                                                                 |     |       |       |
|-------------------------------------------------------------------------------------------------|-----|-------|-------|
| 30 <sup>th</sup> September Profit & Loss A/c [(160 – 150) x 100]                                | Dr. | 1,000 |       |
| To Bank A/c                                                                                     |     |       | 1,000 |
| (Being difference in index price and strike price i.e. loss on exercise of option paid in cash) |     |       |       |
| Equity Stock Option Premium A/c                                                                 | Dr. | 1,000 |       |
| To Profit & Loss A/c                                                                            |     |       | 1,000 |
| (Being premium on option recognized as income)                                                  |     |       |       |

---

### Question 42

ABC Ltd. grants 1,000 employees stock options on 1.4.2004 at Rs.40, when the market price is Rs.160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2006. 600 options are exercised on 30.6.2007. 100 vested options lapse at the end of the exercise period.

Pass Journal Entries giving suitable narrations. (10 Marks)(May, 2008)

### Answer

#### Journal Entries in the Books of ABC Ltd.

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

## Advanced Accounting

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



## Accounting Theory

|            |                                                                                                                                                    |     |        |
|------------|----------------------------------------------------------------------------------------------------------------------------------------------------|-----|--------|
|            | (600 x Rs.150)                                                                                                                                     |     |        |
|            | (Being 600 employees stock option exercised at an exercise price of Rs. 40 each)                                                                   |     |        |
| 01.10.2007 | Employee stock option outstanding account                                                                                                          | Dr. | 12,000 |
|            | To General reserve account                                                                                                                         |     | 12,000 |
|            | (Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period) |     |        |

### Working Note:

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

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

### Question 43

How are capital expenditures not represented by any specific or tangible assets dealt in financial statements?  
(5 marks) (May, 2008)

### Answer

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

### **Advanced Accounting**

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

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

Topics Covered:

- Statutory Financial Statements (Q.Nos. 1 to 9)
- Corporate Restructuring (Q.Nos. 10 to 17)
- Accounting for Amalgamations, takeovers (Q.Nos. 18 to 37)

## Advanced Accounting

### Question 1

What are the main limitations of financial statements?

(8 marks) (May, 1998)

Answer

Limitations of Financial Statements:

- (i) Financial statements provide mostly historical data: Elements of financial statements, i.e., assets, liabilities, income and expenses are measured mostly using historical cost. So in the balance sheet, most of the assets do not represent their current values. Users of accounts cannot understand the real value of the reporting entity from such balance sheet.

Under the historical cost accounting framework impliedly money capital is maintained - not the real value of capital. Thus the profit and loss statement does not represent real profit/loss.

Thus, under inflationary environment, traditional historical cost -based financial statement fail to reflect operating result and financial position of the reporting entity.

- (ii) Financial Statements ignore substance and simply recognise form: In India, financial statements are prepared recognising legal form of the transactions and ignoring the substance. For example, when the reporting entity uses assets on finance lease basis, value of such assets are not shown in the balance sheet. So the balance sheet fails to show the assets used for revenue generation. They may mislead the users of accounts about the degree of asset-turnover of the entity.
- (iii) Financial statements are essentially based on going concern assumption: AS-1 'Disclosure of Accounting Policies' suggests that going concern is a fundamental accounting assumption, a departure from which should be disclosed. In practice, the assumption has been applied universally. Even if the reporting entity has become a sick industrial undertaking and waits for BIFR judgement, still its financial statements are prepared following going concern assumption showing its assets and liabilities at historical cost which is highly illogical and totally misleading.
- (iv) Financial Statements do not reflect cash flow: In India, financial statements do not include a cash flow report to explain movement of cash during the accounting period. As such, there exists a big gulf between accrual profit and operational cash flow. However, now the listed companies/entities whose annual accounts are approved by the shareholders after 31.3.1995, are required to give a cash flow statement (as prescribed by SEBI) in their Annual Report.
- (v) Financial statements are over-generalised: Users of accounts are many; prominent among those are shareholders – existing and potential, employees, lenders and other suppliers, government/regulatory agencies, managers and the public at large. Every section has specific data requirement for making economic decisions. Sometimes the interests of different sections may be conflicting in nature. Financial statements cannot meet the specific data requirement of the users. These are general purpose statements.

**Question 2**

Briefly explain the qualitative characteristics of Financial Statements.

(8 marks) (November, 1998)

**Answer**

Qualitative characteristics are the attributes that make the information provided in the financial statements useful to the users. The four principal qualitative characteristics are: (i) Understandability, (ii) Relevance, (iii) Reliability and (iv) Comparability.

- (i) Understandability: An essential, quality of the information provided in the financial statement is that it is readily understandable by the users. For this purpose, users are deemed to have reasonable knowledge of business and economic activities. However, information about complex matters should be included in the financial statements which is relevant to the users of accounts for their economic decision making although this may be too difficult for certain users to understand.
- (ii) Relevance: To be useful, information must be relevant to the decision making needs of all the users. Information has the quality of relevance when it influences the economic decisions of users by helping them to evaluate past, present or future events or confirming, or correcting their past evaluations.

Relevance of an information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. In other cases, both the nature and materiality are important:

- (iii) Reliability: To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which, it either purports to represent or could reasonably be expected to represent.

Reliability of the financial statement information is dependent on faithful representation, substance over form, neutrality, prudence, and completeness. If information is to represent faithfully the transactions and other events, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely by their legal form. To be reliable, the information contained in financial statement must be neutral i.e. free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a pre-determined result or outcome. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty. To be reliable, information in financial statements must also be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

- (iv) Comparability: Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. An important implication of this qualitative characteristic is that users should be informed of

### Advanced Accounting

the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes.

#### Question 3

- (a) In order to enhance the level of disclosure by the listed companies, SEBI has amended clause 32 of the listing agreement. After amendment what disclosures are required?

(4 marks) (May, 2005)

- (b) One of the important factors generally considered for awarding shields and plaques in India for 'best presented accounts' is that the information presented in the accounts make useful disclosures.

What are actually looked into in this regard?

(5 Marks)(May, 2008)

#### Answer

- (a) After SEBI's amendment of Clause 32 of Listing Agreement, the following disclosures are required:

- (i) In case the company has changed its name consequent upon the going in for a new line of business including software business during any period after 1st January, 1998, the company will disclose the turnover and income etc. from such new activities in the annual reports for a period of 3 years from the date of change of name of the company.
- (ii) The company will give a cash flow statement prepared as per AS 3 presented under indirect method and will attach this cash flow statement to the balance sheet and the profit and loss account of the company.
- (iii) The company shall mandatorily publish consolidated financial statements in the annual report in addition to the individual financial statement. The consolidated financial statement shall be audited by the statutory auditors and submitted to the stock exchange.
- (iv) The company shall make disclosures in compliance with the accounting standard on "Related Party Disclosures" in the annual reports.

- (b) In order to ascertain whether the nature and quality of information presented in the accounts make useful disclosures, the following features are generally looked into:

- 1. Statement of changes in financial position.
- 2. Sufficient details of revenues / expenses for financial analysis e.g. distinction between manufacturing cost, selling cost and administration cost.
- 3. Use of vertical form as against the conventional T form; judicious use of schedules, use of sub-totals, manner of showing comparative figures, ease of getting at figures.
- 4. To what extent additional financial information is provided to the readers through charts and graphs.
- 5. Financial highlights and ratios including earnings per share.

## Company Accounts

6. Inclusion of one or more bits of information like value added statement, break up of operations, organization chart, location of factories / branches, human resource accounting, inflation adjusted accounts, social accounts etc.

### Question 4

The following information has been extracted from the books of account of Jay Ltd. as at 31st March, 1995:

|                                                                              | Dr.<br>(Rs.'000) | Cr.<br>(Rs.'000) |
|------------------------------------------------------------------------------|------------------|------------------|
| Administration Expenses                                                      | 240              |                  |
| Cash at Bank and on Hand                                                     | 114              |                  |
| Cash Received on Sale of Fittings                                            |                  | 5                |
| Long Term Loan                                                               |                  | 35               |
| Investments                                                                  | 100              |                  |
| Depreciation on Fixtures, Fittings, Tools and Equipment<br>(1st April, 1994) |                  | 130              |
| Distribution Costs                                                           | 51               |                  |
| Factory Closure Costs                                                        | 30               |                  |
| Fixtures, Fittings, Tools and Equipment at Cost                              | 340              |                  |
| Profit & Loss Account (at 1st April, 1994)                                   |                  | 40               |
| Purchase of Equipment                                                        | 60               |                  |
| Purchases of Goods for Resale                                                | 855              |                  |
| Sales (net of Excise Duty)                                                   |                  | 1,500            |
| Share Capital<br>(50,000 shares of Rs. 10 each fully paid)                   |                  | 500              |
| Stock (at 1st April, 1994)                                                   | 70               |                  |
| Trade Creditors                                                              |                  | 40               |
| Trade Debtors                                                                | <u>390</u>       | <u>      </u>    |
|                                                                              | <u>2,250</u>     | <u>2,250</u>     |

### Additional Information:

- (1) The stock at 31st March, 1995 (valued at the lower of cost or net realizable value) was estimated to be worth Rs. 1,00,000.
- (2) Fixtures, fittings, tools and equipment all related to administration. Depreciation is charged at a rate of 20% per annum on cost. A full year's depreciation is charged in the year of acquisition, but no depreciation is charged in the year of disposal.

### Advanced Accounting

- (3) During the year to 31st March, 1995, the Company purchased equipment of Rs. 60,000. It also sold some fittings (which had originally cost Rs. 30,000) for Rs. 5,000 and for which depreciation of Rs. 15,000 had been set aside.
- (4) The average Income tax for the Company is 50%. Factory closure cost is to be presumed as an allowable expenditure for Income tax purpose.
- (5) The company proposes to pay a dividend of 20% per Equity Share.

Prepare Jay Ltd.'s Profit and Loss Account for the year to 31st March, 1995 and balance Sheet as at that date in accordance with the Companies Act, 1956 in the Vertical Form along with the Notes on Accounts containing only the significant accounting policies. Details of the schedules are not required. (20 marks) (May, 1996)

Answer

| Jay Ltd.                             |                                         |            |            |
|--------------------------------------|-----------------------------------------|------------|------------|
| Balance Sheet as at 31st March, 1995 |                                         |            |            |
| (Rs. in thousands)                   |                                         |            |            |
| I                                    | SOURCES OF FUNDS                        |            |            |
|                                      | (1) Shareholders' funds:                |            |            |
|                                      | (a) Capital                             | 500        |            |
|                                      | (b) Reserves and surplus                | <u>75</u>  | 575        |
|                                      | (2) Loan funds:                         |            |            |
|                                      | (a) Secured loans                       | 35         |            |
|                                      | (b) Unsecured loans                     | <u>—</u>   | <u>35</u>  |
|                                      | TOTAL                                   |            | <u>610</u> |
| II                                   | APPLICATION OF FUNDS                    |            |            |
|                                      | (1) Fixed assets:                       |            |            |
|                                      | (a) Gross block                         | 370        |            |
|                                      | (b) Less: Depreciation                  | <u>189</u> |            |
|                                      | (c) Net block                           | 181        |            |
|                                      | (d) Capital work in progress            | <u>—</u>   | 181        |
|                                      | (2) Investments                         |            | 100        |
|                                      | (3) Current assets, loans and advances: |            |            |
|                                      | (a) Inventories                         | 100        |            |
|                                      | (b) Sundry debtors                      | 390        |            |
|                                      | (c) Cash and bank balances              | 114        |            |
|                                      | (d) Other current assets                | <u>—</u>   |            |



## Company Accounts

|                                             |            |            |
|---------------------------------------------|------------|------------|
| (e) Loans and advances                      | —          |            |
|                                             | <u>604</u> |            |
| Less: Current Liabilities and Provisions:   |            |            |
| (a) Liabilities                             | 40         |            |
| (b) Provisions                              | <u>235</u> |            |
|                                             | <u>275</u> |            |
| Net current assets                          |            | 329        |
| (4) Miscellaneous expenditure               |            | —          |
| (to the extent not written off or adjusted) |            |            |
| TOTAL                                       |            | <u>610</u> |
| Contingent Liabilities                      | Nil        |            |

### Profit and Loss Account for the year ended 31st March, 1995

(Rs. in thousands)

|                                            |           |              |
|--------------------------------------------|-----------|--------------|
| Income                                     |           |              |
| Sales (Net of Excise Duty)                 |           | 1,500        |
| Increase /(Decrease) in Stocks             |           | <u>30</u>    |
|                                            |           | 1,530        |
| Expenditure                                |           |              |
| Purchase of Goods for Resale               | 855       |              |
| Administration Expenses                    | 240       |              |
| Distribution costs                         | 51        |              |
| Loss on sale of asset                      | 10        |              |
| Depreciation                               | <u>74</u> |              |
|                                            |           | <u>1,230</u> |
| Profit before Extraordinary Items          |           | 300          |
| Factory Closure Costs                      |           | <u>30</u>    |
| Profit before taxation                     |           | 270          |
| Provision for tax                          |           | <u>135</u>   |
| Net profit                                 |           | 135          |
| Balance brought forward from previous year |           | <u>40</u>    |
| Profit Available For Appropriation         |           | 175          |
| Appropriations                             |           |              |
| Proposed Equity Dividend                   | 100       |              |
| Amount transferred to general reserve      | <u>15</u> |              |
|                                            |           | <u>115</u>   |
| Balance carried forward                    |           | <u>60</u>    |

## Advanced Accounting

### NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 1995

#### Significant Accounting Policies:

- (a) Basis for preparation of financial statements: The financial statements have been prepared under the historical cost convention, in accordance with the generally accepted accounting principles and the provisions of the companies Act, 1956 as adopted consistently by the company.
- (b) Depreciation: Depreciation on fixed assets is provided using the straight-line method, based on the period of five years. Depreciation on additions is provided for the full year but no depreciation is provided on assets sold in the year of their disposal.
- (c) Investments: Investments are valued at lower of cost or net realizable value.
- (d) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.

#### Working Notes:

(Rs. in thousands)

(1) Fixtures, Fittings, Tools and Equipment

Gross Block

|                                  |           |     |
|----------------------------------|-----------|-----|
| As on 1.4.1994                   | 340       |     |
| Add: Additions during the year   | <u>60</u> |     |
|                                  | 400       |     |
| Less: Deductions during the year | <u>30</u> |     |
| As on 31.3.1995                  |           | 370 |

Depreciation

|                                 |           |            |
|---------------------------------|-----------|------------|
| As on 1.4.1994                  | 130       |            |
| For the year (20% on 370)       | <u>74</u> |            |
|                                 | 204       |            |
| Less: Deduction during the year | <u>15</u> |            |
| As on 31.3.1995                 |           | <u>189</u> |

Net block as on 31.3.1995 181

(2) Provision for taxation

|                                                           |           |     |
|-----------------------------------------------------------|-----------|-----|
| Profit as per profit and loss account                     |           | 270 |
| Add back: Loss on sale of asset (short term capital loss) | 10        |     |
| Depreciation                                              | <u>74</u> |     |

## Company Accounts

|                                                                                                                         |            |
|-------------------------------------------------------------------------------------------------------------------------|------------|
|                                                                                                                         | <u>84</u>  |
|                                                                                                                         | 354        |
| Less: Depreciation under Income-tax Act                                                                                 | <u>84</u>  |
|                                                                                                                         | <u>270</u> |
| Provision for tax @ 50%                                                                                                 | 135        |
| It has been assumed that depreciation calculated under Income-tax Act amounts to Rs.84,000)                             |            |
| (3) Provisions                                                                                                          |            |
| (a) Provision for taxation                                                                                              | 135        |
| (b) Proposed dividend (20% on Rs. 5,00,000)                                                                             | <u>100</u> |
|                                                                                                                         | <u>235</u> |
| (4) In balance sheet, Reserves and Surplus represent general reserve Rs. 15,000 and profit and loss account Rs. 60,000. |            |

### Notes:

- (1) The rate of interest on long term loan is not given in the question. Reasonable assumption may be made regarding the rate of interest and accordingly it may be accounted for.
- (2) As per Companies (Transfer of Profits to Reserve) Rules, the amount to be transferred to the reserves shall not be less than 7.5% of the current profits since proposed dividend exceeds 15% but does not exceed 20% of the paid up capital. In this answer, it has been assumed that Rs. 15,000 have been transferred to General Reserve. The students may transfer any amount based on a suitable percentage not less than 7.5%.
- (3) In the absence of details regarding factory closure costs, there costs are treated as extraordinary items in the above solution assuming that the factory is permanently closed. However, the factory may close for a short span of time on account of strikes, lockouts etc. and such type of factory closure costs should be treated as loss from ordinary activities. In that case also, a separate disclosure regarding the factory closure costs will be required as per para 12 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.'

### Question 5

The following balances are extracted from the books of Raj Ltd., a real estate company, on 31st March, 1996:

|                        | Dr.   | Cr.       |
|------------------------|-------|-----------|
|                        |       | (Rs.'000) |
| Sales                  |       | 2,760     |
| Purchases of materials | 1,218 |           |

### Advanced Accounting

|                                                        |              |              |
|--------------------------------------------------------|--------------|--------------|
| Share capital fully paid                               |              | 100          |
| Land purchased in the year as stock                    | 73           |              |
| Leasehold premises                                     | 42           |              |
| Creditors                                              |              | 463          |
| Debtors                                                | 735          |              |
| Directors' salaries                                    | 39           |              |
| Wages                                                  | 111          |              |
| Work in progress on 01.04.1995                         | 210          |              |
| Sub-contractors' cost                                  | 894          |              |
| Equipment, Fixtures and Fittings at cost on 01.04.1995 | 264          |              |
| Stock on 01.04.1995                                    | 59           |              |
| Profit and Loss Account, Credit Balance on 01.04.1995  |              | 128          |
| Secured Loan                                           |              | 112          |
| Bank Overdraft                                         |              | 105          |
| Interest on Loan and Overdraft                         | 22           |              |
| Depreciation on Equipment on 01.04.1995                |              | 164          |
| Administration Expenses                                | 147          |              |
| Office Salaries                                        | <u>18</u>    |              |
|                                                        | <u>3,832</u> | <u>3,832</u> |

You also obtain the following information:

- On 31st March, 1996, stock on hand including the land acquired during the year, is valued at Rs. 1,42,000. Work in progress at that date is valued at Rs. 1,40,000.
- On 1st October, 1995 the company moved to new premises. The premises are on a 12 years lease and the lease premium paid amounted to Rs. 42,000. The company used sub-contract labour of Rs. 40,000 and materials at cost of Rs. 38,000 in the refurbishment of the premises. These are to be considered as part of the cost of leasehold premises.
- A review of the debtors reveals specific doubtful debts of Rs. 35,000 and the directors wish to provide for these together with a general provision based on 2% of the balance.
- Depreciation on equipment, fixtures and fittings is provided at 15% on the written down value.
- Raj Ltd. sued Bright Ltd. for supplying defective materials which has been written off as valueless. The Directors are confident that Bright Ltd. will agree for a settlement of Rs. 50,000.
- The directors propose a dividend of 25%.

## Company Accounts

- (g) Rs. 20,000 is to be provided as audit fee.
- (h) The company will provide 10% of the pre tax profit as bonus to employees in the accounts before charging the bonus.
- (i) Income tax to be provided at 50% of the profits.

You are required:

- (i) to prepare the company's financial statements for the year ended 31st March, 1996 as near as possible to proper form of company final accounts; and
- (ii) to prepare a set of Notes to accounts including significant accounting policies.

Notes: Workings should form part of your answer.

Previous year figures can be ignored.

Figures are to be rounded off to nearest thousands.

(20 marks) (November, 1996)

Answer

### Raj Ltd.

#### Balance Sheet as at 31st March, 1996

(Rs. in thousands)

|                                         |            |                   |
|-----------------------------------------|------------|-------------------|
| <b>I SOURCES OF FUNDS</b>               |            |                   |
| (1) Shareholders' funds:                |            |                   |
| (a) Capital                             | 100        |                   |
| (b) Reserves and surplus                | <u>189</u> |                   |
|                                         |            | 289               |
| (2) Loan funds:                         |            |                   |
| (a) Secured loans                       | 112        |                   |
| (b) Unsecured loans                     | <u>—</u>   |                   |
|                                         |            | <u>112</u>        |
| <b>TOTAL</b>                            |            | <b><u>401</u></b> |
| <b>II APPLICATION OF FUNDS</b>          |            |                   |
| (1) Fixed assets:                       |            |                   |
| (a) Gross block                         | 384        |                   |
| (b) Less: Depreciation                  | <u>184</u> |                   |
| (c) Net block                           | 200        |                   |
| (d) Capital work in progress            | <u>—</u>   |                   |
|                                         |            | 200               |
| (2) Investments                         |            | —                 |
| (3) Current assets, loans and advances: |            |                   |
| (a) Inventories                         | 282        |                   |

## Advanced Accounting

|                                                                              |            |            |
|------------------------------------------------------------------------------|------------|------------|
| (b) Sundry debtors                                                           | 686        |            |
| (c) Cash and bank balances                                                   | —          |            |
| (d) Other current assets                                                     | —          |            |
| (e) Loans and advances                                                       | <u>—</u>   |            |
|                                                                              | 968        |            |
| Less: Current Liabilities and Provisions:                                    |            |            |
| (a) Liabilities                                                              | 588        |            |
| (b) Provisions                                                               | <u>179</u> |            |
|                                                                              | <u>767</u> |            |
| Net current assets                                                           |            | 201        |
| (4) Miscellaneous expenditure<br>(to the extent not written off or adjusted) |            | —          |
| TOTAL                                                                        |            | <u>401</u> |
| Contingent Liabilities                                                       | Nil        |            |

## Profit and Loss Account for the year ended 31st March, 1996

(Rs. in thousands)

|                                            |           |              |
|--------------------------------------------|-----------|--------------|
| INCOME                                     |           |              |
| Sales                                      |           | 2,760        |
| EXPENDITURE                                |           |              |
| Manufacturing Expenses                     | 2,205     |              |
| Other Expenses                             | 297       |              |
| Interest                                   | 22        |              |
| Depreciation on Fixed Assets               | <u>20</u> |              |
|                                            |           | <u>2,544</u> |
| Profit before Taxation                     |           | 216          |
| Provision for Tax                          |           | <u>130</u>   |
| Net Profit                                 |           | 86           |
| Balance brought forward from previous year |           | <u>128</u>   |
| Profit Available for Appropriation         |           | 214          |
| Appropriations                             |           |              |
| Proposed Equity Dividend                   | 25        |              |
| Amount transferred to General Reserve*     | <u>9</u>  | <u>34</u>    |
| Balance Carried Forward                    |           | <u>180</u>   |

**NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 1996**

1. **Accounting Policies:** The Accounts have been prepared primarily on the historical cost convention. The significant accounting policies followed by the Company are stated below:
  - (a) **Fixed Assets:** Fixed assets are shown at cost less depreciation. Cost comprises the purchase price and other attributable expenses.
  - (b) **Depreciation on Fixed Assets:** Depreciation on equipment, fixtures and fittings has been provided on written down value method at 15% per annum. Lease-hold premises/improvements are being amortised over the lease period.
  - (c) **Inventories:** Inventories are valued at the lower of historical cost or the net realizable value.
2. **Other Matters:**
  - (a) The cost of leasehold premises includes the cost of refurbishment to the extent of Rs. 78,000 (Materials Rs. 38,000 + Labour Rs. 40,000).
  - (b) Bright Ltd. has been sued for supplying defective materials. Settlement of Rs. 50,000 is hopeful however it has not been recognized in the accounts as it represents contingent gain.

**Working Notes:**

(Rs. in thousands)

|                                     |            |            |
|-------------------------------------|------------|------------|
| (1) Manufacturing Expenses          |            |            |
| Stocks at Commencement:             |            |            |
| Opening Stock                       | 59         |            |
| Opening Work-in-progress            | <u>210</u> |            |
|                                     |            | 269        |
| Purchases of Materials (1,218 – 38) |            | 1,180      |
| Purchase of Land                    |            | 73         |
| Wages                               |            | 111        |
| Sub-contractors' cost (894 – 40)    |            | <u>854</u> |
|                                     |            | 2,487      |
| Less: Stocks at close:              |            |            |
| Closing Stock                       | 142        |            |

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\* As per Companies (Transfer of Profits to Reserves) Rules, the amount to be transferred to the reserves shall not be less than 10% of the current profits since proposed dividend exceeds 20% of the paid up capital. In this answer, it has been assumed that Rs. 9,000 have been transferred to General Reserve. The students may transfer any amount based on a suitable percentage not less than 10%.

## Advanced Accounting

|     |                                                      |            |              |
|-----|------------------------------------------------------|------------|--------------|
|     | Closing Work-in-progress                             | <u>140</u> |              |
|     |                                                      |            | <u>282</u>   |
|     |                                                      |            | <u>2,205</u> |
| (2) | Other Expenses                                       |            |              |
|     | Administration Expenses                              |            | 147          |
|     | Office Salaries                                      |            | 18           |
|     | Directors' Salaries                                  |            | 39           |
|     | Provision for Doubtful Debts [35 + 2% of (735 – 35)] |            | 49           |
|     | Audit Fees                                           |            | 20           |
|     | Bonus (See Working Note 3)                           |            | <u>24</u>    |
|     |                                                      |            | <u>297</u>   |
| (3) | Bonus                                                |            |              |
|     | Sales                                                |            | 2,760        |
|     | Less: Manufacturing Expenses                         | 2,205      |              |
|     | Other Expenses (excluding bonus)                     | 273        |              |
|     | Depreciation                                         | 20         |              |
|     | Interest                                             | <u>22</u>  |              |
|     |                                                      |            | <u>2,520</u> |
|     | Pre-tax Profit                                       |            | <u>240</u>   |
|     | Bonus (10%)                                          |            | <u>24</u>    |
| (4) | Fixed Assets                                         |            |              |
|     | (a) Gross block                                      |            |              |
|     | Equipment, Fixtures and Fittings                     |            | 264          |
|     |                                                      |            |              |
|     | Leasehold Premises (42 + 40 + 38) **                 |            | <u>120</u>   |
|     |                                                      |            | <u>384</u>   |
|     | (b) Depreciation                                     |            |              |
|     | Equipment, Fixtures and Fittings                     |            |              |

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\*\* According to AS 19 'Leases' (issued in 2001), the leases are classified as finance lease and operating lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. An operating lease is a lease other than finance lease. At the inception of lease, assets under finance lease are capitalized in the books of the lessee with the corresponding liability of lease obligations as against the operating lease 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 without capitalizing the asset. The person (lessor/lessee) presenting the leased asset in his balance sheet should also consider the additional requirements of AS 6 and AS 10.



## Company Accounts

|     |                                                                                               |           |            |
|-----|-----------------------------------------------------------------------------------------------|-----------|------------|
|     | as on 1.4.1995                                                                                | 164       |            |
|     | For the year [15% on (264 – 164)]                                                             | <u>15</u> |            |
|     |                                                                                               |           | 179        |
|     | Cost of Leasehold Premises written off**                                                      |           | 5          |
|     | [(42 + 40 + 38) × 1/12 × 1/2]                                                                 |           | <u>184</u> |
| (5) | Provision for Taxation                                                                        |           |            |
|     | Profit as per Profit and Loss Account                                                         |           | 216        |
|     | Add back: Provision for doubtful debts                                                        | 49        |            |
|     | Cost of Leasehold premises written off                                                        | 5         |            |
|     | Depreciation on equipment, fixtures and fittings                                              | <u>15</u> |            |
|     |                                                                                               |           | <u>69</u>  |
|     |                                                                                               |           | 285        |
|     | Less: Depreciation under Income-tax Act                                                       |           | <u>25</u>  |
|     |                                                                                               |           | <u>260</u> |
|     | Provision for Tax (@ 50%)                                                                     |           | 130        |
|     | (It has been assumed that depreciation calculated under Income-tax Act amounts to Rs. 25,000) |           |            |
| (6) | Current Liabilities                                                                           |           |            |
|     | (a) Sundry creditors                                                                          |           | 463        |
|     | (b) Bank overdraft                                                                            |           | 105        |
|     | (c) Audit fees                                                                                |           | <u>20</u>  |
|     |                                                                                               |           | <u>588</u> |
| (7) | Provisions                                                                                    |           |            |
|     | (a) Provision for taxation                                                                    |           | 130        |
|     | (b) Proposed dividend                                                                         |           | 25         |
|     | (c) Provision for bonus                                                                       |           | <u>24</u>  |
|     |                                                                                               |           | <u>179</u> |

### Question 6

E Ltd. manufactures and sells food products. The following draft financial statements were prepared by the chief accountant for the year ended 31.3.1998 and placed before your for advice:

#### Profit and Loss Statement for the year ended 31.3.1998

(Figures in Rs. lakhs)

|                                                                  |       |
|------------------------------------------------------------------|-------|
| Sales and other income                                           | 3,500 |
| Cost of goods sold including operating expenses and depreciation | 2,740 |

## Advanced Accounting

|                                 |     |
|---------------------------------|-----|
| Operating profit                | 760 |
| Profit on sale of property      | 200 |
| Interest charges                | 300 |
| Profit before tax               | 660 |
| Tax provision                   | 330 |
| Profit after tax                | 330 |
| Proposed dividend               | 300 |
| Profit retained                 | 30  |
| Add: Opening balance of profit  | 360 |
| Profit carried to Balance Sheet | 390 |

Balance Sheet as on 31.3.1998

(Figures in Rs. lakhs)

| Liabilities                        |              | Assets                                                  |                    |
|------------------------------------|--------------|---------------------------------------------------------|--------------------|
| Share Capital                      | 3,000        | Fixed Assets                                            | 5,000              |
| General reserve                    | 540          | Less: Depreciation                                      | <u>1,000</u> 4,000 |
| Profit and loss account balance    | 390          | Current Assets                                          |                    |
| Secured Loans                      | 2,000        | Stock                                                   | 800                |
| Current Liabilities and Provisions |              | Debtors                                                 | 1,000              |
| Creditors                          | 240          | Royalty receivable                                      | 100                |
| Provision for tax                  | 330          | Advance tax                                             | 200                |
| Proposed dividend                  | <u>300</u>   | Cash balance                                            | <u>550</u> 2,650   |
|                                    | 870          | Miscellaneous expenditure to the extent not written off | <u>150</u>         |
|                                    | <u>6,800</u> |                                                         | <u>6,800</u>       |

You are provided with further information as follows:

- On 1.4.97 E Ltd. had sold some of its fixed assets for Rs.100 lakhs [written down value Rs. 250 lakhs]. These assets were revalued earlier. As on 1.4.97 the revaluation reserve corresponding to these assets stood at Rs. 200 lakhs. The profit on sale of property as shown in the profit and loss statement represented the transfer of this amount. Loss on sale of the asset was included in the cost of goods sold etc.
- During the year E Ltd. undertook restructuring exercise of its operations at a cost of Rs. 150 lakhs. This amount stood included in "miscellaneous expenditure to the extent not written off".
- Included in sales and other income is a sum of Rs. 100 lakhs representing royalty receivable for supply of know-how to a company in South-East Asia. As per agreement the amount is to be received in US Dollars. However, exchange permission was denied to the company in South-East Asia for remitting the same.

## Company Accounts

- (d) E Ltd. purchased fixed assets costing Rs. 1,825 lakhs on 1.4.97 and the same was fully financed by foreign currency loan [i.e. US Dollars] repayable in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = Rs. 36.50]. As on 31.3.98 the first instalment was paid when 1 US Dollar fetched Rs. 41.50. The entire loss on exchange was included in cost of goods sold etc. E Ltd. normally provides depreciation on fixed assets at 20% on WDV basis.
- (e) Dividend at 10% on paid up equity capital is to be maintained as in prior years.

You are required to redraft the financial statements of E Ltd. for the year ended 31.3.98 in accordance with relevant provisions of accounting standards. Journal entries (wherever applicable) in respect of the information given are to be shown. Schedules previous year's figures and cash flow statement are not required. (20 marks) (November, 1998)

### Answer

1. As per para 14.4 and para 32 of AS 10 on Accounting for Fixed Assets, on disposal or a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

Accordingly, the following journal entries are to be passed.

(Rs. in lakhs)

|                                 |     |     |     |
|---------------------------------|-----|-----|-----|
| Profit on Sale of Property      | Dr. | 200 |     |
| To Loss on Sale of Fixed Assets |     |     | 150 |
| To General Reserve              |     |     | 50  |

[Alternatively, these entries can be passed through Revaluation Reserve Account. That is, 'Profit on Sale of Property' can be credited first to Revaluation Reserve Account and then, this Reserve will be debited with loss on sale of fixed assets (included in 'Cost of Goods Sold etc.') and the balance will be transferred to General Reserve.]

2. As per para 12 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Accordingly, the entire restructuring cost Rs. 150 lakhs requires separate disclosure in the statement of profit and loss instead of deferring and showing it under miscellaneous expenditure.

3. According to 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,

## Advanced Accounting

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.

Thus 'Sales and other income' should be reduced by Rs. 100 lakhs with equivalent credit to Royalty Receivable Account.

Alternatively, the students may apply para 9.3 of AS 9, after making reasonable assumption as to the timing of the uncertainty. According to para 9.3, when the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

4. As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as incomes/expenses in the period in which they arise.

Calculation of Exchange loss:

$$\text{Foreign currency loan} = \frac{\text{Rs. 1,825 lakhs}}{\text{Rs. 36.50}} = 50 \text{ lakhs US Dollars}$$

$$\text{Exchange loss} = 50 \text{ lakhs US dollars} \times (41.50 - 36.50) = \text{Rs. 250 lakhs}$$

(including exchange loss on payment of first instalment)

Thus exchange loss of Rs. 250 lakhs should be recognized as expense in the profit and loss account for the year ended 31st March, 1998.

E Ltd.

Balance Sheet as at 31st March, 1998

|    |                          |            |            | (Rs. in lakhs) |
|----|--------------------------|------------|------------|----------------|
| I  | SOURCES OF FUNDS         |            |            |                |
|    | (1) Shareholders' funds: |            |            |                |
|    | (a) Capital              |            | 3,000      |                |
|    | (b) Reserves and surplus |            |            |                |
|    | General Reserve          | 590        |            |                |
|    | Profit and Loss Account  | <u>240</u> | <u>830</u> | 3,830          |
|    | (2) Loan funds:          |            |            |                |
|    | (a) Secured loans        |            | 2,000      |                |
|    | (b) Unsecured loans      |            | <u>—</u>   | <u>2,000</u>   |
|    | TOTAL                    |            |            | <u>5,830</u>   |
| II | APPLICATION OF FUNDS     |            |            |                |
|    | (1) Fixed assets:        |            |            |                |
|    | (a) Gross block          |            | 5,000      |                |

## Company Accounts

|                                           |              |              |
|-------------------------------------------|--------------|--------------|
| (b) Less: Depreciation                    | <u>1,000</u> |              |
| (c) Net block                             | 4,000        |              |
| (d) Capital work in progress              | <u>—</u>     | 4,000        |
| (2) Investments                           |              | —            |
| (3) Current assets, loans and advances:   |              |              |
| (a) Inventories                           | 800          |              |
| (b) Sundry debtors                        | 1,000        |              |
| (c) Cash balance                          | 550          |              |
| (d) Other current assets                  | —            |              |
| (e) Loans and advances (Advance tax)      | <u>200</u>   |              |
|                                           | <u>2,550</u> |              |
| Less: Current Liabilities and Provisions: |              |              |
| (a) Liabilities                           | 240          |              |
| (b) Provisions                            |              |              |
| Provision for Taxation                    | 180          |              |
| Proposed Dividend                         | <u>300</u>   |              |
|                                           | <u>480</u>   |              |
|                                           | <u>720</u>   |              |
| Net current assets                        |              | 1,830        |
| (4) Miscellaneous expenditure             |              | —            |
| the extent not written off or adjusted)   |              |              |
| TOTAL                                     |              | <u>5,830</u> |

## Profit and Loss Account for the year ended 31st March, 1998

|                                                                                      |                |
|--------------------------------------------------------------------------------------|----------------|
|                                                                                      | (Rs. in lakhs) |
| Sales and other income (3,500 – 100)                                                 | 3,400          |
| Cost of goods sold including operating expenses and depreciation (2,740 – 150 – 250) | (2,340)        |
| Restructuring cost                                                                   | (150)          |
| Interest charges                                                                     | (300)          |
| Foreign exchange loss                                                                | <u>(250)</u>   |
| Profit before taxation                                                               | 360            |
| Provision for tax (@ 50%)                                                            | <u>(180)</u>   |
| Net Profit                                                                           | 180            |
| Balance brought forward from previous year                                           | <u>360</u>     |
| Profit Available for Appropriation                                                   | 540            |
| Proposed Dividend                                                                    | <u>(300)</u>   |
| Balance Carried Forward                                                              | <u>240</u>     |

## Advanced Accounting

Current year profit after tax is only Rs. 180 lakhs as against the proposed dividend of Rs. 300 lakhs. Hence, in order to ensure sufficient compliance with section 205 of the Companies Act, 1956, past profits are utilized to make up the shortfall (assuming that there are no arrears of depreciation).

Note on Accounts: The royalty receivable in US Dollars for supply of know-how to a company in South-East Asia amounting to Rs. 100 lakhs has not been recognized as exchange permission has been denied to the company in South-East Asia for remitting the same.

Notes:

1. In the absence of any information regarding interest on foreign currency loan taken for financing purchase of fixed assets, no provision has been made for interest liability.
2. Deferred tax for the timing difference arising due to treatment of exchange loss on repayment of principal portion of the foreign currency loan is to be accounted for in accordance with AS 22 'Accounting for Taxes on Income'. In the above solution, the exchange loss on repayment of principal amount has been charged to profit and loss account. However, as per Section 43 A of the Income Tax Act, such exchange loss is required to be capitalized and depreciation is to be provided for. In the absence of information regarding nature of fixed asset, the rate of depreciation under Income Tax Act cannot be determined. Hence, the effect of AS 22 has not been disclosed in the redrafted financial statements.
3. Schedule VI to the Companies Act, 1956, provides that the exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of respective fixed assets. The revised AS 11 (2003), however, does not require the adjustment of exchange differences in the carrying amount of fixed assets, and such exchange differences are required to be recognized in the statement of profit and loss since it is felt that this treatment is conceptually preferable to that required in Schedule VI.

The above answer has been given according to revised AS 11 (2003).

4. It has been assumed that restructuring costs are of revenue nature and thus are allowed for tax purposes.

### Question 7

On 1st November, 1998 Yash Ltd. was incorporated with an authorized capital of Rs. 1,000 crores. It issued to its promoters equity capital of Rs. 50 crores which was paid for in full. On that day it purchased the running business of Vijay Ltd. for Rs. 200 crores and allotted at par equity capital of Rs. 200 crores in discharge of the consideration. The net assets taken over from Vijay Ltd. were valued as follows: Fixed Assets Rs. 150 crores, Inventory Rs. 10 crores, Customers' dues Rs. 70 crores and Creditors Rs. 30 crores.

## Company Accounts

Yash Ltd. carried on business and the following information is furnished to you:

(a) Summary of cash/bank transactions (for year ended 31st October, 1999).

|                                                   |            | (Rs. in crores) |
|---------------------------------------------------|------------|-----------------|
| Equity capital raised:                            |            |                 |
| Promoters (as shown above)                        | 50         |                 |
| Others                                            | <u>250</u> | 300             |
| Collections from customers                        |            | 4,000           |
| Sale proceeds of fixed assets (cost Rs.18 crores) |            | <u>20</u>       |
|                                                   |            | <u>4,320</u>    |
| Payments to suppliers                             | 2,000      |                 |
| Payments to employees                             | 700        |                 |
| Payment for expenses                              | <u>500</u> | 3,200           |
| Investments in Upkar Ltd.                         |            | 100             |
| Payments to suppliers of fixed assets:            |            |                 |
| Instalment due                                    | 600        |                 |
| Interest                                          | <u>50</u>  | 650             |
| Tax payment                                       |            | 270             |
| Dividend                                          |            | 50              |
| Closing cash/bank balance                         |            | <u>50</u>       |
|                                                   |            | <u>4,320</u>    |

(b) On 31st October, 1999 Yash Ltd.'s assets and liabilities were:

|                                          | (Rs. in crores) |
|------------------------------------------|-----------------|
| Inventory at cost                        | 15              |
| Customers' dues                          | 400             |
| Prepaid expenses                         | 10              |
| Advances to suppliers                    | 40              |
| Amounts due to suppliers of goods        | 260             |
| Amounts due to suppliers of fixed assets | 750             |
| Outstanding expenses                     | 30              |

(c) Depreciation for the year under:

|                           |                |
|---------------------------|----------------|
| (i) Companies Act, 1956   | Rs. 180 crores |
| (ii) Income tax Act, 1961 | Rs. 200 crores |

(d) Provide for tax at 38.5% of "total income". There are no disallowables for the purpose of income taxation. Provision for tax is to be rounded off.

Yash Ltd. asks you to prepare:

(i) Revenue statement for the year ended 31st October, 1999 and

## Advanced Accounting

(ii) Balance Sheet as on 31st October, 1999 from the above information.

(20 marks)(November, 1999)

Answer

| Yash Ltd.                                 |            |                 |              |
|-------------------------------------------|------------|-----------------|--------------|
| Balance Sheet as at 31st October, 1999    |            |                 |              |
|                                           | Schedule   | (Rs. in crores) |              |
| I SOURCES OF FUNDS                        |            |                 |              |
| (1) Shareholders' funds:                  |            |                 |              |
| (a) Capital                               | A          | 500             |              |
| (b) Reserves and surplus                  |            | <u>387</u>      | 887          |
| (2) Loan funds                            |            |                 | <u>750</u>   |
| TOTAL                                     |            |                 | <u>1,637</u> |
| II APPLICATION OF FUNDS                   |            |                 |              |
| (1) Fixed assets:                         |            |                 |              |
| (a) Gross block                           |            | 1,482           |              |
| (b) Less: Depreciation                    |            | <u>180</u>      |              |
| (c) Net block                             |            |                 | 1,302        |
| (2) Investments in Upkar Ltd.             |            |                 | 100          |
| (3) Current assets, loans and advances:   |            |                 |              |
| (a) Inventories                           | 15         |                 |              |
| (b) Sundry debtors                        | 400        |                 |              |
| (c) Cash and bank balances                | 50         |                 |              |
| (d) Loans and advances:                   |            |                 |              |
| Advances to suppliers                     | 40         |                 |              |
| Prepaid expenses                          | 10         |                 |              |
| Tax payment                               | <u>270</u> |                 |              |
|                                           |            | 785             |              |
| Less: Current liabilities and provisions: |            |                 |              |
| (a) Creditors for                         |            |                 |              |
| Goods                                     | 260        |                 |              |
| Expenses                                  | <u>30</u>  |                 |              |
|                                           | 290        |                 |              |
| (b) Provision for taxation                | <u>260</u> |                 |              |
|                                           |            | 550             |              |
| Net current assets                        |            |                 | <u>235</u>   |
| TOTAL                                     |            |                 | <u>1,637</u> |



## Company Accounts

### Schedule to Balance Sheet

(Rs. in crores)

|                                                      |              |
|------------------------------------------------------|--------------|
| A. Share Capital:                                    |              |
| Authorised:                                          | <u>1,000</u> |
| Issued and paid-up:                                  |              |
| 50 crores equity shares of Rs. 10 each fully paid up | 500          |
| Of the above shares, 20 crores equity shares         |              |
| have been issued for consideration other             |              |
| than cash, on take over of business of Vijay Ltd.    |              |

### Profit and Loss Account

for the year ended 31st October, 1999

(Rs. in crores)

|                                               |                |
|-----------------------------------------------|----------------|
| Sales                                         | 4,330          |
| Expenditure:                                  |                |
| Stock taken over from Vijay Ltd.              | 10             |
| Purchases                                     | <u>2,190</u>   |
|                                               | 2,200          |
| Closing stock                                 | <u>15</u>      |
| Inventory consumed/sold                       | 2,185          |
| Employee cost                                 | 700            |
| Expenses                                      | <u>520</u>     |
|                                               | <u>(3,405)</u> |
| Profit before interest, depreciation and tax  | 925            |
| Interest                                      | <u>(50)</u>    |
| Profit after interest but before depreciation | 875            |
| Depreciation                                  | <u>(180)</u>   |
| Profit after depreciation                     | 695            |
| Profit on sale of fixed assets                | <u>2</u>       |
| Profit before tax                             | 697            |
| Provision for tax                             | <u>(260)</u>   |
| Net profit                                    | 437            |
| Dividend                                      | <u>(50)</u>    |
| Balance carried forward                       | <u>387</u>     |

### Working Notes:

(Rs. in crores)

|                                          |     |
|------------------------------------------|-----|
| (1) Net assets of Vijay Ltd. taken over: |     |
| Fixed Assets                             | 150 |

## Advanced Accounting

|                 |            |
|-----------------|------------|
| Inventory       | 10         |
| Customers' dues | <u>70</u>  |
|                 | 230        |
| Less: Creditors | <u>30</u>  |
|                 | <u>200</u> |

Purchase consideration: 20 crores equity shares of Rs. 10 each.

|                                       |                                   |                          |  |              |
|---------------------------------------|-----------------------------------|--------------------------|--|--------------|
| (2)                                   | Customers' Account                |                          |  |              |
|                                       | Rs.                               |                          |  | Rs.          |
| To Business Purchase A/c              | 70                                | By Bank A/c              |  | 4,000        |
| To Sales A/c (Balancing figure)       | <u>4,330</u>                      | By Balance c/d           |  | <u>400</u>   |
|                                       | <u>4,400</u>                      |                          |  | <u>4,400</u> |
|                                       | Suppliers' (Goods) Account        |                          |  |              |
|                                       | Rs.                               |                          |  | Rs.          |
| To Bank A/c (2,000 – 40)              | 1,960                             | By Business Purchase A/c |  | 30           |
| To Balance c/d                        | 260                               | By Purchases A/c         |  | 2,190        |
|                                       |                                   | (Balancing figure)       |  |              |
|                                       | <u>2,220</u>                      |                          |  | <u>2,220</u> |
|                                       | Suppliers' (Fixed Assets) Account |                          |  |              |
|                                       | Rs.                               |                          |  | Rs.          |
| To Bank A/c                           | 650                               | By Fixed Assets A/c      |  | 1,350        |
| To Balance c/d (Loan funds)           | 750                               | (Balancing figure)       |  |              |
|                                       |                                   | By Interest A/c          |  | <u>50</u>    |
|                                       | <u>1,400</u>                      |                          |  | <u>1,400</u> |
|                                       | Fixed Assets Account              |                          |  |              |
|                                       | Rs.                               |                          |  | Rs.          |
| To Business Purchase A/c              | 150                               | By Bank A/c              |  | 20           |
| To Profit and Loss A/c                | 2                                 | By Balance c/d           |  | 1,482        |
| To Suppliers' A/c                     | <u>1,350</u>                      |                          |  |              |
|                                       | <u>1,502</u>                      |                          |  | <u>1,502</u> |
|                                       | Expenses Account                  |                          |  |              |
|                                       | Rs.                               |                          |  | Rs.          |
| To Bank A/c                           | 500                               | By Profit and Loss A/c   |  | 520          |
| To Balance c/d (Outstanding expenses) | 30                                | (Balancing figure)       |  |              |

## Company Accounts

|                                         |    |                                   |            |
|-----------------------------------------|----|-----------------------------------|------------|
|                                         | By | Balance c/d<br>(Prepaid expenses) | <u>10</u>  |
|                                         |    |                                   | <u>530</u> |
| (3) Calculation of tax provision:       |    |                                   | Rs.        |
| Profit before depreciation              |    |                                   | 875        |
| Less: Depreciation under Income Tax Act |    |                                   | <u>200</u> |
| Total income under Income Tax Act       |    |                                   | <u>675</u> |
| Tax due thereon @ 38.5% (rounded off)   |    |                                   | 260        |

As sale proceeds of fixed assets are reduced from the appropriate "block of assets" for income tax purpose, and depreciation under Income Tax Act is given in the question, no adjustment for profit on sale of fixed assets Rs. 2 crores needs to be made for tax purposes.

Notes:

- (1) Students may provide for corporate dividend tax @ 12.5% i.e., for Rs. 6.25 crores.
- (2) The par value of an equity share has been taken as Rs. 10.

### Question 8

Marks Limited manufactures a special type of Computer. The company has a software division for developing programs with respect to specialised areas such as Medical Imaging, Process Control and Information System.

Following is the draft of Profit and Loss Account prepared by the Chief Accountant for the year ended 31st March, 2000

|                                                                  | Figures in Lakhs |              |
|------------------------------------------------------------------|------------------|--------------|
|                                                                  | Rs.              | Rs.          |
| Sales : Hardware division                                        | 1,200            |              |
| Software division                                                | <u>800</u>       | 2,000        |
| Opening stock of finished goods                                  | 90               |              |
| Raw materials consumed                                           | 400              |              |
| Direct labour — Hardware division                                | 250              |              |
| — Software division                                              | 150              |              |
| Variable production overheads — Hardware division                | 150              |              |
| — Software division                                              | 50               |              |
| Fixed Production Overheads [including interest and depreciation] |                  |              |
| — Hardware division                                              | 290              |              |
| — Software division                                              | 100              |              |
| Closing stock of finished goods                                  | <u>(180)</u>     | <u>1,300</u> |

### Advanced Accounting

|                                   |            |            |
|-----------------------------------|------------|------------|
| Gross Profit                      |            | 700        |
| Administration Expenses           | 50         |            |
| Selling and distribution expenses | <u>150</u> | <u>200</u> |
| Profit before tax                 |            | 500        |
| Tax at 40%                        |            | <u>200</u> |
| Profit after tax                  |            | 300        |
| Add: Balance of profit b/f        |            | <u>200</u> |
| Profit carried forward            |            | <u>500</u> |

The following further informations are given :

- (a) 10 employees, who were working in a software division were made redundant on account of abandoning a particular software program and each of them were paid a compensation of Rs. 5 lakhs on the average. This cost is included in direct labour.
- (b) The fixed production overheads of Hardware division included interest of Rs. 50 lakhs and depreciation of Rs. 50 lakhs. Further this sum of Rs. 50 lakhs included an additional depreciation of Rs. 10 lakhs on a special machinery used in the manufacturer of computer parts for better display purposes.
- (c) During the year, the Software division supplied a special program for a foreign firm on a consideration of Rs. 100 lakhs. It was found on June 1st, 2000 that the foreign firm has become bankrupt. The company had received an advance of Rs. 50 lakhs in the year ended 31st March, 2000 from the foreign firm.
- (d) The Software division was involved in a special program on hospital information system. The company so far incurred a sum of Rs. 20 lakhs as salaries and Rs. 10 lakhs as overheads, which were included in direct labour and fixed production overheads respectively. Management feels that a further Rs. 50 lakhs will be required to complete the program, so that it can be effectively marketed.
- (e) Included in Fixed production overheads of Hardware division is a sum of Rs. 50 lakhs being the cost of prototype computers manufactured by the company. These are not to be sold, but to be kept back for demonstrating the medical imaging software program.
- (f) The company manufactured 550 computers during the year. It has a policy of valuing finished stock of goods at a standard cost of Rs. 1.8 lakhs per computer.
  - (i) Redraft the Profit and Loss Account for the year ended 31st March, 2000 with reference to relevant Accounting Standards issued by the institute. (15 marks)
  - (ii) Compute the value of Closing Stock of finished goods. (5 marks) (May, 2001)

## Company Accounts

Answer

(i) Marks Limited  
Profit and Loss Account  
for the year ended 31st March, 2000

|                                                                  | (Rs. in lakhs) |               |
|------------------------------------------------------------------|----------------|---------------|
| Sales— Hardware division                                         | 1200           |               |
| — Software division                                              | <u>800</u>     | 2000          |
| Opening stock of finished goods                                  | 90             |               |
| Raw materials consumed                                           | 400            |               |
| Direct labour — Hardware division                                | 250            |               |
| — Software division                                              | 80             |               |
| Variable production overheads — Hardware division                | 150            |               |
| — Software division                                              | 50             |               |
| Fixed Production Overheads                                       |                |               |
| — Hardware division                                              | 140            |               |
| — Software division                                              | 90             |               |
| Closing stock of finished goods                                  | (180)          |               |
| Cost of prototype computers written off                          | 10             |               |
| Administration Expenses                                          | 50             |               |
| Selling and distribution expenses                                | 150            |               |
| Provision for bad debts                                          | 50             |               |
| Redundancy payment                                               | 50             |               |
| Depreciation (including additional depreciation of Rs. 10 lakhs) | 50             |               |
| Interest                                                         | <u>50</u>      | <u>(1480)</u> |
| Profit before tax                                                |                | 520           |
| Provision for tax (40%)                                          |                | <u>(208)</u>  |
| Profit after tax                                                 |                | 312           |
| Add : Balance of profit b/f                                      |                | <u>200</u>    |
| Surplus carried to balance sheet                                 |                | <u>512</u>    |

## Advanced Accounting

### Comments :

- (a) Compensation : The compensation on account of redundancy Rs. 50 lakhs should be disclosed separately as per para 12 of AS-5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
- (b) Interest and Depreciation : Interest of Rs. 50 lakhs cannot be treated as production overheads. It will be disclosed separately in the profit and loss account as per the requirements of Part II of schedule VI to the Companies Act. Similarly depreciation is also to be disclosed separately.
- (c) Sales to foreign firm : This is an event occurring after the balance sheet date and the accounts are only at draft stage. In accordance with para 13 of AS-4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date, adjustments to assets and liabilities are required. Hence the sum of Rs. 50 lakhs (Rs. 100 lakhs – advance of Rs. 50 lakhs) should be provided for by way of provision for bad debts.
- (d) Special program on hospital information system: From the information given in the question, it may be inferred that the cost of Rs. 30 lakhs (Rs. 20 lakhs direct labour and Rs. 10 lakhs production overheads) is development cost. The entire expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all of the following conditions (as specified in para 44 of AS 26 'Intangible Assets'):
  - (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;
  - (b) its intention to complete the intangible asset and use or sell it;
  - (c) its ability to use or sell the intangible asset;
  - (d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
  - (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
  - (f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.
- (e) Cost of prototype computers : An accounting policy is necessary regarding the writing off of the cost of these prototype computers as per AS-1 on Disclosure of Accounting Policies. Hence assuming that expenditure is to be written off over a period of five years, the amount to be treated as expense of the year is Rs. 10 lakhs.

Note : Students may assume any appropriate number of years for the purpose of writing off)

## Company Accounts

- (ii) As per AS-2 (Revised) on Valuation of Inventories, finished stock of goods should be valued on the basis of absorption costing. In this case finished stock has been valued at a standard cost of Rs. 1.8 lakhs per computer which incidentally synchronises with the value computed on the basis of absorption costing as under :

|                               |           |            | (Rs. in lakhs) |
|-------------------------------|-----------|------------|----------------|
| Materials                     |           |            | 400            |
| Labour                        |           |            | 250            |
| Variable production overheads |           |            | 150            |
| Fixed production Overheads    |           | 290        |                |
| Less : Interest               | 50        |            |                |
| Cost of prototype computers   | <u>50</u> | <u>100</u> | <u>190</u>     |
| Total cost                    |           |            | <u>990</u>     |
| Number of computers produced  | 550       |            |                |

(assumed to be normal production)

Cost per computer  $990/550 = \text{Rs. } 1.8$  lakhs.

Note : For the purpose of tax computation, Rs. 520 lakhs have been taken as taxable profits.

### Question 9

On 30th September, 1999 Beta Enterprises Ltd. was incorporated with an Authorised Capital of Rs. 50 lakhs. Its first accounts were closed on 31st March, 2000 by which time it had become a listed company with an issued subscribed and paid up Capital of Rs. 40 lakhs in 4,00,000 Equity Shares of Rs. 10 each.

The company started off with two lines of business namely 'Engineering Division' and 'Chemicals Division', with equal asset base with effect from 1st April, 2000. The 'Ceramics Division' was added by the company on 1st April, 2001. The following data is gathered from the books of account of Beta Enterprises Ltd. :

Trial Balance as on 31st March, 2002

|                                     | (Rupees in 000's) |       |
|-------------------------------------|-------------------|-------|
|                                     | Dr.               | Cr.   |
| Engineering Division sales          | —                 | 6,000 |
| Cost of Engineering Division sales  | 2,600             | —     |
| Chemicals Division sales            | —                 | 8,000 |
| Cost of sales of Chemicals Division | 4,300             | —     |
| Ceramics Division Sales             | —                 | 1,500 |
| Cost of sales of Ceramics Division  | 900               | —     |
| Administration costs                | 2,000             | —     |
| Distribution costs                  | 1,500             | —     |
| Dividend-Interim                    | 1,200             | —     |
| Fixed Assets at cost                | 9,000             | —     |

### Advanced Accounting

|                                               |               |               |
|-----------------------------------------------|---------------|---------------|
| Depreciation on Fixed Assets                  | –             | 1,500         |
| Stock on 31st March, 2002                     | 400           | –             |
| Trade Debtors                                 | 440           | –             |
| Cash at Bank                                  | 160           | –             |
| Trade Creditors                               | –             | 500           |
| Equity Share Capital in shares of Rs. 10 each | –             | 4,000         |
| Retained Profits                              | –             | <u>1,000</u>  |
|                                               | <u>22,500</u> | <u>22,500</u> |

Additional Information:

- (a) Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.
- (b) Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.
- (c) Directors have proposed a Final Dividend of Rs. 8 lakhs.
- (d) Some of the users of Ceramics Division are unhappy with the product and have lodged claims against the company for damages of Rs. 7.5 lakhs. The claim is hotly contested by the company on legal advice.
- (e) Fixed Assets worth Rs. 30 lakhs were added in the Ceramics Division on 1.4.2001.
- (f) Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.
- (g) Income tax rate may be assumed at 35%.
- (h) During the year Engineering Division has sold to Alpha Ltd. goods having a sales value of Rs. 25 lakhs. Mr. Gamma, the Managing Director of Beta Enterprises Ltd. owns 100% of the issued Equity Shares of Alpha Ltd. The sales made to Alpha Ltd. were at normal selling price of Beta Enterprises Ltd.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2002 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards. (20 marks)(November, 2002)

Answer

Beta Enterprises Ltd.

Profit and Loss Account for the year ending 31st March, 2002

|                      |                |
|----------------------|----------------|
|                      | Rs. '000       |
| Sales                | 15,500         |
| Cost of Sales        | <u>(7,800)</u> |
|                      | 7,700          |
| Distribution costs   | (1,500)        |
| Administration costs | <u>(2,000)</u> |
| Profit before tax    | 4,200          |



## Company Accounts

|                                                       |            |                |
|-------------------------------------------------------|------------|----------------|
| Provision for tax                                     | 1,239      |                |
| Deferred tax (35% of Rs. 660)                         | <u>231</u> | (1,470)        |
| Profit after tax                                      |            | 2,730          |
| Dividends (Rs. 1,200 + Rs. 800)                       |            | <u>(2,000)</u> |
| Profit for the year                                   |            | 730            |
| Retained profit brought forward (Rs. 1,000 – Rs. 210) |            | <u>790</u>     |
| Retained Profit carried forward                       |            | <u>1,520</u>   |

### Beta Enterprises Ltd. Balance Sheet as at 31st March, 2002

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

#### Notes to Accounts:

##### 1. Segmental Disclosures (Business Segments)

(Figures in Rs. 000's)

|                             | Engineering<br>Division | Chemical<br>Division | Ceramics<br>division | Total         |
|-----------------------------|-------------------------|----------------------|----------------------|---------------|
| Sales                       | <u>6,000</u>            | <u>8,000</u>         | <u>1,500</u>         | <u>15,500</u> |
| Cost of Sales               | 2,600                   | 4,300                | 900                  | 7,800         |
| Administration Cost (5:3:2) | 1,000                   | 600                  | 400                  | 2,000         |
| Distribution Cost (3:1:1)   | 900                     | 300                  | 300                  | 1,500         |

## Advanced Accounting

|                                              |              |              |              |               |
|----------------------------------------------|--------------|--------------|--------------|---------------|
| Profit/Loss                                  | <u>1,500</u> | <u>2,800</u> | <u>(100)</u> | <u>4,200</u>  |
|                                              | <u>6,000</u> | <u>8,000</u> | <u>1,500</u> | <u>15,500</u> |
| Original cost of Assets (Equal Capital Base) | 3,000        | 3,000        | 3,000        | 9,000         |
| Depreciation @ 10% p.a.                      |              |              |              |               |
| For the year ended 31.3.2001                 | 300          | 300          | NIL          | 600           |
| For the year ended 31.3.2002                 | 300          | 300          | 300          | 900           |

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

### 2. Tax computation

|                                                            |                |
|------------------------------------------------------------|----------------|
|                                                            | (Rs. in 000's) |
| Profit before tax for the year ended 31.3.2002             | 4,200          |
| Add: Depreciation provided in the books (300 + 300 + 300)  | <u>900</u>     |
|                                                            | 5,100          |
| Less: Depreciation as per Income Tax Act (480 + 480 + 600) | <u>1,560</u>   |
| Taxable Income                                             | <u>3,540</u>   |
| Tax at 35%                                                 | <u>1,239</u>   |

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

|                                                                     |              |
|---------------------------------------------------------------------|--------------|
|                                                                     | Rs.'000      |
| Opening Timing Difference on 1.4.2001                               |              |
| WDV of fixed assets as per books                                    | 5,400        |
| WDV of fixed assets as per Income Tax Act                           | <u>4,800</u> |
| Difference                                                          | <u>600</u>   |
| Deferred Tax Liability @ 35% on 600                                 | 210          |
| This has been adjusted against opening balance of retained profits. |              |
| Current year (ended 31st March, 2002)                               | Rs.'000      |
| Depreciation as per Books                                           | 900          |
| Depreciation as per Income Tax Act (480 + 480 + 600)                | <u>1,560</u> |
| Difference                                                          | <u>660</u>   |
| Deferred Tax Liability @ 35% on 660 (to be carried forward)         | 231          |

## Company Accounts

4. Contingent Liabilities not provided: Company is contesting claim for damages for Rs. 7,50,000 and as such the same is not acknowledged as debts.
5. Related Party Disclosure: Para 3 of AS 18 lists out related party relationships. It includes individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises, and relatives of any such individual. In the instant case, Mr. Gamma as a managing director controls operating and financial actions of Beta Enterprise Ltd. He is also owning 100% share Capital of Alpha Ltd. thereby exercising control over it. Hence, Alpha Ltd. is a related party as per para 3 of AS 18.

Disclosure to be made:

|                                                      |                                          |
|------------------------------------------------------|------------------------------------------|
| Name of the related party and nature of relationship | Alpha Ltd. common director               |
| Nature of the transaction                            | Sale of goods at normal commercial terms |
| Volume of the transaction                            | Sales to Alpha Ltd. worth Rs. 25 lakhs.  |

### Question 10

The following is the Balance Sheet of Diverse Ltd. having an authorised capital of Rs. 1,000 Crores as on 31st March, 1997:

|                                                  | (Rs. in crores) | Rs.        | Rs.          |
|--------------------------------------------------|-----------------|------------|--------------|
| Sources of funds:                                |                 |            |              |
| Shareholders' funds:                             |                 |            |              |
| Share capital                                    |                 |            |              |
| Equity shares of Rs. 10 each fully paid in cash  |                 | 250        |              |
| Reserves and surplus (Revenue)                   |                 | <u>750</u> | 1,000        |
| Loan funds:                                      |                 |            |              |
| Secured against: (a) Fixed assets Rs. 300 Cr.    |                 |            |              |
| (b) Working capital Rs. 100 Cr.                  |                 | 400        |              |
| Unsecured:                                       |                 | <u>600</u> | <u>1,000</u> |
|                                                  |                 |            | <u>2,000</u> |
| Employment of funds:                             |                 |            |              |
| Fixed assets:                                    |                 |            |              |
| Gross block                                      |                 | 800        |              |
| Less: Depreciation                               |                 | <u>200</u> | 600          |
| Investments at cost (Market value Rs. 1,000 Cr.) |                 |            | 400          |
| Net current assets:                              |                 |            |              |

### Advanced Accounting

|                           |              |              |
|---------------------------|--------------|--------------|
| Current assets            | 3,000        |              |
| Less: Current liabilities | <u>2,000</u> | <u>1,000</u> |
|                           |              | <u>2,000</u> |

Capital commitments : Rs. 700 crores.

The company consists of 2 divisions:

- (i) Established division whose gross block was Rs. 200 crores and net block was Rs. 30 crores; current assets were Rs. 1,500 crores and working capital was Rs. 1,200 crores; the entire amount being financed by shareholders' funds.
- (ii) New project division to which the remaining fixed assets, current assets and current liabilities related.

The following scheme of reconstruction was agreed upon:

- (a) Two new companies Sunrise Ltd. and Khajana Ltd. are to be formed. The authorised capital of Sunrise Ltd. is to be Rs. 1,000 crores. The authorised capital of Khajana Ltd. is to be Rs. 500 crores.
- (b) Khajana Ltd. is to take over investments at Rs. 800 crores and unsecured loans at balance sheet value. It is to allot equity shares of Rs. 10 each at par to the members of Diverse Ltd. in satisfaction of the amount due under the arrangement.
- (c) Sunrise Ltd. is to take over the fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which Diverse Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of Rs. 10 each as consideration to Diverse Ltd. Sunrise Ltd. made an issue of unsecured convertible debentures of Rs. 500 crores carrying interest at 15% per annum and having a right to convert into equity shares of Rs. 10 each at par on 31.3.2002. This issue was made to the members of Sunrise Ltd. as a right who grabbed the opportunity and subscribed in full.
- (d) Diverse Ltd. is to guarantee all liabilities transferred to the 2 companies.
- (e) Diverse Ltd. is to make a bonus issue of equity shares in the ratio of one equity share for every equity share held by making use of the revenue reserves.

Assume that the above scheme was duly approved by the Honourable High Court and that there are no other transactions. Ignore taxation.

You are asked to:

- (i) Pass journal entries in the books of Diverse Ltd., and
- (ii) Prepare the balance sheets of the three companies giving all the information required by the Companies Act, 1956 in the manner so required to the extent of available information.

(20 marks) (May, 1997)

## Company Accounts

Answer

### Journal of Diverse Ltd.

(Rs. in crores)

|   |                                                                                                                                                                                                        | Dr.   | Cr.   |
|---|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|
| 1 | Khajana Ltd. A/c                                                                                                                                                                                       | 800   |       |
|   | To Investments A/c                                                                                                                                                                                     |       | 400   |
|   | To Members A/c                                                                                                                                                                                         |       | 400   |
|   | (Being transfer of investments at agreed value of Rs. 800 crores under the scheme of reconstruction approved by the high court)                                                                        |       |       |
| 2 | Unsecured loans A/c                                                                                                                                                                                    | 600   |       |
|   | To Khajana Ltd.                                                                                                                                                                                        |       | 600   |
|   | (Being unsecured loans taken over by Khajana Ltd. under the scheme of reconstruction approved by the honourable high court)                                                                            |       |       |
| 3 | Members A/c                                                                                                                                                                                            | 200   |       |
|   | To Khajana Ltd.                                                                                                                                                                                        |       | 200   |
|   | (Being allotment by Khajana Ltd. of 20 crore equity shares of Rs. 10 each to the members of the company in the ratio of 4 equity shares of Khajana Ltd. for every 5 equity shares held in the company) |       |       |
| 4 | Members A/c                                                                                                                                                                                            | 200   |       |
|   | To Capital reserve                                                                                                                                                                                     |       | 200   |
|   | (Being balance in Members A/c transferred to capital reserve)                                                                                                                                          |       |       |
| 5 | Sunrise Ltd. A/c                                                                                                                                                                                       | 10    |       |
|   | Provision for depreciation A/c                                                                                                                                                                         | 30    |       |
|   | Secured loans against fixed assets A/c                                                                                                                                                                 | 300   |       |
|   | Secured loans against working capital A/c                                                                                                                                                              | 100   |       |
|   | Current liabilities A/c                                                                                                                                                                                | 1,700 |       |
|   | To Fixed assets A/c                                                                                                                                                                                    |       | 600   |
|   | To Current assets A/c                                                                                                                                                                                  |       | 1,500 |

## Advanced Accounting

|                                                                                                                                                                                                                                                                                      |     |     |     |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|-----|-----|
| To Capital reserve A/c                                                                                                                                                                                                                                                               |     |     | 40  |
| (Being assets and liabilities of new project division transferred to Sunrise Ltd. along with capital commitments of Rs. 700 crores, the difference between consideration and the book values at which transferred assets and liabilities appeared being credited to capital reserve) |     |     |     |
| <hr/>                                                                                                                                                                                                                                                                                |     |     |     |
| 6 Equity shares of Sunrise Ltd.                                                                                                                                                                                                                                                      | Dr. | 10  |     |
| To Sunrise Ltd.                                                                                                                                                                                                                                                                      |     |     | 10  |
| (Being the receipt of one crore equity shares of Rs. 10 each from Sunrise Ltd. in full discharge of consideration on transfer of assets and liabilities of the new project division)                                                                                                 |     |     |     |
| <hr/>                                                                                                                                                                                                                                                                                |     |     |     |
| 7 Investment in debentures A/c                                                                                                                                                                                                                                                       | Dr. | 500 |     |
| To Bank A/c                                                                                                                                                                                                                                                                          |     |     | 500 |
| (Being issue of unsecured convertible debentures by Sunrise Ltd., subscribed in full)                                                                                                                                                                                                |     |     |     |
| <hr/>                                                                                                                                                                                                                                                                                |     |     |     |
| 8 Revenue reserves A/c                                                                                                                                                                                                                                                               | Dr. | 250 |     |
| To Equity share capital A/c                                                                                                                                                                                                                                                          |     |     | 250 |
| (Being allotment of 25 crores equity shares of Rs. 10 each as fully paid bonus shares to the members of the company by using revenue reserves in the ratio of one equity share for every equity share held)                                                                          |     |     |     |
| <hr/>                                                                                                                                                                                                                                                                                |     |     |     |

Diverse Ltd.

Balance Sheet after the scheme of arrangement

Schedule

(Rs. in crores)

No.

### I SOURCES OF FUNDS

(1) Shareholders' funds:

|             |   |     |
|-------------|---|-----|
| (a) Capital | A | 500 |
|-------------|---|-----|

## Company Accounts

|                                         |   |            |              |
|-----------------------------------------|---|------------|--------------|
| (b) Reserves and surplus                | B | <u>740</u> |              |
|                                         |   |            | 1,240        |
| (2) Loan funds:                         |   |            |              |
| (a) Secured against:                    |   |            |              |
| Fixed assets                            |   | —          |              |
| Working capital                         |   | —          |              |
| (b) Unsecured                           |   | <u>—</u>   | <u>—</u>     |
| TOTAL                                   |   |            | <u>1,240</u> |
| II APPLICATION OF FUNDS                 |   |            |              |
| (1) Fixed assets:                       | C |            |              |
| (a) Gross block                         |   | 200        |              |
| (b) Less: Depreciation                  |   | <u>170</u> |              |
| (c) Net block                           |   |            | 30           |
| (2) Investments                         | D |            | 10           |
| (3) Current assets                      |   | 1,500      |              |
| Less: Current liabilities               |   | <u>300</u> |              |
| Net current assets                      |   |            | <u>1,200</u> |
| TOTAL                                   |   |            | <u>1,240</u> |
| 1. Capital commitments                  |   |            | Nil          |
| 2. Contingent Liability                 |   |            |              |
| Guarantee given in respect of:          |   |            |              |
| Capital commitments by Sunrise Ltd.     |   |            | 700          |
| Liabilities transferred to Sunrise Ltd. |   |            | 2,100        |
| Liabilities transferred to Khajana Ltd. |   |            | 600          |

## Schedules to Accounts

(Rs. in crores)

|                                         |              |
|-----------------------------------------|--------------|
| A Share capital:                        |              |
| Authorised:                             |              |
| 100 crores Equity Shares of Rs. 10 each | <u>1,000</u> |
| Issued, Subscribed and Paid-up:         |              |
| 50 crores Equity Shares of Rs. 10       |              |

## Advanced Accounting

|                                                                                                                                                |            |            |
|------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| each fully paid-up                                                                                                                             |            | 500        |
| Of the above shares, 25 crores fully paid Equity Shares of Rs. 10 each have been issued as bonus shares by capitalisation of revenue reserves. |            |            |
| B Reserves and Surplus:                                                                                                                        |            |            |
| Capital Reserve on transfer of :                                                                                                               |            |            |
| Investments to Khajana Ltd.                                                                                                                    |            | 200        |
| Business of new project division to Sunrise Ltd.                                                                                               |            | <u>40</u>  |
|                                                                                                                                                |            | 240        |
| Revenue Reserves:                                                                                                                              |            |            |
| As per last balance sheet                                                                                                                      | 750        |            |
| Less: Used for issue of fully paid bonus shares                                                                                                | <u>250</u> |            |
|                                                                                                                                                |            | <u>500</u> |
|                                                                                                                                                |            | <u>740</u> |
| C Fixed assets:                                                                                                                                |            |            |
| Gross block:                                                                                                                                   |            |            |
| As per last balance sheet                                                                                                                      | 800        |            |
| Less: Transfer to Sunrise Ltd.                                                                                                                 | <u>600</u> |            |
|                                                                                                                                                |            | 200        |
| Provision for depreciation:                                                                                                                    |            |            |
| As per last balance sheet                                                                                                                      | 200        |            |
| Less: In respect of assets transferred to Sunrise Ltd.                                                                                         | <u>30</u>  |            |
|                                                                                                                                                |            | <u>170</u> |
|                                                                                                                                                |            | <u>30</u>  |
| D Investments (at cost):                                                                                                                       |            |            |
| In wholly owned subsidiary Sunrise Ltd.                                                                                                        |            |            |
| (a) 1 crore equity shares of Rs. 10 each                                                                                                       |            | 10         |
| (b) 15% unsecured convertible debentures                                                                                                       |            | <u>500</u> |
|                                                                                                                                                |            | <u>510</u> |



## Company Accounts

### Balance Sheet of Sunrise Ltd. after the scheme of arrangement

|                                    | Schedule No. |              | (Rs. in crores) |
|------------------------------------|--------------|--------------|-----------------|
| <b>I SOURCES OF FUNDS</b>          |              |              |                 |
| (1) Shareholders' funds:           |              |              |                 |
| (a) Capital                        | A            | 10           |                 |
| (b) Reserves and surplus           |              | <u>—</u>     | 10              |
| (2) Loan funds :                   |              |              |                 |
| (a) Secured loans                  | B            | 400          |                 |
| (b) Unsecured loans                | C            | <u>500</u>   |                 |
|                                    |              |              | <u>900</u>      |
| <b>TOTAL</b>                       |              |              | <u>910</u>      |
| <b>II APPLICATION OF FUNDS</b>     |              |              |                 |
| (1) Fixed assets:                  |              |              |                 |
| (a) Goodwill                       |              | 40           |                 |
| (b) Other fixed assets             |              | <u>570</u>   |                 |
|                                    |              |              | 610             |
| (2) Investments                    |              |              | —               |
| (3) Current assets :               |              |              |                 |
| (a) Bank balance                   | 500          |              |                 |
| (b) Others                         | <u>1,500</u> |              |                 |
|                                    |              | 2,000        |                 |
| Less: Current liabilities          |              | <u>1,700</u> |                 |
|                                    |              |              | <u>300</u>      |
| <b>TOTAL</b>                       |              |              | <u>910</u>      |
| 1. Capital commitments             |              |              |                 |
| 2. Guarantee given by Diverse Ltd. |              |              |                 |
| in respect of:                     |              |              |                 |
| Capital commitments                |              | 700          |                 |
| Liabilities                        |              | <u>2,100</u> |                 |
|                                    |              |              | 2,800           |

## Advanced Accounting

### Schedules to Accounts

(Rs. in crores)

|   |                                                                                                                                |              |
|---|--------------------------------------------------------------------------------------------------------------------------------|--------------|
| A | Share Capital                                                                                                                  |              |
|   | Authorised                                                                                                                     |              |
|   | 100 crores Equity Shares of Rs. 10 each                                                                                        | <u>1,000</u> |
|   | Issued, Subscribed and Paid-up                                                                                                 |              |
|   | 1 crore Equity Shares of Rs. 10                                                                                                |              |
|   | each fully paid-up                                                                                                             | 10           |
|   | All the above shares have been issued for consideration other than cash, on takeover of new project division from Diverse Ltd. |              |
|   | All the above shares are held by the holding company Diverse Ltd.                                                              |              |
| B | Secured Loans                                                                                                                  |              |
|   | (a) Against fixed assets                                                                                                       | 300          |
|   | (b) Against working capital                                                                                                    | <u>100</u>   |
|   |                                                                                                                                | <u>400</u>   |
| C | Unsecured Loans                                                                                                                |              |
|   | 15% Unsecured convertible Debentures                                                                                           | 500          |
|   | (Convertible into equity shares of Rs. 10 each at par on 31.3.2002)                                                            |              |

### Balance Sheet of Khajana Ltd. after the scheme of arrangement

|                          | Schedule No. |            | (Rs. in crores) |
|--------------------------|--------------|------------|-----------------|
| SOURCES OF FUNDS         |              |            |                 |
| (1) Shareholders' funds: |              |            |                 |
| (a) Capital              | A            | 200        |                 |
| (b) Reserves and surplus |              | <u>—</u>   |                 |
|                          |              |            | 200             |
| (2) Loan funds:          |              |            |                 |
| (a) Secured loans        |              | —          |                 |
| (b) Unsecured loans      |              | <u>600</u> |                 |
|                          |              |            | <u>600</u>      |
| TOTAL                    |              |            | <u>800</u>      |

## Company Accounts

### APPLICATION OF FUNDS

|                                                                  |            |
|------------------------------------------------------------------|------------|
| Investments                                                      | <u>800</u> |
| TOTAL                                                            | <u>800</u> |
| Guarantee given by Diverse Ltd.<br>in respect of unsecured loans | 600        |

### Schedule to Accounts

(Rs. in crores )

#### A Share Capital

##### Authorised

50 crores Equity Shares of Rs. 10 each 500

##### Issued, Subscribed and Paid-up

20 crores Equity Shares of Rs. 10 200  
each fully paid-up

All the above shares have been issued to members of Diverse Ltd. for consideration other than cash, on acquisition of investments and taking over of liability for unsecured loans from Diverse Ltd.

#### Working Notes :

(Rs. in crores)

| 1.                                           | Established<br>division | New Project<br>division | Total        |
|----------------------------------------------|-------------------------|-------------------------|--------------|
| Fixed assets:                                |                         |                         |              |
| Gross block                                  | 200                     | 600                     | 800          |
| Less: Depreciation                           | <u>170</u>              | <u>30</u>               | <u>200</u>   |
|                                              | <u>30</u>               | <u>570</u>              | <u>600</u>   |
| Current assets                               | 1,500                   | 1,500                   | 3,000        |
| Less: Current liabilities                    | <u>300</u>              | <u>1,700</u>            | <u>2,000</u> |
| Employment of funds                          | <u>1,200</u>            | <u>(200)</u>            | <u>1,000</u> |
| 2. Guarantee by Diverse Ltd. against:        |                         |                         |              |
| (a) (i) Capital commitments                  |                         |                         | 700          |
| (ii) Liabilities transferred to Sunrise Ltd. |                         |                         |              |

## Advanced Accounting

|                                             |              |       |
|---------------------------------------------|--------------|-------|
| Secured loans against fixed assets          | 300          |       |
| Secured loans against working capital       | 100          |       |
| Current liabilities                         | <u>1,700</u> |       |
|                                             |              | 2,100 |
| (b) Liabilities transferred to Khajana Ltd. |              | 600   |

### Question 11

Ksha Ltd. and Yaa Ltd. are two companies. On 31st March, 1999 their Balance Sheets were as under:

|                                                    | (Rs. in crores) |              |            |              |
|----------------------------------------------------|-----------------|--------------|------------|--------------|
|                                                    | Ksha Ltd.       |              | Yaa Ltd.   |              |
|                                                    | Rs.             | Rs.          | Rs.        | Rs.          |
| Sources of funds:                                  |                 |              |            |              |
| Share Capital:                                     |                 |              |            |              |
| Authorised:                                        |                 | <u>500</u>   |            | <u>500</u>   |
| Issued: Equity shares of Rs. 10 each fully paid up |                 | 300          |            | 200          |
| Reserves and surplus:                              |                 |              |            |              |
| Capital reserves                                   | 40              |              | 20         |              |
| Revenue reserves                                   | 700             |              | 425        |              |
| Surplus                                            | <u>10</u>       | <u>750</u>   | <u>5</u>   | <u>450</u>   |
| Owners' funds                                      |                 | 1,050        |            | 650          |
| Loan funds                                         |                 | <u>250</u>   |            | <u>350</u>   |
|                                                    |                 | <u>1,300</u> |            | <u>1,000</u> |
| Fund employed in:                                  |                 |              |            |              |
| Fixed assets:                                      |                 |              |            |              |
| Cost                                               | 1,000           |              | 700        |              |
| Less: Depreciation                                 | <u>400</u>      | 600          | <u>300</u> | 400          |
| Net current assets:                                |                 |              |            |              |
| Current assets                                     | 2,000           |              | 1,500      |              |
| Less: Current liabilities                          | <u>1,300</u>    | <u>700</u>   | <u>900</u> | <u>600</u>   |
|                                                    |                 | <u>1,300</u> |            | <u>1,000</u> |

Ksha Ltd. has 2 divisions very profitable division A and loss making division B. Yaa Ltd. similarly has 2 divisions very profitable division B and loss making division A.

The two companies decided to reorganize. Necessary approvals from creditors and members and sanction by High Court have been obtained to the following scheme:

1. Division B of Ksha Ltd. which has fixed assets costing Rs. 400 crores (written down value Rs. 160 crores), Current assets Rs. 900 crores, Current liabilities Rs. 750 crores and loan funds of Rs. 200 crores is to be transferred at Rs. 125 crores to Yaa Ltd.

## Company Accounts

2. Division A of Yaa Ltd. which has fixed assets costing Rs. 500 crores (depreciation Rs. 200 crores), Current assets Rs. 800 crores, Current liabilities Rs. 700 crores, and loan funds Rs. 250 crores is to be transferred at Rs. 140 crores to Ksha Ltd.
3. The difference in the two considerations is to be treated as loan carrying interest at 15% per annum.
4. The directors of each of the companies revalued the fixed assets taken over as follows:
  - (i) Division of A of Yaa Ltd. taken over: Rs. 325 crores.
  - (ii) Division B of Ksha Ltd. taken over: Rs. 200 crores.

All the other assets and liabilities are recorded at the balance sheet values.
- (a) The directors of both the companies ask you to prepare the balance sheets after reconstruction (showing the corresponding figures before reconstruction).
- (b) Master Richie Rich, who owns 50,000 equity shares of Ksha Ltd. and 30,000 equity shares of Yaa Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above reorganizations. (16 + 4 = 20 marks)(May, 1999)

Answer

### Ksha Ltd.

#### Balance Sheet as at 31st March, 1999

|                           |          |              |                      | (Rs. in crores)       |              |
|---------------------------|----------|--------------|----------------------|-----------------------|--------------|
|                           | Schedule |              | After reconstruction | Before reconstruction |              |
| I SOURCES OF FUNDS        |          |              |                      |                       |              |
| (1) Shareholders' funds:  |          |              |                      |                       |              |
| (a) Capital               | A        | 300          |                      | 300                   |              |
| (b) Reserves and surplus  | B        | <u>800</u>   | 1,100                | <u>750</u>            | 1,050        |
| (2) Loan funds            | C        |              | <u>315</u>           |                       | <u>250</u>   |
| TOTAL                     |          |              | <u>1,415</u>         |                       | <u>1,300</u> |
| II APPLICATION OF FUNDS   |          |              |                      |                       |              |
| (1) Fixed assets:         |          |              |                      |                       |              |
| (a) Gross block           |          | 925          |                      | 1,000                 |              |
| (b) Less: Depreciation    |          | <u>160</u>   |                      | <u>400</u>            |              |
| (c) Net block             |          |              | 765                  |                       | 600          |
| (2) Investments           |          |              | —                    |                       | —            |
| (3) Current assets        |          | 1,900        |                      | 2,000                 |              |
| Less: Current liabilities |          | <u>1,250</u> |                      | <u>1,300</u>          |              |
| Net current assets        |          |              | <u>650</u>           |                       | <u>700</u>   |
| TOTAL                     |          |              | <u>1,415</u>         |                       | <u>1,300</u> |

## Advanced Accounting

### Schedules to Balance Sheet

|                                                      |                      | (Rs. in crores)       |
|------------------------------------------------------|----------------------|-----------------------|
|                                                      | After reconstruction | Before reconstruction |
| A. Share Capital                                     |                      |                       |
| Authorised:                                          |                      |                       |
| 50 crores equity shares of Rs. 10 each               | <u>500</u>           | <u>500</u>            |
| Issued and subscribed:                               |                      |                       |
| 30 crores equity shares of Rs. 10 each fully paid up | 300                  | 300                   |
| B. Reserves and surplus                              |                      |                       |
| Capital reserves                                     | 40                   | 40                    |
| Add: Capital profit on reconstruction                | <u>50</u>            | <u>—</u>              |
|                                                      | 90                   | 40                    |
| Revenue reserves                                     | 700                  | 700                   |
| Surplus                                              | <u>10</u>            | <u>10</u>             |
|                                                      | <u>800</u>           | <u>750</u>            |
| C. Loan funds                                        |                      |                       |
| Yaa Ltd. (Interest @ 15% p.a.)                       | 15                   | —                     |
| Others                                               | <u>300</u>           | <u>250</u>            |
|                                                      | <u>315</u>           | <u>250</u>            |

Yaa Ltd.

Balance Sheet as at 31st March, 1999

|                          | Schedule | After reconstruction | (Rs. in crores)       |
|--------------------------|----------|----------------------|-----------------------|
|                          |          |                      | Before reconstruction |
| I SOURCES OF FUNDS       |          |                      |                       |
| (1) Shareholders' funds: |          |                      |                       |
| (a) Capital              | A        | 200                  | 200                   |
| (b) Reserves and surplus | B        | <u>465</u>           | <u>450</u>            |
|                          |          | 665                  | 650                   |
| (2) Loan funds (others)  |          | <u>300</u>           | <u>350</u>            |
| TOTAL                    |          | <u>965</u>           | <u>1,000</u>          |
| II APPLICATION OF FUNDS  |          |                      |                       |
| (1) Fixed assets:        |          |                      |                       |
| (a) Gross block          |          | 400                  | 700                   |
| (b) Less: Depreciation   |          | <u>100</u>           | <u>300</u>            |
| (c) Net block            |          | 300                  | 400                   |
| (2) Investments          |          | —                    | —                     |

## Company Accounts

|                                        |            |            |              |
|----------------------------------------|------------|------------|--------------|
| (3) Current assets, loans and advances |            |            |              |
| (a) Current assets                     | 1,600      | 1,500      |              |
| (b) Loan to Ksha Ltd.                  | <u>15</u>  | <u>—</u>   |              |
|                                        | 1,615      | 1,500      |              |
| Less: Current liabilities              | <u>950</u> | <u>900</u> |              |
| Net current assets                     |            | <u>665</u> | <u>600</u>   |
| TOTAL                                  |            | <u>965</u> | <u>1,000</u> |

## Schedules to Balance Sheet

|                                                      | (Rs. in crores)         |                          |
|------------------------------------------------------|-------------------------|--------------------------|
|                                                      | After<br>reconstruction | Before<br>reconstruction |
| A. Share Capital                                     |                         |                          |
| Authorised:                                          |                         |                          |
| 50 crores equity shares of Rs. 10 each               | <u>500</u>              | <u>500</u>               |
| Issued and subscribed:                               |                         |                          |
| 20 crores equity shares of Rs. 10 each fully paid up | 200                     | 200                      |
| B. Reserves and surplus                              |                         |                          |
| Capital reserves                                     | 20                      | 20                       |
| Add: Capital profit on reconstruction                | <u>15</u>               | <u>—</u>                 |
|                                                      | 35                      | 20                       |
| Revenue reserves                                     | 425                     | 425                      |
| Surplus                                              | <u>5</u>                | <u>5</u>                 |
|                                                      | <u>465</u>              | <u>450</u>               |

## (b) Net asset value of Master Riche Rich's holdings

|                                                                  | Pre-<br>reorganisation<br>Rs. | Post-<br>reorganisation<br>Rs. | Change<br>(Gain)<br>Rs. |
|------------------------------------------------------------------|-------------------------------|--------------------------------|-------------------------|
| Net asset value of one equity share:<br>(Refer to working notes) |                               |                                |                         |
| Ksha Ltd.                                                        | 35.00                         | 36.67                          | 1.67                    |
| Yaa Ltd.                                                         | 32.50                         | 33.25                          | 0.75                    |
| Net asset value of equity shares owned by<br>Master Riche Rich   |                               |                                |                         |
| Ksha Ltd. (50,000 shares)                                        | 17,50,000                     | 18,33,500                      | 83,500                  |
| Yaa Ltd. (30,000 shares)                                         | <u>9,75,000</u>               | <u>9,97,500</u>                | <u>22,500</u>           |
|                                                                  | <u>27,25,000</u>              | <u>28,31,000</u>               | <u>1,06,000</u>         |

## Advanced Accounting

Master Riche Rich has gained in terms of net asset value of his holdings as indicated in the last column.

Working Notes:

(1) Ksha Ltd.

(i)

|                                                                          | Amounts (Rs. in crores)    |                    |                                    |                             |
|--------------------------------------------------------------------------|----------------------------|--------------------|------------------------------------|-----------------------------|
|                                                                          | Pre-reorganisation figures | Sale of division B | Purchase of division A of Yaa Ltd. | Post-reorganisation figures |
|                                                                          | (a)                        | (b)                | (c)                                | (d) = (a) – (b) + (c)       |
| Fixed assets:                                                            |                            |                    |                                    |                             |
| Cost                                                                     | 1,000                      | 400                | 325                                | 925                         |
| Depreciation                                                             | <u>(400)</u>               | <u>(240)</u>       | <u>—</u>                           | <u>(160)</u>                |
| Written down value (I)                                                   | <u>600</u>                 | <u>160</u>         | <u>325</u>                         | <u>765</u>                  |
| Current assets                                                           | 2,000                      | 900                | 800                                | 1,900                       |
| Current liabilities                                                      | <u>(1,300)</u>             | <u>(750)</u>       | <u>(700)</u>                       | <u>(1,250)</u>              |
| Net current assets (II)                                                  | <u>700</u>                 | <u>150</u>         | <u>100</u>                         | <u>650</u>                  |
| Funds employed [(I) + (II)]                                              | 1,300                      | 310                | 425                                | 1,415                       |
| Loan funds:                                                              |                            |                    |                                    |                             |
| Others (III)                                                             | (250)                      | (200)              | (250)                              | (300)                       |
| Yaa Ltd. (balance payable on transfers of divisions i.e. 140 – 125) (IV) | <u>—</u>                   | <u>—</u>           | <u>—</u>                           | <u>(15)</u>                 |
| Net worth (I + II – III – IV)                                            | <u>1,050</u>               | <u>110</u>         | <u>175</u>                         | <u>1,100</u>                |

(ii) Sale of division B

(Rs. in crores)

|                                        |            |
|----------------------------------------|------------|
| Transfer price                         | 125        |
| Cost of the division (160 + 150 – 200) | <u>110</u> |
| Capital Profit                         | <u>15</u>  |

(iii) Purchase of division A of Yaa Ltd.

(Rs. in crores)

|                                                                      |            |
|----------------------------------------------------------------------|------------|
| Agreed value of assets less liabilities taken over (325 + 100 – 250) | 175        |
| Less: Transfer price                                                 | <u>140</u> |
| Capital Profit                                                       | <u>35</u>  |



## Company Accounts

|                                  |           |                       |
|----------------------------------|-----------|-----------------------|
|                                  |           | (Rs. in<br>crores)    |
| Pre-reorganisation net worth     |           | 1,050                 |
| Add: Capital profit on           |           |                       |
| Sale                             | 15        |                       |
| Acquisition                      | <u>35</u> | <u>50</u>             |
| Post-reorganisation net worth    |           | <u>1,100</u>          |
| No. of equity shares             |           | 30 crores             |
| Net asset value of equity share: |           | Rs.                   |
| Pre-reorganisation               | 1,050/30  | = 35.00               |
| Post-reorganisation              | 1,100/30  | = 36.67 (Rounded off) |

### (2) Yaa Ltd.

(i)

|                                                                     | Amounts (Rs. in crores)       |                          |                                              |                                |
|---------------------------------------------------------------------|-------------------------------|--------------------------|----------------------------------------------|--------------------------------|
|                                                                     | Pre-reorganisation<br>figures | Sale of<br>division<br>A | Purchase<br>of division<br>B of Ksha<br>Ltd. | Post-reorganisation<br>figures |
|                                                                     | (a)                           | (b)                      | (c)                                          | (d) = (a) – (b)<br>+ (c)       |
| Fixed assets:                                                       |                               |                          |                                              |                                |
| Cost                                                                | 700                           | 500                      | 200                                          | 400                            |
| Depreciation                                                        | <u>(300)</u>                  | <u>(200)</u>             | <u>—</u>                                     | <u>(100)</u>                   |
| Written down value (I)                                              | 400                           | 300                      | 200                                          | 300                            |
| Current assets                                                      | 1,500                         | 800                      | 900                                          | 1,600                          |
| Current liabilities                                                 | <u>(900)</u>                  | <u>(700)</u>             | <u>(750)</u>                                 | <u>(950)</u>                   |
| Net current assets (II)                                             | <u>600</u>                    | <u>100</u>               | <u>150</u>                                   | <u>650</u>                     |
| Funds employed [(I) + (II)]                                         | 1,000                         | 400                      | 350                                          | 950                            |
| Loan funds—others (III)                                             | <u>(350)</u>                  | <u>(250)</u>             | <u>(200)</u>                                 | <u>(300)</u>                   |
|                                                                     | 650                           | 150                      | 150                                          | 650                            |
| Ksha Ltd. (balance on<br>account of transfers of<br>divisions) (IV) | <u>—</u>                      | <u>—</u>                 | <u>—</u>                                     | <u>15</u>                      |
| Net worth ( I + II – III + IV)                                      | <u>650</u>                    | <u>150</u>               | <u>150</u>                                   | <u>665</u>                     |

(ii)

|                                  | Purchase of division B of<br>Ksha Ltd. | Sale of division A      |
|----------------------------------|----------------------------------------|-------------------------|
| Value of assets less liabilities | 150                                    | 150                     |
| (Value to Yaa Ltd.)              | (200 + 900 – 750 – 200)                | (300 + 800 – 700 – 250) |
| Less: Transfer Price             | <u>125</u>                             | <u>140</u>              |
| Capital Profit                   | <u>25</u>                              | <u>(10)</u>             |

## Advanced Accounting

|       |                                    |             |            |
|-------|------------------------------------|-------------|------------|
| (iii) | Pre-reorganisation net worth       |             | 650        |
|       | Add: Capital profit on acquisition |             |            |
|       |                                    | 25          |            |
|       | Sale                               | <u>(10)</u> | <u>15</u>  |
|       | Post-reorganisation net worth      |             | <u>665</u> |
|       | No. of equity shares               |             | 20 crores  |
|       | Net asset value of equity share:   |             | Rs.        |
|       | Pre-reorganisation                 | 650/20      | = 32.50    |
|       | Post-reorganisation                | 665/20      | = 33.25    |

### Question 12

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The Balance Sheet as at 31st October, 1999 was as under:

|                                       | Maxi<br>division<br>Rs. | Mini<br>division<br>Rs.<br>(in crores) | Total<br>Rs. |
|---------------------------------------|-------------------------|----------------------------------------|--------------|
| Fixed assets:                         |                         |                                        |              |
| Cost                                  | 600                     | 300                                    | 900          |
| Depreciation                          | <u>500</u>              | <u>100</u>                             | <u>600</u>   |
| W.D.V.                                | 100                     | 200                                    | 300          |
| Net current assets:                   |                         |                                        |              |
| Current assets                        | 400                     | 300                                    | 700          |
| Less: Current liabilities             | <u>100</u>              | <u>100</u>                             | <u>200</u>   |
|                                       | <u>300</u>              | <u>200</u>                             | <u>500</u>   |
| TOTAL                                 | <u>400</u>              | <u>400</u>                             | <u>800</u>   |
| Financed by :                         |                         |                                        |              |
| Loan funds                            | —                       | 100                                    | 100          |
| (secured by a charge on fixed assets) |                         |                                        |              |
| Own funds:                            |                         |                                        |              |
| Equity capital                        |                         |                                        | 50           |
| (fully paid up Rs. 10 shares)         |                         |                                        |              |
| Reserves and surplus                  |                         |                                        | <u>650</u>   |
|                                       | <u>?</u>                | <u>?</u>                               | <u>700</u>   |
| TOTAL                                 | <u>400</u>              | <u>400</u>                             | <u>800</u>   |

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

## Company Accounts

Accordingly Mini Ltd. was incorporated to take over at Balance Sheet figures the assets and liabilities of that division. Mini Ltd. is to allot 5 crores equity shares of Rs. 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

- (a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 1999, showing corresponding previous year's figures.
- (b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.
- (c) Comment on the impact of demerger on "shareholders wealth".

(16 marks) (November, 1999)

Answer

### Journal of Maxi Mini Ltd.

|                                           |            | (Rs. in crores) |
|-------------------------------------------|------------|-----------------|
|                                           | Dr.<br>Rs. | Cr.<br>Rs.      |
| Current liabilities A/c                   | Dr. 100    |                 |
| Loan fund (secured) A/c                   | Dr. 100    |                 |
| Provision for depreciation A/c            | Dr. 100    |                 |
| Loss on reconstruction (Balancing figure) | Dr. 300    |                 |
| To Fixed assets A/c                       |            | 300             |
| To Current assets A/c                     |            | 300             |

(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of Rs. 10 each of that company at par for every share held in the company vide scheme of reorganisation.)

Note : Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students.

### Journal of Mini Ltd.

|                            |            | (Rs. in crores) |
|----------------------------|------------|-----------------|
|                            | Dr.<br>Rs. | Cr.<br>Rs.      |
| Fixed assets (300-100) A/c | Dr. 200    |                 |
| Current assets A/c         | Dr. 300    |                 |

## Advanced Accounting

|                             |     |
|-----------------------------|-----|
| To Current liabilities A/c  | 100 |
| To Secured loan funds A/c   | 100 |
| To Equity share capital A/c | 50  |
| To Capital reserve          | 250 |

(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of Rs. 10 each at par as fully paid up to the members of Maxi Mini Ltd.)

Maxi Mini Ltd.

Balance Sheet as at 1st November, 1999

|                           | Schedule | After<br>reconstruction | (Rs. in crores)<br>Before<br>reconstruction |
|---------------------------|----------|-------------------------|---------------------------------------------|
| I. SOURCES OF FUNDS       |          |                         |                                             |
| (1) Shareholder's funds : |          |                         |                                             |
| (a) Capital               |          | 50                      | 50                                          |
| (b) Reserves and Surplus  | A        | <u>350</u>              | <u>650</u>                                  |
|                           |          | 400                     | 700                                         |
| (2) Loan funds :          |          |                         |                                             |
| Secured loans             |          | <u>—</u>                | <u>100</u>                                  |
| TOTAL                     |          | <u>400</u>              | <u>800</u>                                  |
| II. APPLICATION OF FUNDS  |          |                         |                                             |
| (1) Fixed assets :        |          |                         |                                             |
| (a) Gross block           |          | 600                     | 900                                         |
| (b) Less: Depreciation    |          | <u>500</u>              | <u>600</u>                                  |
| (c) Net block             |          | 100                     | 300                                         |
| (2) Investments           |          | —                       | —                                           |
| (3) Current assets        |          | 400                     | 700                                         |
| Less: Current liabilities |          | <u>100</u>              | <u>200</u>                                  |
| Net current assets        |          | <u>300</u>              | <u>500</u>                                  |
| TOTAL                     |          | <u>400</u>              | <u>800</u>                                  |

Schedule to Balance Sheet

|                              | After<br>reconstruction | Before<br>reconstruction |
|------------------------------|-------------------------|--------------------------|
| A. Reserves and Surplus      | 650                     | 650                      |
| Less: Loss on reconstruction | <u>300</u>              | <u>—</u>                 |
|                              | <u>350</u>              | <u>650</u>               |

Note to Accounts : Consequent on reconstruction of the company and transfer of Mini division

## Company Accounts

to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of Rs. 10 each at par of Mini Ltd.

Mini Ltd.

Balance Sheet as at 1 November, 1999

(Rs. in crores)

| Schedule                  |            |            |
|---------------------------|------------|------------|
| I. SOURCES OF FUNDS       |            |            |
| (1) Shareholder's funds : |            |            |
| (a) Capital               | A          | 50         |
| (b) Reserves and Surplus  |            | <u>250</u> |
|                           |            | 300        |
| (2) Loan funds :          |            |            |
| Secured loans             |            | <u>100</u> |
| TOTAL                     |            | <u>400</u> |
| II. APPLICATION OF FUNDS  |            |            |
| (1) Fixed assets          |            | 200        |
| (2) Investments           |            | —          |
| (3) Current assets        | 300        |            |
| Less: Current liabilities | <u>100</u> |            |
| Net current assets        |            | <u>200</u> |
| TOTAL                     |            | <u>400</u> |

Schedules to Balance Sheet

(Rs. in crores)

|                                                                                                                                                              |                       |                       |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| A. Share Capital :                                                                                                                                           |                       |                       |
| Issued and paid up :                                                                                                                                         |                       |                       |
| 5 crores Equity shares of                                                                                                                                    |                       |                       |
| Rs. 10 each fully paid up                                                                                                                                    |                       |                       |
|                                                                                                                                                              |                       | 50                    |
| All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on take over of Mini division from Maxi Mini Ltd. |                       |                       |
| (b) Net asset value of an equity share                                                                                                                       |                       |                       |
|                                                                                                                                                              | Pre-demerger          | Post-demerger         |
| Maxi Mini Ltd. :                                                                                                                                             | <u>Rs. 700 crores</u> | <u>Rs. 400 crores</u> |
|                                                                                                                                                              | 5 crores              | 5 crores              |
|                                                                                                                                                              | = Rs. 140             | = Rs. 80              |
| Mini Ltd.:                                                                                                                                                   |                       | <u>Rs. 300 crores</u> |
|                                                                                                                                                              |                       | 5 crores              |
|                                                                                                                                                              |                       | = Rs. 60              |

### Advanced Accounting

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

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

#### Question 13

Kuber Ltd. furnishes you with the following Balance Sheet as at 31st March, 2000:

| (Rs. in crores)                                             |            |            |
|-------------------------------------------------------------|------------|------------|
| Sources of funds:                                           |            |            |
| Share Capital:                                              |            |            |
| Authorised                                                  |            | <u>100</u> |
| Issued:                                                     |            |            |
| 12% redeemable preference shares of Rs. 100 each fully paid | 75         |            |
| Equity shares of Rs. 10 each fully paid                     | <u>25</u>  | 100        |
| Reserves and surplus:                                       |            |            |
| Capital reserve                                             | 15         |            |
| Share premium                                               | 25         |            |
| Revenue reserves                                            | <u>260</u> | <u>300</u> |
|                                                             |            | <u>400</u> |
| Funds employed in:                                          |            |            |
| Fixed assets: Cost                                          | 100        |            |
| Less: Provision for depreciation                            | <u>100</u> | nil        |
| Investment at cost (market value Rs. 400 Cr.)               |            | 100        |
| Current assets                                              | 340        |            |
| Less: Current liabilities                                   | <u>40</u>  |            |
|                                                             |            | <u>300</u> |
|                                                             |            | <u>400</u> |

The company redeemed preference shares on 1st April, 2000. It also bought back 50 lakh equity shares of Rs. 10 each at Rs. 50 per share. The payments for the above were made out of the huge bank balances, which appeared as part of current assets.

You are asked to :

- Pass journal entries to record the above.
  - Prepare balance sheet.
  - Value equity share on net asset basis.
- (10 marks) (May, 2000)

## Company Accounts

Answer

(a)

Journal of Kuber Ltd.

|                                                                                                                                                |     | (Rs. in crores) |            |
|------------------------------------------------------------------------------------------------------------------------------------------------|-----|-----------------|------------|
|                                                                                                                                                |     | Dr.<br>Rs.      | Cr.<br>Rs. |
| Redeemable preference share capital                                                                                                            | Dr. | 75              |            |
| To Bank                                                                                                                                        |     |                 | 75         |
| (Being redemption of 12% preference shares pursuant to capital re-organisation)                                                                |     |                 |            |
| Revenue reserves                                                                                                                               | Dr. | 75              |            |
| To Capital redemption reserve                                                                                                                  |     |                 | 75         |
| (Being amount equal to par value of preference shares redeemed out of profits, transferred to capital redemption reserve)                      |     |                 |            |
| Equity share capital                                                                                                                           | Dr. | 5               |            |
| Revenue reserves                                                                                                                               | Dr. | 20              |            |
| To Bank                                                                                                                                        |     |                 | 25         |
| (Being buyback of 50 lakhs equity shares of Rs. 10 each from the members at a price of Rs. 50 per share, premium paid out of revenue reserves) |     |                 |            |
| Revenue reserves                                                                                                                               | Dr. | 5               |            |
| To Capital redemption reserve                                                                                                                  |     |                 | 5          |
| (Being transfer to capital redemption reserve, as required by Section 77AA, on buyback out of reserves)                                        |     |                 |            |

Kuber Ltd.

Balance Sheet (after reconstruction)

(Rs. In crores)

|     |                      | Schedule |            |
|-----|----------------------|----------|------------|
| I   | SOURCES OF FUNDS     |          |            |
| (1) | Shareholders' funds: |          |            |
| (a) | Capital              | A        | 20         |
| (b) | Reserves and surplus | B        | <u>280</u> |
|     |                      |          | 300        |
| (2) | Loan funds           |          | <u>—</u>   |
|     | TOTAL                |          | <u>300</u> |

## Advanced Accounting

### II APPLICATION OF FUNDS

|                                                 |            |            |
|-------------------------------------------------|------------|------------|
| (1) Fixed assets                                |            |            |
| (a) Gross block                                 | 100        |            |
| (b) Less: Depreciation                          | <u>100</u> |            |
| (c) Net block                                   |            | —          |
| (2) Investments (market value : Rs. 400 crores) |            | 100        |
| (3) Current assets                              | 240        |            |
| Less: Current liabilities                       | <u>40</u>  |            |
| Net current assets                              |            | <u>200</u> |
| TOTAL                                           |            | <u>300</u> |

### Schedules to Balance Sheet

(Rs. in crores)

|                                                                                                                |           |            |
|----------------------------------------------------------------------------------------------------------------|-----------|------------|
| A. Share Capital                                                                                               |           |            |
| Authorised:                                                                                                    |           | <u>100</u> |
| Issued, Subscribed and Paid up                                                                                 |           |            |
| 200 lakhs equity shares of Rs. 10 each fully paid up                                                           |           | <u>20</u>  |
|                                                                                                                |           | <u>20</u>  |
| 50 lakhs Equity Shares of Rs. 10 each have been bought back out of reserves at Rs. 50 per share                |           |            |
| 12% 75 lakhs Redeemable Preference Shares of Rs. 100 each fully paid up, have been redeemed on 1st April, 2000 |           |            |
| B. Reserves and surplus                                                                                        |           |            |
| (1) Capital reserve                                                                                            |           | 15         |
| (2) Capital Redemption Reserve                                                                                 |           |            |
| As per last account                                                                                            | —         |            |
| Add: Transfer from Revenue Reserves                                                                            | <u>80</u> | 80         |
| (3) Share (Securities) Premium                                                                                 |           | 25         |
| (4) Revenue Reserves                                                                                           |           |            |
| As per last account                                                                                            | 260       |            |
| Less: Transfer to Capital Redemption Reserve                                                                   | <u>80</u> |            |
|                                                                                                                | 180       |            |
| Less: Premium paid on buyback                                                                                  | <u>20</u> | <u>160</u> |
|                                                                                                                |           | <u>280</u> |

Net asset value of an equity share

(Rs. in crores)

|                                             |            |
|---------------------------------------------|------------|
| Investments (at market value)               | 400        |
| Net current assets                          | <u>200</u> |
| Net assets available to equity shareholders | <u>600</u> |



No. of equity shares = 2 crores

$$\text{Value of an equity share} = \frac{600 \text{ crores}}{2 \text{ crores}} = \text{Rs. } 300$$

Note: As regards treatment of profit (loss) on buyback, there is no authoritative pronouncement as to whether the difference between the nominal value and the amount paid should be treated as capital or revenue in nature. In the given case, the debit has been given to revenue reserves.

Also, in the absence of any other information, it has been assumed that shares have been bought back out of free reserves.

#### Question 14

Enterprise Ltd. has 2 divisions A and B.

Division A has been making constant profits while division B has been invariably suffering losses.

On 31st March, 2000 the divisionwise Balance Sheet was:

|                             | (Rs. in crores) |              |            |
|-----------------------------|-----------------|--------------|------------|
|                             | A               | B            | Total      |
| Fixed assets cost           | 250             | 500          | 750        |
| Depreciation                | <u>225</u>      | <u>400</u>   | <u>625</u> |
|                             | 25              | 100          | 125        |
| Current assets              | 200             | 500          | 700        |
| Less: Current liabilities   | <u>25</u>       | <u>400</u>   | <u>425</u> |
|                             | <u>175</u>      | <u>100</u>   | <u>275</u> |
|                             | <u>200</u>      | <u>200</u>   | <u>400</u> |
| Financed by:                |                 |              |            |
| Loan funds                  | —               | 300          | 300        |
| Capital: Equity Rs. 10 each | 25              | —            | 25         |
| Surplus                     | <u>175</u>      | <u>(100)</u> | <u>75</u>  |
|                             | <u>200</u>      | <u>200</u>   | <u>400</u> |

Division B along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company.

- (a) Assuming that there are no other transactions, you are asked to:
- Pass journal entries in the books of Enterprise Ltd.
  - Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
  - Prepare the Balance Sheet of Turnaround Ltd.

## Advanced Accounting

- (b) Shri Rustom, who holds 5,000 equity shares of Enterprise Ltd. wants to be explained the impact on net asset value of his investments as a result of the above reconstruction.

(10 + 6 = 16 marks)(May, 2000)

Answer

| (a) (i) Journal of Enterprise Ltd. |                                                                                                                                                                      | (Rs. in crores) |     |
|------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-----|
|                                    |                                                                                                                                                                      | Dr.             | Cr. |
| (1)                                | Turnaround Ltd.                                                                                                                                                      | Dr. 25          |     |
|                                    | Loan Funds                                                                                                                                                           | Dr. 300         |     |
|                                    | Current Liabilities                                                                                                                                                  | Dr. 400         |     |
|                                    | Provision for Depreciation                                                                                                                                           | Dr. 400         |     |
|                                    | To Fixed Assets                                                                                                                                                      |                 | 500 |
|                                    | To Current Assets                                                                                                                                                    |                 | 500 |
|                                    | To Capital Reserve                                                                                                                                                   |                 | 125 |
|                                    | (Being division B along with its assets and liabilities sold to Turnaround Ltd. for Rs. 25 crores)                                                                   |                 |     |
| (2)                                | Capital Reserve                                                                                                                                                      | Dr. 25          |     |
|                                    | To Turnaround Ltd.                                                                                                                                                   |                 | 25  |
|                                    | (Being allotment of 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration) |                 |     |

Notes :

- (1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.
- (2) Profit on sale of division may, alternatively, be credited to Profit and Loss Account instead of Capital Reserve, in accordance with the requirements of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies.

|                         |                                    |                 |
|-------------------------|------------------------------------|-----------------|
| (ii)                    | Enterprise Ltd.                    |                 |
|                         | Balance Sheet after reconstruction |                 |
|                         |                                    | (Rs. in crores) |
|                         | Schedule                           |                 |
| I. SOURCES OF FUNDS     |                                    |                 |
| (1) Shareholders' funds |                                    |                 |

### Company Accounts

|                           |   |            |            |
|---------------------------|---|------------|------------|
| (a) Capital               |   | 25         |            |
| (b) Reserves and surplus  | A | <u>175</u> | 200        |
| (2) Loan funds            |   |            | <u>—</u>   |
| TOTAL                     |   |            | <u>200</u> |
| II. APPLICATION OF FUNDS  |   |            |            |
| (1) Fixed assets          |   |            |            |
| (a) Gross block           |   | 250        |            |
| (b) Less: Depreciation    |   | <u>225</u> |            |
| (c) Net block             |   |            | 25         |
| (2) Investments           |   |            | —          |
| (3) Current assets        |   | 200        |            |
| Less: Current liabilities |   | <u>25</u>  |            |
| Net current assets        |   |            | <u>175</u> |
| TOTAL                     |   |            | <u>200</u> |

#### Schedule to Balance Sheet

|                                        |                |
|----------------------------------------|----------------|
|                                        | (Rs.in crores) |
| A Reserves and Surplus                 | 75             |
| Add: Capital Reserve on reconstruction | <u>100</u>     |
|                                        | <u>175</u>     |

Note to Accounts : Consequent on transfer of Division B to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

(iii) Balance Sheet of Turnaround Ltd.

(Rs. in crores)

|                           |   |            |            |
|---------------------------|---|------------|------------|
| Schedule                  |   |            |            |
| I. SOURCES OF FUNDS       |   |            |            |
| (1) Shareholders' funds   |   |            |            |
| (a) Capital               | A | 10         |            |
| (b) Reserves and surplus  |   | <u>15</u>  | 25         |
| (2) Loan funds            |   |            | <u>300</u> |
| TOTAL                     |   |            | <u>325</u> |
| II. APPLICATION OF FUNDS  |   |            |            |
| (1) Fixed assets          | B |            | 225        |
| (2) Investments           |   |            | —          |
| (3) Current assets        |   | 500        |            |
| Less: Current liabilities |   | <u>400</u> |            |

## Advanced Accounting

|                    |            |
|--------------------|------------|
| Net current assets | <u>100</u> |
| TOTAL              | <u>325</u> |

### Schedules to Balance Sheet

(Rs.in crores)

#### A. Share Capital:

Issued and Paid-up:

1 crore Equity shares of

Rs. 10 each fully paid up

10

All the above shares have been issued for consideration other than cash, to the members of Enterprise Ltd on take over of Division B from Enterprise Ltd.

(at a premium of Rs.15 crores)

#### B. Fixed Assets:

Goodwill

125

Other fixed assets

100

225

(b)

### Net Asset Value of Shri Rustom's Investments

|                                                                                                                                                          | Pre-reconstruction | Post-reconstruction |                                           |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|---------------------|-------------------------------------------|
|                                                                                                                                                          | Enterprise Ltd.    | Enterprise Ltd.     | Turnaround Ltd.                           |
| Net worth (Rs. in crores)                                                                                                                                | 100                | 200                 | 25                                        |
| No. of equity shares (in crores)                                                                                                                         | 2.5                | 2.5                 | 1                                         |
| Net asset value of one equity share (Rs.)                                                                                                                | 40                 | 80                  | 25                                        |
| No. of equity shares held by Rustom                                                                                                                      | 5,000              | 5,000               | 2,000                                     |
|                                                                                                                                                          |                    |                     | $\left(\frac{1}{2.5} \times 5,000\right)$ |
| Net asset value of Rustom's holdings (Rs.)                                                                                                               | 2,00,000           | 4,00,000            | 50,000                                    |
| Thus, Rustom has gained Rs. 2,50,000 (4,00,000 + 50,000 – 2,00,000) in terms of net asset value of his holdings as a result of the above reconstruction. |                    |                     |                                           |

#### Question 15

The summarized Balance Sheets of A Ltd. and its subsidiary B Ltd. as on 31.3.2001 are as follows:

|                       | A Ltd.      | B Ltd.    |
|-----------------------|-------------|-----------|
|                       | Rs.         | Rs.       |
| Shares of Rs. 10 each | 1,00,00,000 | 20,00,000 |
| Reserves and Surplus  | 1,40,00,000 | 60,00,000 |
| Secured Loans         | 40,00,000   | —         |

## Company Accounts

|                      |                    |                    |
|----------------------|--------------------|--------------------|
| Current Liabilities  | <u>60,00,000</u>   | <u>20,00,000</u>   |
|                      | <u>3,40,00,000</u> | <u>1,00,00,000</u> |
| Fixed Assets         | 1,20,00,000        | 35,00,000          |
| Investment in B Ltd. | 7,40,000           | —                  |
| Sundry Debtors       | 70,00,000          | 10,00,000          |
| Inventories          | 60,00,000          | 50,00,000          |
| Cash and Bank        | <u>82,60,000</u>   | <u>5,00,000</u>    |
|                      | <u>3,40,00,000</u> | <u>1,00,00,000</u> |

A Ltd. holds 76% of the paid up capital of B Ltd. The balance shares in B Ltd. are held by a Foreign Collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:

- (a) The shares held by the foreign company will be sold to A Ltd. The price per share will be calculated by capitalizing the yield at 16%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were Rs. 35 lakhs. Rs. 44 lakhs and Rs. 65 lakhs.
- (b) The actual cost of shares to the foreign company was Rs. 2,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable be deducted from the proceeds and A Ltd. will pay it to the Government.
- (c) Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after one year. It was also decided that A Ltd. would absorb B Ltd. simultaneously by writing down the Fixed Assets of B Ltd. by 5%. The Balance Sheet figures included a sum of Rs. 1,50,000 due by B Ltd. to A Ltd.

The entire arrangement was approved by all concerned for giving effect to on 1.4.2001.

You are required to show the Balance Sheet of A Ltd. as it would appear after the arrangement is put through on 1.4.2001. (16 marks)(November, 2001)

Answer

### Balance Sheet of A Ltd.

as at 1st April, 2001

| Liabilities                 | Amount        | Assets                      | (Rs. in lakhs)<br>Amount |
|-----------------------------|---------------|-----------------------------|--------------------------|
| Share Capital               | 100.00        | Fixed Assets                | 153.25                   |
| (Shares of Rs. 10 each)     |               | Sundry Debtors              | 78.50                    |
| Reserves and Surplus        | 140.00        | (Less: Mutual Indebtedness) |                          |
| Capital Reserve             | 42.05         | Inventories                 | 110.00                   |
| Secured Loans               | 40.00         | Cash and Bank               | 69.24                    |
| Unsecured Loans             | 10.44         |                             |                          |
| Current Liabilities         | 78.50         |                             |                          |
| (Less: Mutual Indebtedness) |               |                             |                          |
|                             | <u>410.99</u> |                             | <u>410.99</u>            |

## Advanced Accounting

### Working Notes:

1. Yield of B Ltd.:  $\frac{(35 + 44 + 65)}{3} \times \frac{40}{100} = \text{Rs. } 19.20 \text{ lakhs}$
2. Price per share of B Ltd.:  
 Capitalised value of yield of B Ltd.:  $\frac{19.20 \times 100}{16} = \text{Rs. } 120 \text{ lakhs}$   
 Number of shares = 2,00,000  
 Price per share = Rs. 60
3. Purchase consideration for 24% of share capital of B Ltd.:  
 $2,00,000 \times \text{Rs. } 60 \times \frac{24}{100} = \text{Rs. } 28.80 \text{ lakhs}$
4. Discharge of Purchase Consideration:
  - (i) As Tax :  $(28.80 - 2.40) \times \frac{30}{100} = \text{Rs. } 7.92 \text{ lakhs}$
  - (ii) 50% of  $(28.80 - 7.92)$  i.e. Rs. 20.88 lakhs = Rs. 10.44 lakhs (to be remitted immediately)
  - (iii) Balance 50% = Rs. 10.44 lakhs (to be retained as unsecured loan)
5. Goodwill /Capital Reserve to A Ltd.: (Rs. in lakhs)
 

|                                                           |              |
|-----------------------------------------------------------|--------------|
| Total Assets as per Balance sheet of B Ltd.               | 100.00       |
| Less: 5% Reduction in the value of Fixed Assets           | <u>1.75</u>  |
|                                                           | 98.25        |
| Less: Current Liabilities                                 | <u>20.00</u> |
|                                                           | 78.25        |
| Less: Purchase Consideration                              | <u>28.80</u> |
|                                                           | 49.45        |
| Less: Investment in B Ltd. as per Balance sheet of A Ltd. | <u>7.40</u>  |
| Capital Reserve                                           | <u>42.05</u> |
6. Cash and bank balance of A Ltd. after acquisition of shares: (Rs. in lakhs)
 

|                                                       |              |
|-------------------------------------------------------|--------------|
| Opening Balance                                       | 82.60        |
| Cash and Bank Balance of B Ltd.                       | <u>5.00</u>  |
|                                                       | 87.60        |
| Less: Remittance to the foreign collaborating company | 10.44        |
| TDS paid                                              | <u>7.92</u>  |
|                                                       | <u>18.36</u> |
|                                                       | <u>69.24</u> |

## Company Accounts

### Question 16

The Balance Sheet of Z Ltd. as at 31st March, 2003 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

|                                             | (All amounts in crores of Rupees) |            |              |
|---------------------------------------------|-----------------------------------|------------|--------------|
|                                             | S Division                        | W Division | Total        |
| Fixed Assets:                               |                                   |            |              |
| Cost                                        | 875                               | 249        |              |
| Less: Depreciation                          | <u>360</u>                        | <u>81</u>  |              |
| Written-down value                          | <u>515</u>                        | <u>168</u> | 683          |
| Investments                                 |                                   |            | 97           |
| Net Current assets:                         |                                   |            |              |
| Current Assets                              | 445                               | 585        |              |
| Less: Current Liabilities                   | <u>270</u>                        | <u>93</u>  |              |
|                                             | <u>175</u>                        | <u>492</u> | <u>667</u>   |
|                                             |                                   |            | <u>1,447</u> |
| Financed by:                                |                                   |            |              |
| Loan funds                                  |                                   | 15         | 417          |
| Own funds:                                  |                                   |            |              |
| Equity share capital: shares of Rs. 10 each |                                   |            | 345          |
| Reserves and surplus                        |                                   |            | <u>685</u>   |
|                                             |                                   |            | <u>1,447</u> |

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2002 and 30th September, 2003.

On 1st April, 2003 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

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

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

You are required to:

- (i) Show the journal entries in the books of Z Ltd.

## Advanced Accounting

- (ii) Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).
- (iii) Calculate the intrinsic value of one share of Z Ltd. immediately before the demerger and immediately after the demerger; and
- (iv) Calculate the gain, if any, per share to the shareholders of Z Ltd. arising out of the demerger. (20 marks)(May, 2004)

Answer

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

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

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

|                    | Rs. in crores | Rs. in crores |
|--------------------|---------------|---------------|
| Fixed Assets       |               |               |
| Gross Block        | 875           |               |
| Less: Depreciation | <u>360</u>    | 515           |
| Net Current Assets |               |               |
| Current Assets     | 422           |               |



## Company Accounts

|                           |            |            |
|---------------------------|------------|------------|
| Less: Current Liabilities | <u>270</u> | <u>152</u> |
|                           |            | <u>667</u> |
| Financed by               |            |            |
| Shareholders' Funds       |            |            |
| Equity Share Capital      | 345        |            |
| Reserves and Surplus      | <u>45</u>  | 390        |
| Loan Funds                |            | <u>277</u> |
|                           |            | <u>667</u> |

### Working Notes:

|                                               | Rs. in crores | Rs. in crores |
|-----------------------------------------------|---------------|---------------|
| 1. Reserves and Surplus                       |               |               |
| Balance as on 31st March, 2003                |               | 685           |
| Add: Profit on sale of investments            |               | <u>5</u>      |
|                                               |               | 690           |
| Less: Loss on demerger                        |               | <u>645</u>    |
| Balance shown in balance sheet after demerger |               | <u>45</u>     |
| 2. Loan Funds                                 |               |               |
| Balance as on 31st March, 2003                |               | 417           |
| Less: Bank Loan transferred to Y Ltd.         | 15            |               |
| Debentures redeemed                           | <u>125</u>    | <u>140</u>    |
| Balance shown in balance sheet after demerger |               | <u>277</u>    |
| 3. Current Assets                             |               |               |
| Balance as on 31st March, 2003                |               | 445           |
| Add: Cash received from sale of investments   |               | <u>102</u>    |
|                                               |               | 547           |
| Less: Cash paid to redeem debentures          |               | <u>125</u>    |
| Balance shown in balance sheet after demerger |               | <u>422</u>    |
| (b) Initial Balance Sheet of Y Ltd.           |               |               |

|                                              | Rs. in crores | Rs. in crores |
|----------------------------------------------|---------------|---------------|
| Fixed Assets                                 |               | 218           |
| Net Current Assets                           |               |               |
| Current Assets                               | 585           |               |
| Less: Current Liabilities                    | <u>93</u>     | <u>492</u>    |
|                                              |               | <u>710</u>    |
| Financed by                                  |               |               |
| Shareholders' funds:                         |               |               |
| Capital (Issued for acquisition of business) |               | 690           |

## Advanced Accounting

|                  |            |
|------------------|------------|
| Capital Reserve* | 5          |
| Loan Funds       | <u>15</u>  |
|                  | <u>710</u> |

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

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

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

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

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

(iv) Gain per share to Shareholders:

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

|                                                                                                     |              |
|-----------------------------------------------------------------------------------------------------|--------------|
|                                                                                                     | Rs.          |
| Value of one share in Z Ltd.                                                                        | 11.30        |
| Value of two shares in Y Ltd. (Rs. 10 × 2)                                                          | <u>20.00</u> |
|                                                                                                     | 31.30        |
| Less: Value of one share before demerger                                                            | <u>30.00</u> |
| Gain per share                                                                                      | <u>1.30</u>  |
| The gain per share amounting Rs. 1.30 is due to appreciation in the value of fixed assets by Y Ltd. |              |

---

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

## Company Accounts

### Question 17

Travels & Tours Ltd. has two divisions – 'Inland' and 'International'. The Balance Sheet as at 31st December, 2004 was as under:

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

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

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

- You are asked to pass journal entries in relation to the above in the books of 'Travels & Tours Ltd.' and also in 'IT Ltd.'. Also show the Balance Sheets of both the companies as on 1st January, 2005 showing corresponding figures, before the reconstruction also.
- The directors of both the companies ask you to find out the net asset value of equity shares pre and post-demerger.
- Comment on the impact of demerger on "shareholders wealth".

(16 marks)(May,2005))

## Advanced Accounting

Answer

| (a)                                               |                           | Journal of Travels & Tours Ltd. |  | (Rs. in crores) |  |
|---------------------------------------------------|---------------------------|---------------------------------|--|-----------------|--|
| Particulars                                       |                           | Dr.                             |  | Cr.             |  |
|                                                   |                           | Rs.                             |  | Rs.             |  |
| Current liabilities account                       | Dr.                       | 200                             |  |                 |  |
| Loan fund (secured) account                       | Dr.                       | 100                             |  |                 |  |
| Provision for depreciation account                | Dr.                       | 200                             |  |                 |  |
| Loss on reconstruction account (Balancing figure) | Dr.                       | 400                             |  |                 |  |
|                                                   | To Fixed assets account   |                                 |  | 600             |  |
|                                                   | To Current assets account |                                 |  | 300             |  |

(Being the assets and liabilities of International division taken out of the books on transfer of the division to IT Ltd.; the consideration being allotment to the members of the company of one equity share of Rs. 10 each of that company at par for every share held in the company vide scheme of reorganisation)\*

|                                  |                                 | Journal of IT Ltd. |  | (Rs. in crores) |  |
|----------------------------------|---------------------------------|--------------------|--|-----------------|--|
|                                  |                                 | Dr.                |  | Cr.             |  |
|                                  |                                 | Rs.                |  | Rs.             |  |
| Fixed assets account (600 – 200) | Dr.                             | 400                |  |                 |  |
| Current assets account           | Dr.                             | 300                |  |                 |  |
|                                  | To Current liabilities account  |                    |  | 200             |  |
|                                  | To Loan funds (secured) account |                    |  | 100             |  |
|                                  | To Equity share capital account |                    |  | 50              |  |
|                                  | To Capital reserve account      |                    |  | 350             |  |

(Being the assets and liabilities of International division of Travels & Tours Ltd. taken over by IT Ltd. and allotment of 5 crore equity shares of Rs. 10 each at par as fully paid up to the members of Travels & Tours Ltd.)

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

## Company Accounts

### Travels & Tours Ltd. Balance Sheet as on 1st January, 2005

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

#### Schedule to Balance Sheet

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

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

### IT Ltd. Balance Sheet as on January 1, 2005

|                          | (Rs. in crores) |
|--------------------------|-----------------|
| I. SOURCES OF FUNDS      |                 |
| (1) Shareholder's Funds  |                 |
| (a) Capital (Schedule A) | 50              |
| (b) Reserves and Surplus | <u>350</u>      |

## Advanced Accounting

|     |                           |            |            |
|-----|---------------------------|------------|------------|
|     | (2) Loans Funds           |            |            |
|     | Secured Loans             |            | <u>100</u> |
|     |                           | Total      | <u>500</u> |
| II. | APPLICATION OF FUNDS      |            |            |
|     | (1) Fixed Assets          |            | 400        |
|     | (2) Investments           |            | —          |
|     | (3) Current Assets        | 300        |            |
|     | Less: Current Liabilities | <u>200</u> |            |
|     | Net current assets        |            | <u>100</u> |
|     |                           | Total      | <u>500</u> |

### Schedule to Balance Sheet

(Rs. in crores)

#### A. Share Capital:

Issued and paid up capital:

5 crore equity shares of Rs. 10 each fully paid up 50

(All the above equity shares have been issued for consideration other than cash to the members of Travels and Tours Ltd. on takeover of International division.)

#### (b) Net Asset Value of an equity share

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

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

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

### Question 18

A Ltd. and B Ltd. were amalgamated on and from 1st April, 1995. A new company C Ltd. was formed to take over the business of the existing companies. The Balance Sheets of A

## Company Accounts

Ltd. and B Ltd. as on 31st March, 1995 are given below:

|                                      |              |              |                                    | (Rs. in lakhs) |              |
|--------------------------------------|--------------|--------------|------------------------------------|----------------|--------------|
| Liabilities                          | A Ltd.       | B Ltd.       | Assets                             | A Ltd.         | B Ltd.       |
| Share Capital                        |              |              | Fixed Assets                       |                |              |
| Equity Shares of Rs. 100 each        | 800          | 750          | Land and Building                  | 550            | 400          |
| 12% Preference shares of Rs.100 each | 300          | 200          | Plant and Machinery                | 350            | 250          |
| Reserves and Surplus                 |              |              | Investments                        | 150            | 50           |
| Revaluation Reserve                  | 150          | 100          | Current Assets, Loans and Advances |                |              |
| General Reserve                      | 170          | 150          | Stock                              | 350            | 250          |
| Investment Allowance Reserve         | 50           | 50           | Sundry Debtors                     | 250            | 300          |
| Profit and Loss Account              | 50           | 30           | Bills Receivable                   | 50             | 50           |
| Secured Loans                        |              |              | Cash and Bank                      | 300            | 200          |
| 10% Debentures (Rs. 100 each)        | 60           | 30           |                                    |                |              |
| Current Liabilities and provisions   |              |              |                                    |                |              |
| Sundry Creditors                     | 270          | 120          |                                    |                |              |
| Bills Payable                        | <u>150</u>   | <u>70</u>    |                                    |                |              |
|                                      | <u>2,000</u> | <u>1,500</u> |                                    | <u>2,000</u>   | <u>1,500</u> |

Additional Information:

- (1) 10% Debentureholders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of Rs. 100 each so as to maintain the same amount of interest.
- (2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of Rs. 150 per share (face value of Rs. 100).
- (3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ Rs. 30 each, having a face value of Rs. 10 per share.
- (4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 1995 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

(15 marks) (May, 1996)

Answer

### Balance Sheet of C Ltd.

as at 1st April, 1995

| Liabilities                           | Amount | Assets            | (Rs. In lakhs)<br>Amount |
|---------------------------------------|--------|-------------------|--------------------------|
| SHARE CAPITAL                         |        | FIXED ASSETS      |                          |
| 70,00,000 Equity shares of Rs.10 each | 700    | Goodwill          | 20                       |
|                                       |        | Land and Building | 950                      |

## Advanced Accounting

|                               |              |                                             |              |
|-------------------------------|--------------|---------------------------------------------|--------------|
| 5,00,000 Preference shares of | 500          | Plant and Machinery                         | 600          |
| Rs. 100 each (all the above   |              | INVESTMENTS                                 | 200          |
| shares are allotted as fully  |              | CURRENT ASSETS,                             |              |
| paid-up pursuant to contracts |              | LOANS AND ADVANCES                          |              |
| without payment being         |              |                                             |              |
| received in cash)             |              |                                             |              |
| RESERVES AND SURPLUS          |              | A Current Assets                            |              |
| Securities Premium Account    | 1,650        | Stock                                       | 600          |
| Investment Allowance Reserve  | 100          | Sundry debtors                              | 550          |
| SECURED LOANS                 |              | Cash and Bank                               | 500          |
| 15% Debentures                | 60           | B Loans and Advances                        |              |
| UNSECURED LOANS               | —            | Bills Receivable                            | 100          |
| CURRENT LIABILITIES AND       |              | MISCELLANEOUS EXPENDITURE                   |              |
| PROVISIONS                    |              | (to the extent not written off or adjusted) |              |
| A Current Liabilities         |              | Amalgamation Adjustment Account             | 100          |
| Acceptances                   | 220          |                                             |              |
| Sundry Creditors              | 390          |                                             |              |
| B Provisions                  | —            |                                             |              |
|                               | <u>3,620</u> |                                             | <u>3,620</u> |

Working Notes:

|                                                                                                                             | (Rs. in lakhs) |              |
|-----------------------------------------------------------------------------------------------------------------------------|----------------|--------------|
|                                                                                                                             | A Ltd.         | B Ltd.       |
| (1) Computation of Purchase consideration                                                                                   |                |              |
| (a) Preference shareholders:                                                                                                |                |              |
| $\left( \frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares} \right) \times \text{Rs. } 150 \text{ each}$          | 450            |              |
| $\left( \frac{2,00,00,000}{100} \text{ i.e. } 2,00,000 \text{ shares} \right) \times \text{Rs. } 150 \text{ each}$          |                | 300          |
| (b) Equity shareholders:                                                                                                    |                |              |
| $\left( \frac{8,00,00,000 \times 5}{100} \text{ i.e. } 40,00,000 \text{ shares} \right) \times \text{Rs. } 30 \text{ each}$ | 1,200          |              |
| $\left( \frac{7,50,00,000 \times 4}{100} \text{ i.e. } 30,00,000 \text{ shares} \right) \times \text{Rs. } 30 \text{ each}$ |                | 900          |
| Amount of Purchase Consideration                                                                                            | <u>1,650</u>   | <u>1,200</u> |



## Company Accounts

(2) Net Assets Taken Over

Assets taken over:

|                     |            |            |
|---------------------|------------|------------|
| Land and Building   | 550        | 400        |
| Plant and Machinery | 350        | 250        |
| Investments         | 150        | 50         |
| Stock               | 350        | 250        |
| Sundry Debtors      | 250        | 300        |
| Bills receivable    | 50         | 50         |
| Cash and bank       | <u>300</u> | <u>200</u> |
|                     | 2,000      | 1,500      |

Less: Liabilities taken over:

|                        |              |            |
|------------------------|--------------|------------|
| Debentures             | 40           | 20         |
| Sundry Creditors       | 270          | 120        |
| Bills payable          | <u>150</u>   | <u>70</u>  |
|                        | <u>460</u>   | <u>210</u> |
| Net assets taken over  | 1,540        | 1,290      |
| Purchase consideration | <u>1,650</u> | 1,200      |
| Goodwill               | <u>110</u>   |            |
| Capital reserve        |              | <u>90</u>  |

Note:

Since Investment Allowance Reserve is to be maintained for 4 more years, it is carried forward by a corresponding debit to Amalgamation Adjustment Account in accordance with AS-14.

Question 19

The Balance Sheets of Big Ltd. and Small Ltd. as on 31.03.1995 were as follows:

Balance Sheet as on 31.03.1995

|                                           | Big Ltd.<br>(Rs.) | Small Ltd.<br>(Rs.) |             | Big Ltd.<br>(Rs.) | Small Ltd.<br>(Rs.) |
|-------------------------------------------|-------------------|---------------------|-------------|-------------------|---------------------|
| Equity Share Capital (Rs. 10)             | 8,00,000          | 3,00,000            | Building    | 2,00,000          | 1,00,000            |
| 10% Preference Share<br>Capital (Rs. 100) | —                 | 2,00,000            | Machinery   | 5,00,000          | 3,00,000            |
| General reserve                           | 3,00,000          | 1,00,000            | Furniture   | 1,00,000          | 60,000              |
|                                           |                   |                     | Investment: |                   |                     |

### Advanced Accounting

|                         |                  |                  |                               |                  |                  |
|-------------------------|------------------|------------------|-------------------------------|------------------|------------------|
| Profit and Loss Account | 2,00,000         | 1,00,000         | 6,000 shares<br>of Small Ltd. | 60,000           | —                |
| Creditors               | 2,00,000         | 3,00,000         | Stock                         | 1,50,000         | 1,90,000         |
|                         |                  |                  | Debtors                       | 3,50,000         | 2,50,000         |
|                         |                  |                  | Cash and<br>Bank              | 90,000           | 70,000           |
|                         |                  |                  | Preliminary<br>Expenses       | <u>50,000</u>    | <u>30,000</u>    |
|                         | <u>15,00,000</u> | <u>10,00,000</u> |                               | <u>15,00,000</u> | <u>10,00,000</u> |

Big Ltd. has taken over the entire undertaking of Small Ltd. on 30.09.1995, on which date the position of current assets except Cash and Bank balances and Current Liabilities were as under:

|           | Big Ltd.<br>(Rs.) | Small<br>Ltd.<br>(Rs.) |
|-----------|-------------------|------------------------|
| Stock     | 1,20,000          | 1,50,000               |
| Debtors   | 3,80,000          | 2,50,000               |
| Creditors | 1,80,000          | 2,10,000               |

Profits earned for the half year ended on 30.09.1995 after charging depreciation at 5% on building, 15% on machinery and 10% on furniture, are:

|            |              |
|------------|--------------|
| Big Ltd.   | Rs. 1,02,500 |
| Small Ltd. | Rs. 54,000   |

On 30.08.1995 both Companies have declared 15% dividend for 1994-1995.

Goodwill of Small Ltd. has been valued at Rs. 50,000 and other Fixed assets at 10% above their book values on 31.03.1995. Preference shareholders of Small Ltd. are to be allotted 10% Preference Shares of Big Ltd. and equity shareholders of Small Ltd. are to receive requisite number of equity shares of Big Ltd. valued at Rs. 15 per share in satisfaction of their claims.

Show the Balance Sheet of Big Ltd. as of 30.09.1995 assuming absorption is through by that date.  
(15 marks)(November, 1996)

## Company Accounts

Answer

| Balance Sheet of Big Ltd.<br>as at 30th September, 1995                                                                               |                  |                                                |                  |
|---------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------------------------------------|------------------|
| Liabilities                                                                                                                           | Amount<br>(Rs.)  | Assets                                         | Amount<br>(Rs.)  |
| SHARE CAPITAL                                                                                                                         |                  | FIXED ASSETS                                   |                  |
| 1,09,600 Equity shares of Rs.10 each                                                                                                  | 10,96,000        | Building                                       | 2,00,000         |
| 10% Preference shares                                                                                                                 | 2,00,000         | Less: Depreciation                             | <u>5,000</u>     |
| (Of the above shares, 29,600 equity shares and all preference shares are allotted as fully paid-up for consideration other than cash) |                  |                                                | 1,95,000         |
|                                                                                                                                       |                  | Add: Taken over                                | <u>1,07,500</u>  |
|                                                                                                                                       |                  | Machinery                                      | 5,00,000         |
|                                                                                                                                       |                  | Less: Depreciation                             | <u>37,500</u>    |
|                                                                                                                                       |                  |                                                | 4,62,500         |
| RESERVES AND SURPLUS                                                                                                                  |                  | Add: Taken over                                | <u>3,07,500</u>  |
| Capital Reserve                                                                                                                       | 1,000            |                                                | 7,70,000         |
| Securities Premium Account                                                                                                            | 1,48,000         | Furniture                                      | 1,00,000         |
| General Reserve                                                                                                                       | 3,00,000         | Less: Depreciation                             | <u>5,000</u>     |
| Profit and Loss Account                                                                                                               | 1,91,500         |                                                | 95,000           |
| SECURED LOANS                                                                                                                         | —                | Add: Taken over                                | <u>63,000</u>    |
| UNSECURED LOANS                                                                                                                       | —                |                                                | 1,58,000         |
| CURRENT LIABILITIES AND PROVISIONS                                                                                                    |                  | INVESTMENTS                                    |                  |
| Sundry Creditors                                                                                                                      | 3,90,000         | CURRENT ASSETS,<br>LOANS AND ADVANCES          |                  |
|                                                                                                                                       |                  | Current Assets                                 |                  |
|                                                                                                                                       |                  | Stock                                          | 2,70,000         |
|                                                                                                                                       |                  | Sundry Debtors                                 | 6,30,000         |
|                                                                                                                                       |                  | Cash and Bank                                  | 1,46,000         |
|                                                                                                                                       |                  | MISCELLANEOUS<br>EXPENDITURE                   |                  |
|                                                                                                                                       |                  | (to the extent not written<br>off or adjusted) |                  |
|                                                                                                                                       |                  | Preliminary Expenses                           | <u>50,000</u>    |
|                                                                                                                                       | <u>23,26,500</u> |                                                | <u>23,26,500</u> |

## Advanced Accounting

### Working Notes:

#### 1. Ascertainment of Cash and Bank Balances as on 30th September, 1995

##### Balance Sheets as at 30th September, 1995

| Liabilities                  | Big Ltd.         | Small Ltd.      | Assets               | Big Ltd.         | Small Ltd.      |
|------------------------------|------------------|-----------------|----------------------|------------------|-----------------|
|                              | (Rs.)            | (Rs.)           |                      | (Rs.)            | (Rs.)           |
| Equity Share Capital         | 8,00,000         | 3,00,000        | Building**           | 1,95,000         | 97,500          |
| 10% Preference Share Capital | —                | 2,00,000        | Machinery**          | 4,62,500         | 2,77,500        |
| General reserve              | 3,00,000         | 1,00,000        | Furniture**          | 95,000           | 57,000          |
| Profit and Loss Account*     | 1,91,500         | 89,000          | Investment           | 60,000           | —               |
| Creditors                    | 1,80,000         | 2,10,000        | Stock                | 1,20,000         | 1,50,000        |
|                              |                  |                 | Debtors              | 3,80,000         | 2,50,000        |
|                              |                  |                 | Cash and Bank        | 1,09,000         | 37,000          |
|                              |                  |                 | (Balancing figure)   |                  |                 |
|                              |                  |                 | Preliminary Expenses | <u>50,000</u>    | <u>30,000</u>   |
|                              | <u>14,71,500</u> | <u>8,99,000</u> |                      | <u>14,71,500</u> | <u>8,99,000</u> |

\*Balance of Profit and Loss Account on 30th September, 1995.

|                                                                   | Big Ltd.<br>(Rs.) | Small Ltd.<br>(Rs.) |
|-------------------------------------------------------------------|-------------------|---------------------|
| Net profit (for the first half)                                   | 1,02,500          | 54,000              |
| Balance brought forward                                           | <u>2,00,000</u>   | <u>1,00,000</u>     |
|                                                                   | 3,02,500          | 1,54,000            |
| Less: Dividend on Equity Share Capital Paid                       | <u>1,20,000</u>   | <u>45,000</u>       |
|                                                                   | 1,82,500          | 1,09,000            |
| Less: Dividend on Preference Share Capital Paid                   | <u>—</u>          | <u>20,000</u>       |
|                                                                   | 1,82,500          | 89,000              |
| Add: Dividend received $\left[ \frac{1}{5} \times 45,000 \right]$ | <u>9,000</u>      | <u>—</u>            |
|                                                                   | <u>1,91,500</u>   | <u>89,000</u>       |

\*\*Fixed Assets on 30th September, 1995 (Before absorption)

|                              | Big Ltd.<br>(Rs.) | Small Ltd.<br>(Rs.) |
|------------------------------|-------------------|---------------------|
| (1) Building                 |                   |                     |
| As on 1.4.1995               | 2,00,000          | 1,00,000            |
| Less: Depreciation (5% p.a.) | <u>5,000</u>      | <u>2,500</u>        |
|                              | <u>1,95,000</u>   | <u>97,500</u>       |

**Company Accounts**

|                               |                 |                 |
|-------------------------------|-----------------|-----------------|
| (2) Machinery                 |                 |                 |
| As on 1.4.1995                | 5,00,000        | 3,00,000        |
| Less: Depreciation (15% p.a.) | <u>37,500</u>   | <u>22,500</u>   |
|                               | <u>4,62,500</u> | <u>2,77,500</u> |
| (3) Furniture                 |                 |                 |
| As on 1.4.1995                | 1,00,000        | 60,000          |
| Less: Depreciation (10% p.a.) | <u>5,000</u>    | <u>3,000</u>    |
|                               | <u>95,000</u>   | <u>57,000</u>   |

2. Calculation of Shares Allotted

|                                                                                      |               |                 |
|--------------------------------------------------------------------------------------|---------------|-----------------|
| Assets taken over:                                                                   |               | Rs.             |
| Goodwill                                                                             |               | 50,000          |
| Building                                                                             | 1,00,000      |                 |
| Add: 10%                                                                             | <u>10,000</u> |                 |
|                                                                                      | 1,10,000      |                 |
| Less: Depreciation                                                                   | <u>2,500</u>  |                 |
|                                                                                      |               | 1,07,500        |
| Machinery                                                                            | 3,00,000      |                 |
| Add: 10%                                                                             | <u>30,000</u> |                 |
|                                                                                      | 3,30,000      |                 |
| Less: Depreciation                                                                   | <u>22,500</u> |                 |
|                                                                                      |               | 3,07,500        |
| Furniture                                                                            | 60,000        |                 |
| Add: 10%                                                                             | <u>6,000</u>  |                 |
|                                                                                      | 66,000        |                 |
| Less: Depreciation                                                                   | <u>3,000</u>  |                 |
|                                                                                      |               | 63,000          |
| Stock                                                                                |               | 1,50,000        |
| Debtors                                                                              |               | 2,50,000        |
| Cash and Bank                                                                        |               | <u>37,000</u>   |
|                                                                                      |               | 9,65,000        |
| Less: Liabilities taken over:                                                        |               |                 |
| Creditors                                                                            |               | <u>2,10,000</u> |
| Net assets taken over                                                                |               | 7,55,000        |
| Less: Allotment of 10% Preference Shares<br>to preference shareholders of Small Ltd. |               | <u>2,00,000</u> |
|                                                                                      |               | 5,55,000        |

## Advanced Accounting

|                                                                                |                       |
|--------------------------------------------------------------------------------|-----------------------|
| Less: Belonging to Big Ltd.***                                                 | 1,11,000              |
| $\left[ \frac{1}{5} \times 5,55,000 \right]$                                   | <u>          </u>     |
| Payable to other Equity Shareholders                                           | <u>4,44,000</u>       |
| Number of equity shares of Rs. 10 each to<br>be Issued (valued at Rs. 15 each) | $\frac{4,44,000}{15}$ |
|                                                                                | = 29,600              |

[\*\*\* 6,000 shares out of 30,000 shares of Small Ltd. are already with Big Ltd.]

### 3. Ascertainment of Goodwill / Capital Reserve

|                                                 | Rs.             |
|-------------------------------------------------|-----------------|
| (A) Net Assets taken over                       | 7,55,000        |
| (B) Preference shares allotted                  | 2,00,000        |
| Payable to other equity shareholders            | 4,44,000        |
| Cost of investments                             | <u>60,000</u>   |
|                                                 | <u>7,04,000</u> |
| (C) Capital Reserve [(A) – (B)]                 | 51,000          |
| (D) Goodwill taken over                         | 50,000          |
| (E) Final figure of Capital Reserve [(C) – (D)] | 1,000           |

### Question 20

The following are the Balance Sheets of Big Ltd. and Small Ltd. for the year ending on 31st March, 1998. (Figures in crores of rupees):

|                                                                        | Big Ltd.   | Small Ltd. |
|------------------------------------------------------------------------|------------|------------|
| Equity share capital – in equity shares of Rs. 10 each                 | 50         | 40         |
| Preference share capital – in 10% preference shares<br>of Rs. 100 each | —          | 60         |
| Reserves and Surplus                                                   | <u>200</u> | <u>150</u> |
|                                                                        | 250        | 250        |
| Loans – Secured                                                        | <u>100</u> | <u>100</u> |
| Total funds                                                            | <u>350</u> | <u>350</u> |
| Applied for: Fixed assets at cost less depreciation                    | 150        | 150        |
| Current assets less current liabilities                                | <u>200</u> | <u>200</u> |
|                                                                        | <u>350</u> | <u>350</u> |

The present worth of fixed assets of Big Ltd. is Rs. 200 crores and that of Small Ltd. is Rs. 429 crores. Goodwill of Big Ltd. is Rs. 40 crores and of Small Ltd. is 75 crores.

## Company Accounts

Small Ltd. absorbs Big Ltd. by issuing equity shares at par in such a way that intrinsic net worth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

- (a) Show the Balance Sheet after absorption.
- (b) Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings. (15 marks) (May, 1998)

Answer

| Small Ltd.                          |                 |            |                    |
|-------------------------------------|-----------------|------------|--------------------|
| Balance Sheet as at 1st April, 1998 |                 |            |                    |
|                                     | Schedule<br>No. |            | (Rs. in<br>crores) |
| I SOURCES OF FUNDS                  |                 |            |                    |
| (1) Shareholders' funds:            |                 |            |                    |
| (a) Capital                         | A               | 125        |                    |
| (b) Reserves and surplus            | B               | <u>375</u> |                    |
|                                     |                 |            | 500                |
| (2) Loan funds:                     |                 |            |                    |
| Secured loans                       | C               | <u>200</u> |                    |
| TOTAL                               |                 | <u>700</u> |                    |
| II APPLICATION OF FUNDS             |                 |            |                    |
| (1) Fixed assets:                   |                 |            |                    |
| Net block                           | D               |            | 300                |
| (2) Investments                     |                 |            | —                  |
| (3) Net current assets              | E               | <u>400</u> |                    |
| TOTAL                               |                 | <u>700</u> |                    |
|                                     |                 |            | (Rs. in Crores)    |

Schedules to Accounts:

|                                                                                                                 |            |
|-----------------------------------------------------------------------------------------------------------------|------------|
| A Share Capital:                                                                                                |            |
| 6.5 crores equity shares of Rs. 10 each                                                                         | 65         |
| (of the above shares, 2.5 crores equity shares are allotted as fully paid-up for consideration other than cash) |            |
| 60 lakhs 10% Preference shares of Rs. 100 each                                                                  | <u>60</u>  |
|                                                                                                                 | <u>125</u> |
| B Reserves and Surplus:                                                                                         |            |
| As per last Balance Sheet                                                                                       | 150        |
| Capital Reserve                                                                                                 | <u>225</u> |
|                                                                                                                 | <u>375</u> |
| C Secured Loans:                                                                                                |            |
| As per last Balance Sheet                                                                                       | 100        |

## Advanced Accounting

|   |                                      |            |
|---|--------------------------------------|------------|
|   | Taken over on absorption of Big Ltd. | <u>100</u> |
|   |                                      | <u>200</u> |
| D | Fixed Assets:                        |            |
|   | As per last Balance Sheet            | 150        |
|   | Taken over on absorption of Big Ltd. | <u>150</u> |
|   |                                      | <u>300</u> |
| E | Net Current Assets:                  |            |
|   | As per last Balance Sheet            | 200        |
|   | Taken over on absorption of Big Ltd. | <u>200</u> |
|   |                                      | <u>400</u> |

### (b) Valuation of shares on intrinsic value basis

|                                                                          |            |                               |
|--------------------------------------------------------------------------|------------|-------------------------------|
| (i)                                                                      | Big Ltd.   | Small Ltd.<br>(Rs. in crores) |
| Equity share capital                                                     | 50         | 40                            |
| Reserves and Surplus                                                     | <u>200</u> | <u>150</u>                    |
|                                                                          | 250        | 190                           |
| Goodwill agreed upon                                                     | 40         | 75                            |
| Increase in the value of fixed assets<br>(Present worth less book value) | <u>50</u>  | <u>279</u>                    |
|                                                                          | <u>340</u> | <u>544</u>                    |
| (ii)                                                                     | Big Ltd.   | Small Ltd.                    |
| Number of Equity shares                                                  | 5 crores   | 4 crores                      |
| Intrinsic value per equity share                                         | Rs. 68     | Rs. 136                       |

(iii) Ratio of intrinsic value of shares in the two companies 1 : 2

Since the shares are to be issued at par, the number of equity shares of Rs. 10 each to be issued to maintain the intrinsic net worth = 5 crores / 2 = 2.5 crores

### (iv) Statement to prove the accuracy of workings

|                                                              |                 |
|--------------------------------------------------------------|-----------------|
|                                                              | (Rs. in crores) |
| (1) Equity share capital (after absorption)                  | 65              |
| Reserves and Surplus (after absorption)                      | <u>375</u>      |
|                                                              | 440             |
| Add: Unrecorded value of goodwill (40 + 75)                  | 115             |
| Add: Unrecorded incremental value of fixed assets (50 + 279) | <u>329</u>      |
|                                                              | <u>884</u>      |
| (2) Number of equity shares                                  | 6.5 crores      |
| (3) Intrinsic value of an equity share (884/6.5)             | Rs. 136         |



## Company Accounts

Working Note:

### Calculation of Capital Reserve on Absorption

|                                | (Rs. in crores) |
|--------------------------------|-----------------|
| Fixed Assets taken over        | 150             |
| Net current assets taken over  | <u>200</u>      |
|                                | 350             |
| Less: Secured loans taken over | <u>100</u>      |
| Net Assets taken over          | 250             |
| Less: Purchase consideration   | <u>25</u>       |
|                                | <u>225</u>      |

### Question 21

Given below is the Balance Sheet of H Ltd. as on 31.3.1997:

| (Figures in Rs. lakhs)            |              |                                        |              |
|-----------------------------------|--------------|----------------------------------------|--------------|
| Equity share capital              | 4.00         | Block assets less depreciation to date | 6.00         |
| (in equity shares of Rs. 10 each) |              | Stock and debtors                      | 5.30         |
| 10% preference share capital      | 3.00         | Cash and bank                          | 0.70         |
| General reserve                   | 1.00         |                                        |              |
| Profit and loss account           | 1.00         |                                        |              |
| Creditors                         | <u>3.00</u>  |                                        |              |
|                                   | <u>12.00</u> |                                        | <u>12.00</u> |

M Ltd. another existing company holds 25% of equity share capital of H Ltd. purchased at Rs. 10 per share.

It was agreed that M Ltd. should take over the entire undertaking of H Ltd. on 30.09.1997 on which date the position of current assets (except cash and bank balances) and creditors was as follows:

|                   |         |
|-------------------|---------|
| Stock and debtors | 4 lakhs |
| Creditors         | 2 lakhs |

Profits earned for half year ended 30.09.1997 by H Ltd. was Rs. 70,500 after charging depreciation of Rs. 32,500 on block assets. H Ltd. declared 10% dividend for 1996-97 on 30.08.1997 and the same was paid within a week.

Goodwill of H Ltd. was valued at Rs. 80,000 and block assets were valued at 10% over their book value as on 31.3.1997 for purposes of take over. Preference shareholders of H Ltd. will be allotted 10% preference shares of Rs. 10 each by M Ltd. Equity shareholders of H Ltd.

### Advanced Accounting

will receive requisite number of equity shares of Rs. 10 each from M Ltd. valued at Rs. 10 per share.

- (a) Compute the purchase consideration.  
(b) Explain, how the capital reserve or goodwill, if any, will appear in the Balance Sheet of M Ltd. after absorption. (15 marks)(November, 1998)

Answer

- (a) Calculation of Purchase Consideration (for net assets of H Ltd. taken over)

|                                                                                                       |                 |
|-------------------------------------------------------------------------------------------------------|-----------------|
| Assets taken over:                                                                                    | Rs.             |
| Goodwill as agreed                                                                                    | 80,000          |
| Block Assets at 10% over their book value as on 31.3.1997<br>(agreed value for purposes of take over) | 6,60,000        |
| Stock and Debtors                                                                                     | 4,00,000        |
| Cash and Bank (See Working Note)                                                                      | <u>1,33,000</u> |
|                                                                                                       | 12,73,000       |

|                               |                  |
|-------------------------------|------------------|
| Less: Liabilities taken over: |                  |
| Creditors                     | <u>2,00,000</u>  |
|                               | <u>10,73,000</u> |

|                                                                                  |                 |
|----------------------------------------------------------------------------------|-----------------|
| Calculation of Shares Allotted:                                                  | Rs.             |
| Net Assets taken over                                                            | 10,73,000       |
| Less: Allotment of 10% preference shares to preference<br>shareholders of H Ltd. | <u>3,00,000</u> |
|                                                                                  | 7,73,000        |
| Less: Belonging to M Ltd. ( $\frac{1}{4} \times 7,73,000$ )                      | <u>1,93,250</u> |
| Payable to other equity shareholders                                             | <u>5,79,750</u> |

Number of equity shares of Rs. 10 each to be issued (valued at Rs. 10 each) = 57,975

|                                        |                 |
|----------------------------------------|-----------------|
| Calculation of Capital Reserve:        | Rs.             |
| Net Assets taken over                  | 10,73,000       |
| Less: Preference shares to be allotted | 3,00,000        |
| Equity shares to be allotted           | 5,79,750        |
| Cost of investments                    | <u>1,00,000</u> |
|                                        | <u>9,79,750</u> |
| Capital Reserve                        | <u>93,250</u>   |

Alternatively, Capital Reserve may be computed as follows:

|                                |                 |
|--------------------------------|-----------------|
| Value of investments in H Ltd. | 1,93,250        |
| Less: Cost of investments      | <u>1,00,000</u> |
|                                | <u>93,250</u>   |

## Company Accounts

(b) Balance Sheet of M Ltd. as at 30th September, 1997

(Extract)

Rs.

|                 |               |        |
|-----------------|---------------|--------|
| Capital Reserve | 93,250        |        |
| Less: Goodwill  | <u>80,000</u> | 13,250 |

Working Note:

Ascertainment of Cash and Bank Balances as on 30th September, 1997:

Balance Sheet as at 30th September, 1997

|                                                 |                             |                    |               |                  |
|-------------------------------------------------|-----------------------------|--------------------|---------------|------------------|
|                                                 | Rs.                         |                    |               | Rs.              |
| Equity Share Capital                            | 4,00,000                    | Block Assets       | 6,00,000      |                  |
| 10% Preference Share Capital                    | 3,00,000                    | Less: Depreciation | <u>32,500</u> | 5,67,500         |
| General Reserve                                 | 1,00,000                    | Stock and Debtors  |               | 4,00,000         |
| Profit and Loss Account:                        |                             | Cash and Bank      |               | 1,33,000         |
| Balance brought forward                         | 1,00,000                    | (Balancing figure) |               |                  |
| Add: Profit for the first half                  | <u>70,500</u>               |                    |               |                  |
|                                                 | 1,70,500                    |                    |               |                  |
| Less: Dividend on preference share capital paid | 30,000                      |                    |               |                  |
| Dividend on equity share capital paid           | <u>40,000</u> <u>70,000</u> |                    |               |                  |
| Creditors                                       |                             |                    |               |                  |
|                                                 | <u>2,00,000</u>             |                    |               |                  |
|                                                 | <u>11,00,500</u>            |                    |               | <u>11,00,500</u> |

### Question 22

AB Ltd. and MB Ltd. decide to amalgamate and to form a new company AM Ltd. The following are their balance sheets as at 31.3.1998:

| Liabilities                   | AB Ltd.          | MB Ltd.         | Assets             | AB Ltd.          | MB Ltd.         |
|-------------------------------|------------------|-----------------|--------------------|------------------|-----------------|
| Share Capital (Rs. 100) each  | 10,00,000        | 6,00,000        | Fixed Assets       | 7,50,000         | 2,00,000        |
| General Reserve               | 1,00,000         | 50,000          | Investments:       |                  |                 |
| Investment Allowance Reserve  | 40,000           | 30,000          | 1,500 Shares in MB | 3,50,000         | —               |
| 12% Debentures (Rs. 100 each) | 3,00,000         | 1,00,000        | 4,000 Shares in AB | —                | 5,00,000        |
| Sundry Creditors              | <u>60,000</u>    | <u>20,000</u>   | Current Assets     | 4,00,000         | 1,00,000        |
|                               | <u>15,00,000</u> | <u>8,00,000</u> |                    | <u>15,00,000</u> | <u>8,00,000</u> |

## Advanced Accounting

Calculate the amount of purchase consideration for AB Ltd. and MB Ltd. and draw up the balance sheet of AM Ltd. after considering the following:

- Assume amalgamation is in the nature of purchase.
- Fixed assets of AB Ltd. are to be reduced by Rs. 50,000 and that of MB Ltd. are to be taken at Rs. 3,00,000.
- 12% debentureholders of AB Ltd. and MB Ltd. are discharged by AM Ltd. by issuing such number of its 15% debentures of Rs. 100 each so as to maintain the same amount of interest.
- Shares of AM Ltd. are of Rs. 100 each.

Also show, how the investment allowance reserve will be treated in the Financial Statement assuming the Reserve will be maintained for 3 years. (16 marks)(May, 1999)

Answer

Calculation of Purchase consideration

- Value of Net Assets of AB Ltd. and MB Ltd. as on 31st March, 1998

|                               |                 | AB Ltd.<br>Rs.  |                 | MB Ltd.<br>Rs.  |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|
| Assets taken over:            |                 |                 |                 |                 |
| Fixed Assets                  | 7,00,000        |                 | 3,00,000        |                 |
| Current Assets                | <u>4,00,000</u> | 11,00,000       | <u>1,00,000</u> | 4,00,000        |
| Less: Liabilities taken over: |                 |                 |                 |                 |
| Debentures                    | 2,40,000*       |                 | 80,000**        |                 |
| Sundry Creditors              | <u>60,000</u>   | <u>3,00,000</u> | <u>20,000</u>   | <u>1,00,000</u> |
|                               |                 | <u>8,00,000</u> |                 | <u>3,00,000</u> |

$$* 3,00,000 \times \frac{12}{100} \times \frac{100}{15} = \text{Rs. } 2,40,000$$

$$** 1,00,000 \times \frac{12}{100} \times \frac{100}{15} = \text{Rs. } 80,000$$

- Value of Shares of AB Ltd. and MB Ltd.

The value of shares of AB Ltd. is Rs. 8,00,000 plus 1/4 of the value of the shares of MB Ltd.

Similarly, the value of shares of MB Ltd. is Rs. 3,00,000 plus 2/5 of the value of shares of AB Ltd.

Let a denote the value of shares of AB Ltd. and m denote the value of shares of MB Ltd. then

$$a = 8,00,000 + \frac{1}{4} m ; \text{ and}$$

$$M = 3,00,000 + \frac{2}{5} a.$$

## Company Accounts

Substituting the value of m,

$$a = 8,00,000 + \frac{1}{4} (3,00,000 + \frac{2}{5} a)$$

$$a = 8,00,000 + 75,000 + \frac{1}{10} a$$

$$\frac{9}{10} a = 8,75,000$$

$$a = 9,72,222$$

$$m = 3,00,000 + \frac{2}{5} (9,72,222)$$

$$m = 6,88,889$$

(iii) Amount of Purchase Consideration

|                                             | AB Ltd.<br>Rs.    | MB Ltd.<br>Rs.  |
|---------------------------------------------|-------------------|-----------------|
| Total value of shares (as determined above) | 9,72,222          | 6,88,889        |
| Less: Internal investments:                 |                   |                 |
| 2/5 for shares held by MB Ltd.              | 3,88,889          |                 |
| 1/4 for shares held by AB Ltd.              | <u>          </u> | <u>1,72,222</u> |
| Amount due to outsiders                     | <u>5,83,333</u>   | <u>5,16,667</u> |

Purchase Consideration will be satisfied by AM Ltd. as follows:

|                             | AB Ltd.<br>Rs. | MB Ltd.<br>Rs. |
|-----------------------------|----------------|----------------|
| In shares (of Rs. 100 each) | 5,83,300       | 5,16,600       |
| In cash                     | 33             | 67             |

(iv) Net Amount of Goodwill/Capital Reserve

|                              | Rs.             | Rs.              |
|------------------------------|-----------------|------------------|
| Total Purchase Consideration |                 |                  |
| AB Ltd.                      | 5,83,333        |                  |
| MB Ltd.                      | <u>5,16,667</u> | 11,00,000        |
| Less: Net Assets taken over  |                 |                  |
| AB Ltd.                      | 8,00,000        |                  |
| MB Ltd.                      | <u>3,00,000</u> | <u>11,00,000</u> |
|                              |                 | <u>Nil</u>       |

(Alternatively, the calculations may be made separately for both the companies)

## Advanced Accounting

### Balance Sheet of AM Ltd.

as at 31st March, 1998

| Liabilities                                                                                                                           | Amount<br>Rs.    | Assets                                                                       | Amount<br>Rs.    |
|---------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------------------------------------------------------------------|------------------|
| Share Capital 10,999 shares of Rs. 100 each<br>(All the above shares are allotted as fully paid-up for consideration other than cash) | 10,99,900        | Goodwill                                                                     | —                |
| Investment Allowance Reserve                                                                                                          | 70,000           | Fixed Assets                                                                 | 10,00,000        |
| 15% Debentures                                                                                                                        | 3,20,000         | Investments                                                                  | —                |
| Sundry Creditors                                                                                                                      | 80,000           | Current Assets                                                               | 4,99,900         |
|                                                                                                                                       |                  | (5,00,000 – 33 – 67)                                                         |                  |
|                                                                                                                                       |                  | Miscellaneous Expenditure<br>(to the extent not written<br>off or adjusted): |                  |
|                                                                                                                                       |                  | Amalgamation<br>Adjustment Account                                           | 70,000           |
|                                                                                                                                       | <u>15,69,900</u> |                                                                              | <u>15,69,900</u> |

### Treatment of Investment Allowance Reserve

According to para 39 (read with para 18) of AS 14 on Accounting for Amalgamations, where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are to be complied with, the statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

### Question 23

The summarised Balance Sheets of R Ltd. and P Ltd. for the year ending on 31.3.2000 are as under:

|                                                               | R Ltd.<br>Rs. | P Ltd.<br>Rs. |                   | R Ltd.<br>Rs. | P Ltd.<br>Rs. |
|---------------------------------------------------------------|---------------|---------------|-------------------|---------------|---------------|
| Equity share Capital<br>(in shares of Rs. 10<br>each)         | 24,00,000     | 12,00,000     | Fixed Assets      | 55,00,000     | 27,00,000     |
| 8% Preference Share<br>Capital (in shares of<br>Rs. 10 each)  | 8,00,000      | —             | Current<br>Assets | 25,00,000     | 23,00,000     |
| 10% Preference Share<br>Capital (in shares of<br>Rs. 10 each) | —             | 4,00,000      |                   |               |               |

## Company Accounts

|                     |                  |                  |                  |                  |
|---------------------|------------------|------------------|------------------|------------------|
| Reserves            | 30,00,000        | 24,00,000        |                  |                  |
| Current Liabilities | <u>18,00,000</u> | <u>10,00,000</u> |                  |                  |
|                     | <u>80,00,000</u> | <u>50,00,000</u> | <u>80,00,000</u> | <u>50,00,000</u> |

The following information is provided:

- |                                                                                                                                                                                                                                                  | R Ltd.    | P Ltd.   |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|----------|
|                                                                                                                                                                                                                                                  | Rs.       | Rs.      |
| (1) (a) Profit before tax                                                                                                                                                                                                                        | 10,64,000 | 4,80,000 |
| (b) Taxation                                                                                                                                                                                                                                     | 4,00,000  | 2,00,000 |
| (c) Preference dividend                                                                                                                                                                                                                          | 64,000    | 40,000   |
| (d) Equity dividend                                                                                                                                                                                                                              | 2,88,000  | 1,92,000 |
| (2) The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.                                                                                                       |           |          |
| (3) R Ltd. proposes to absorb P Ltd. as on 31.3.2000. The terms of absorption are as under:                                                                                                                                                      |           |          |
| (a) Preference shareholders of P Ltd. will receive 8% preference shares of R Ltd. sufficient to increase the income of preference shareholders of P Ltd. by 10%.                                                                                 |           |          |
| (b) The equity shareholders of P Ltd. will receive equity shares of R Ltd. on the following basis:                                                                                                                                               |           |          |
| (i) The equity shares of P Ltd. will be valued by applying to the earnings per share of P Ltd. 75% of price earnings ratio of R Ltd. based on the results of 1999–2000 of both the companies.                                                    |           |          |
| (ii) The market price of equity shares of R Ltd. is Rs. 40 per share.                                                                                                                                                                            |           |          |
| (iii) The number of shares to be issued to the equity shareholders of P Ltd. will be based on the above market value.                                                                                                                            |           |          |
| (iv) In addition to equity shares, 8% preference shares of R Ltd. will be issued to the equity shareholders of P Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 1999–2000. |           |          |
| (4) The assets and liabilities of P Ltd. as on 31.3.2000 are revalued by professional valuer as under:                                                                                                                                           |           |          |

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

### Advanced Accounting

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

You are required to:

(i) Set out in detail the purchase consideration. (10 marks)

(ii) Give the Balance Sheet as on 31.3.2000 after absorption. (6 marks)

Note: Journal entries are not required.

(November, 2000)

Answer

(i) Computation of Purchase Consideration

|                                                     | Rs.           |
|-----------------------------------------------------|---------------|
| (a) Preference Shareholders                         |               |
| Current income of preference shareholders of P Ltd. | 40,000        |
| Add: 10% increase thereof                           | <u>4,000</u>  |
|                                                     | <u>44,000</u> |
| Preference shares to be issued                      |               |
| $= 44,000 \times \frac{100}{8} =$                   | 5,50,000      |

(b) Equity Shareholders  
(1) Issue of Equity Shares  
P/E ratio in R Ltd.

|                                          | Rs.             |
|------------------------------------------|-----------------|
| Profit before tax                        | 10,64,000       |
| Less: Tax                                | <u>4,00,000</u> |
|                                          | 6,64,000        |
| Less: Preference dividend                | <u>64,000</u>   |
| Profit available for equity shareholders | <u>6,00,000</u> |

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

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

EPS of P Ltd:

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



## Company Accounts

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

Valuation of equity shares of P Ltd:

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

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

Number of equity shares to be issued:

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

|                                                                             |                  |
|-----------------------------------------------------------------------------|------------------|
|                                                                             | Rs.              |
| Equity Share Capital                                                        | 7,20,000         |
| Share (Securities) Premium                                                  | <u>21,60,000</u> |
|                                                                             | <u>28,80,000</u> |
| (2) Issue of Preference Shares                                              | Rs.              |
| Current equity dividend                                                     | 1,92,000         |
| Less: Expected equity dividend from R Ltd.                                  |                  |
| (Rs. 7,20,000 × 2,88,000/24,00,000)                                         | <u>86,400</u>    |
| Loss in income                                                              | <u>1,05,600</u>  |
| 8% Preference Shares to be issued = $\frac{1,05,600}{0.08}$ = Rs. 13,20,000 |                  |
| Total Purchase Consideration:                                               | Rs.              |
| Preference shares to be issued                                              | 5,50,000         |
|                                                                             | <u>13,20,000</u> |
| Equity shares to be issued (at premium)                                     | <u>28,80,000</u> |
|                                                                             | <u>47,50,000</u> |

(ii)

R Ltd.

Balance Sheet as at 31st March, 2000

(after absorption)

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

## Advanced Accounting

|                        |   |                    |
|------------------------|---|--------------------|
| (2) Investments        |   | –                  |
| (3) Net Current assets | D | <u>18,40,000</u>   |
| Total                  |   | <u>1,09,50,000</u> |

### Schedules to Balance Sheet

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

### Working Note:

#### Calculation of Goodwill on Absorption

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

## Company Accounts

### Question 24

Alpha Limited and Beta Limited were amalgamated on and from 1st April, 2001. A new Company Gamma Limited was formed to takeover the business of the existing companies. The Balance Sheets of Alpha Limited and Beta Limited as on 31st March, 2001 are given below :

| (Rs. in Lakhs)                        |               |              |                                    |               |              |
|---------------------------------------|---------------|--------------|------------------------------------|---------------|--------------|
| Liabilities                           | Alpha Limited | Beta Limited | Assets                             | Alpha Limited | Beta Limited |
| Share Capital                         |               |              | Fixed Assets                       | 1,200         | 1,000        |
| Equity shares of Rs. 100 each         | 1,000         | 800          | Current Assets, Loans and Advances | 880           | 565          |
| 15% Preference shares of Rs. 100 each | 400           | 300          |                                    |               |              |
| Reserve & Surplus                     |               |              |                                    |               |              |
| Revaluation Reserve                   | 100           | 80           |                                    |               |              |
| General Reserve                       | 200           | 150          |                                    |               |              |
| P & L Account                         | 80            | 60           |                                    |               |              |
| Secured Loan                          |               |              |                                    |               |              |
| 12% Debentures of Rs. 100 each        | 96            | 80           |                                    |               |              |
| Current Liabilities & Provisions      | <u>204</u>    | <u>95</u>    |                                    |               |              |
|                                       | <u>2,080</u>  | <u>1,565</u> |                                    | <u>2,080</u>  | <u>1,565</u> |

Other informations :

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

Required :

Prepare the Balance Sheet of Gamma Limited as on 1st April, 2001 after the amalgamation has been carried out using the 'pooling of interest method'.

(8 marks)(May, 2001)

## Advanced Accounting

Answer

### Balance Sheet of Gamma Limited As at 1st April, 2000

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

Working Notes :

(i) Purchase consideration

|                                                 |              | (Rs. in lakhs) |              |
|-------------------------------------------------|--------------|----------------|--------------|
|                                                 | Alpha Ltd.   | Beta Ltd.      | Total        |
| Equity shares                                   | 1,500        | 800            | 2,300        |
| Preference shares                               | <u>400</u>   | <u>300</u>     | <u>700</u>   |
|                                                 | 1,900        | 1,100          | 3,000        |
| Amount of share capital of transferor companies | <u>1,400</u> | <u>1,100</u>   | <u>2,500</u> |
| Difference                                      | <u>500</u>   | <u>Nil</u>     | <u>500</u>   |

(ii) Amount of debentures issued  $12/16 \times 96 = 72$        $12/16 \times 80 = 60$       132

|                                              |             |             |             |
|----------------------------------------------|-------------|-------------|-------------|
| Amount of debentures of transferor companies | <u>96</u>   | <u>80</u>   | <u>176</u>  |
| Difference                                   | <u>(24)</u> | <u>(20)</u> | <u>(44)</u> |

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

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

## Company Accounts

### Question 25

The Balance Sheets of O Ltd. and P Ltd. as on 31st March, 2000 are as under:

|                             |               |              |                           | (Rs. in lakhs) |              |
|-----------------------------|---------------|--------------|---------------------------|----------------|--------------|
| Liabilities                 | O             | P            | Assets                    | O              | P            |
|                             | Rs.           | Rs.          |                           | Rs.            | Rs.          |
| Equity Shares of Rs.10 each | 25.00         | 50.00        | Fixed Assets              | 110.00         | 50.00        |
| Reserves                    | 131.00        | 29.25        | Investments               | 16.25          | 25.00        |
| 12% Debentures              | 11.00         | 5.50         | Current Assets            | 40.25          | 3.25         |
| Creditors                   | 8.00          | 2.75         | Miscellaneous Expenditure | 8.50           | 9.25         |
|                             | <u>175.00</u> | <u>87.50</u> |                           | <u>175.00</u>  | <u>87.50</u> |

Investments of O Ltd. represent 1,25,000 shares of P Ltd. Investments of P Ltd. are considered worth Rs. 30 lakhs.

P Ltd. is taken over by O Ltd. on the basis of the intrinsic value of shares in their respective books of account.

Prepare a statement showing the number of shares to be allotted by O Ltd. to P Ltd. and the Balance Sheet of O Ltd. after absorption of P Ltd. (16 marks) (November, 2001)

Answer

### Balance sheet of O Ltd. (after absorption)

| Liabilities                                                                                                 | Amount        | Assets          | (Rs. in lakhs) |         |
|-------------------------------------------------------------------------------------------------------------|---------------|-----------------|----------------|---------|
|                                                                                                             |               |                 | (Amount)       |         |
| SHARE CAPITAL                                                                                               |               | FIXED ASSETS    |                |         |
| 3,43,750 Equity Shares of Rs. 10 each                                                                       | 34.375        | Fixed Assets    | 110.000        |         |
| (Of the above shares, 93,750 equity shares are allotted as fully paid-up for consideration other than cash) |               | Add: Taken over | <u>50.000</u>  | 160.000 |
|                                                                                                             |               | INVESTMENTS     |                | 30.000  |
| RESERVES AND SURPLUS                                                                                        |               | CURRENT ASSETS, |                |         |
| As per last Balance Sheet                                                                                   | 131.00        | LOANS AND       |                |         |
| Capital Reserve                                                                                             | 2.500         | ADVANCES        |                |         |
| Securities Premium                                                                                          | <u>46.875</u> | Current Assets  | 40.250         |         |
| SECURED LOANS                                                                                               |               | Add: Taken over | <u>3.250</u>   | 43.500  |
| 12% Debentures                                                                                              | 11.000        | MISCELLANEOUS   |                |         |
|                                                                                                             |               | EXPENDITURE     |                | 8.500   |

## Advanced Accounting

|                                    |              |                |                |
|------------------------------------|--------------|----------------|----------------|
| Add: Taken over                    | <u>5.500</u> | 16.500         |                |
| CURRENT LIABILITIES AND PROVISIONS |              |                |                |
| Creditors                          | 8.000        |                |                |
| Add: Taken over                    | <u>2.750</u> | <u>10.750</u>  |                |
|                                    |              | <u>242.000</u> | <u>242.000</u> |

### Working Notes:

|                                                       |                                                                   |                |
|-------------------------------------------------------|-------------------------------------------------------------------|----------------|
| (a)                                                   | (i) Calculation of Net Assets                                     | (Rs. in lakhs) |
|                                                       | O Ltd.                                                            | P Ltd.         |
| Fixed Assets                                          | 110.00                                                            | 50.00          |
| Investments                                           | 18.75*                                                            | 30.00          |
| Current Assets                                        | <u>40.25</u>                                                      | <u>3.25</u>    |
|                                                       | <u>169.00</u>                                                     | <u>83.25</u>   |
| 12% Debentures                                        | 11.00                                                             | 5.50           |
| Creditors                                             | <u>8.00</u>                                                       | <u>2.75</u>    |
|                                                       | <u>19.00</u>                                                      | <u>8.25</u>    |
| Net Assets                                            | <u>150.00</u>                                                     | <u>75.00</u>   |
|                                                       | O Ltd.                                                            | P Ltd.         |
| (ii) Number of equity shares                          | 2.50 lakhs                                                        | 5.00 lakhs     |
| Intrinsic Value                                       | Rs. 60.00                                                         | Rs. 15.00      |
| * 1.25 lakhs shares × Rs. 15                          |                                                                   |                |
| (b)                                                   | Calculation of Shares Allotted                                    | (Rs. in lakhs) |
| Net assets taken over                                 |                                                                   | 75.00          |
| Less: Belonging to O Ltd.                             |                                                                   |                |
|                                                       | $\left( \frac{125,000}{5,00,000} \times 75 \text{ lakhs} \right)$ | <u>18.75</u>   |
| Payable to other equity shareholders                  |                                                                   | <u>56.25</u>   |
| Number of equity shares of Rs. 10 each to be issued = | $\frac{\text{Rs. } 56,25,000}{\text{Rs. } 60} =$                  |                |
| = 93,750 shares (valued at Rs. 60 each)               |                                                                   |                |
| Credit to share capital                               |                                                                   | Rs. 9,37,500   |
| Credit to securities premium                          |                                                                   | Rs. 46,87,500  |

## Company Accounts

### Question 26

A Ltd. agreed to take over B Ltd. as on 1st October, 2001. No Balance Sheet of B was prepared on that date:

Balance Sheets of A and B as at 31st March, 2001 were as follows:

|                                                                     | A<br>Rs.         | B<br>Rs.         |                 | A<br>Rs.         | B<br>Rs.         |
|---------------------------------------------------------------------|------------------|------------------|-----------------|------------------|------------------|
| Share Capital : In<br>equity shares of Rs.<br>10 each fully paid up | 15,00,000        | 10,00,000        | Fixed Assets    | 12,50,000        | 8,75,000         |
| Reserves and Surplus:                                               |                  |                  | Current Assets: |                  |                  |
| Reserve                                                             | 4,15,000         | 2,56,000         | Stock           | 2,37,500         | 1,87,500         |
| Profit and Loss                                                     | 1,87,500         | 1,50,000         | Debtors         | 3,90,000         | 2,56,000         |
| Creditors                                                           | 93,750           | 75,000           | Bank            | 2,93,750         | 1,50,000         |
|                                                                     |                  |                  | Miscellaneous   |                  |                  |
|                                                                     |                  |                  | Expenditure:    |                  |                  |
|                                                                     |                  |                  | Preliminary     |                  |                  |
|                                                                     |                  |                  | Expenses        | 25,000           | 12,500           |
|                                                                     | <u>21,96,250</u> | <u>14,81,000</u> |                 | <u>21,96,250</u> | <u>14,81,000</u> |

Additional information available:

- (i) For the six months period from 1st April, 2001, A made a profit of Rs. 4,20,000 after writing off depreciation at 10% per annum on its fixed assets.
- (ii) For the same period, B made a net profit of Rs. 2,04,000 after writing off depreciation at 10% p.a. on its fixed assets.
- (iii) Both the companies paid on 1st August, 2001, equity dividends of 15%. Tax at 10% on such payments was also paid by each of them.
- (iv) Goodwill of B was valued at Rs. 1,20,000 on the date of take-over; stock of B, subject to an abnormal item of Rs. 7,500 to be fully written off, would be appreciated by 25% for purpose of take-over:
- (v) A to issue to B's shareholders fully paid equity shares of Rs. 10 each, on the basis of the comparative intrinsic values of the shares on the take-over date.

Draft the Balance Sheet of A after absorption of B. All workings are to form part of your answer. (16 marks)(May, 2002)

Answer

#### Balance Sheet of A Ltd. (after absorption of B Ltd.)

| Liabilities                                                          | Rs. | Assets       | Rs. | Rs.      |
|----------------------------------------------------------------------|-----|--------------|-----|----------|
| Share Capital                                                        |     | Fixed Assets |     |          |
| 2,56,000 Equity Shares of Rs. 10<br>each fully paid (1,06,000 shares |     | Goodwill     |     | 1,20,000 |

## Advanced Accounting

|                                                                |                  |                                    |                  |
|----------------------------------------------------------------|------------------|------------------------------------|------------------|
| allotted as fully paid without payment being received in cash) | 25,60,000        | Other Fixed Assets                 | 21,25,000        |
|                                                                |                  | (12,50,000 + 8,75,000)             |                  |
|                                                                |                  | Less: Depreciation                 | <u>1,06,250</u>  |
| Reserves and Surplus                                           |                  |                                    | 20,18,750        |
| Securities Premium                                             | 5,30,000         | Current Assets, Loans and Advances |                  |
| Reserves                                                       | 4,15,000         | Stock                              |                  |
| Profit and Loss Account                                        | 3,60,000         | (2,37,500 + 2,25,000)              | 4,62,500         |
| Current Liabilities                                            |                  | Debtors                            |                  |
| Creditors                                                      | 1,68,750         | (3,90,000 + 2,56,000)              | 6,46,000         |
|                                                                |                  | Bank Balance                       |                  |
|                                                                |                  | (5,28,750 + 2,32,750)              | 7,61,500         |
|                                                                |                  | Miscellaneous Expenditure          |                  |
|                                                                |                  | Preliminary Expenses               | <u>25,000</u>    |
|                                                                | <u>40,33,750</u> |                                    | <u>40,33,750</u> |

### Working Notes:

(1) Bank Balance on 1.10.2001

|                              | A Ltd.<br>Rs.   | B Ltd.<br>Rs.   |
|------------------------------|-----------------|-----------------|
| Bank Balance as on 31.3.2001 | 2,93,750        | 1,50,000        |
| Add: Net Profit              | 4,20,000        | 2,04,000        |
| Depreciation                 | <u>62,500</u>   | <u>43,750</u>   |
|                              | 7,76,250        | 3,97,750        |
| Less: Dividend               | <u>2,25,000</u> | <u>1,50,000</u> |
|                              | 5,51,250        | 2,47,750        |
| Less: Dividend Tax           | <u>22,500</u>   | <u>15,000</u>   |
| Bank Balance as on 1.10.2001 | <u>5,28,750</u> | <u>2,32,750</u> |

(2) Profit and Loss Account as on 1.10.2001

|                         | A Ltd.<br>Rs.   | B Ltd.<br>Rs.   |
|-------------------------|-----------------|-----------------|
| Balance as on 31.3.2001 | 1,87,500        | 1,50,000        |
| Add: 6 months' profit   | <u>4,20,000</u> | <u>2,04,000</u> |
|                         | 6,07,500        | 3,54,000        |



## Company Accounts

|                |                 |                 |
|----------------|-----------------|-----------------|
| Less: Dividend | 2,25,000        | 1,50,000        |
| Dividend tax   | <u>22,500</u>   | <u>15,000</u>   |
|                | <u>3,60,000</u> | <u>1,89,000</u> |

(3) Balance Sheets of A Ltd. and B Ltd.  
as on 1st October, 2001 (before absorption)

|                 | A Ltd.           | B Ltd.           |                              | A Ltd.           | B Ltd.           |
|-----------------|------------------|------------------|------------------------------|------------------|------------------|
|                 | Rs.              | Rs.              |                              | Rs.              | Rs.              |
| Share Capital   | 15,00,000        | 10,00,000        | Fixed Assets                 | 12,50,000        | 8,75,000         |
| Reserves        | 4,15,000         | 2,56,000         | Less: Depreciation           | <u>(62,500)</u>  | <u>(43,750)</u>  |
| Profit and Loss | 3,60,000         | 1,89,000         | Net Fixed Assets             | 11,87,500        | 8,31,250         |
| Creditors*      | 93,750           | 75,000           | Current Assets               |                  |                  |
|                 |                  |                  | Stock*                       | 2,37,500         | 1,87,500         |
|                 |                  |                  | Debtors*                     | 3,90,000         | 2,56,000         |
|                 |                  |                  | Bank                         | 5,28,750         | 2,32,750         |
|                 |                  |                  | Miscellaneous<br>Expenditure |                  |                  |
|                 |                  |                  | Preliminary<br>Expenses      | <u>25,000</u>    | <u>12,500</u>    |
|                 | <u>23,68,750</u> | <u>15,20,000</u> |                              | <u>23,68,750</u> | <u>15,20,000</u> |

\*It is assumed that these amounts as on 1st October, 2001 are same in the absence of any other information.

(4) Purchase consideration

|                  | A Ltd.           | B Ltd.           |
|------------------|------------------|------------------|
|                  | Rs.              | Rs.              |
| Goodwill         | –                | 1,20,000         |
| Fixed Assets     | 11,87,500        | 8,31,250         |
| Stock            | 2,37,500         | 2,25,000         |
| Debtors          | 3,90,000         | 2,56,000         |
| Bank Balance     | <u>5,28,750</u>  | <u>2,32,750</u>  |
|                  | 23,43,750        | 16,65,000        |
| Less: Creditors  | <u>93,750</u>    | <u>75,000</u>    |
| Net Assets       | <u>22,50,000</u> | <u>15,90,000</u> |
| Number of Shares | <u>1,50,000</u>  | <u>1,00,000</u>  |
| Intrinsic value  | <u>15.00</u>     | <u>15.90</u>     |

Purchase consideration Rs. 15,90,000 in the form of Share capital Rs. 10,60,000 and securities premium Rs. 5,30,000.

## Advanced Accounting

### Question 27

The following are the Balance Sheets of A Ltd. and B Ltd. as on 31st December, 2001 :

| Liabilities                      | A Ltd.<br>Rs.    | B Ltd.<br>Rs.   | Assets                 | A Ltd.<br>Rs.    | B Ltd.<br>Rs.   |
|----------------------------------|------------------|-----------------|------------------------|------------------|-----------------|
| Share Capital                    |                  |                 | Fixed Assets           | 7,00,000         | 2,50,000        |
| Equity Shares of Rs. 10 each     | 6,00,000         | 3,00,000        | Investment:            |                  |                 |
| 10% Pref. Shares of Rs. 100 each | 2,00,000         | 1,00,000        | 6,000 Shares of B Ltd. | 80,000           | —               |
| Reserves and Surplus             | 3,00,000         | 2,00,000        | 5,000 Shares of A Ltd. | —                | 80,000          |
| Secured Loans:                   |                  |                 | Current Assets:        |                  |                 |
| 12% Debentures                   | 2,00,000         | 1,50,000        | Stock                  | 2,40,000         | 3,20,000        |
| Current Liabilities:             |                  |                 | Debtors                | 3,60,000         | 1,90,000        |
| Sundry Creditors                 | 2,20,000         | 1,25,000        | Bills Receivable       | 60,000           | 20,000          |
| Bills Payable                    | <u>30,000</u>    | <u>25,000</u>   | Cash at Bank           | <u>1,10,000</u>  | <u>40,000</u>   |
|                                  | <u>15,50,000</u> | <u>9,00,000</u> |                        | <u>15,50,000</u> | <u>9,00,000</u> |

Fixed Assets of both the companies are to be revalued at 15% above book value. Stock in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, A Ltd. will absorb B Ltd. on the following terms:

- 8 Equity Shares of Rs. 10 each will be issued by A Ltd. at par against 6 shares of B Ltd.
- 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of Rs. 100 each at par in A Ltd.
- 12% Debentureholders of B Ltd. are to be paid at 8% premium by 12% Debentures in A Ltd. issued at a discount of 10%.
- Rs. 30,000 is to be paid by A Ltd. to B Ltd. for Liquidation expenses. Sundry Creditors of B Ltd. include Rs. 10,000 due to A Ltd.

Prepare :

- Absorption entries in the books of A Ltd.
- Statement of consideration payable by A Ltd. (16 marks)(November, 2002)

Answer

- Absorption Entries in the Books of A Ltd.

|                                                       |              |          |
|-------------------------------------------------------|--------------|----------|
|                                                       | Dr.          | Cr.      |
|                                                       | Rs.          | Rs.      |
| Fixed Assets                                          | Dr. 1,05,000 |          |
| To Revaluation Reserve                                |              | 1,05,000 |
| (Revaluation of fixed assets at 15% above book value) |              |          |

**Company Accounts**

|                                                                                                                                                                                               |     |          |          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----------|----------|
| Bank Account                                                                                                                                                                                  | Dr. | 6,000    |          |
| To Reserves and Surplus                                                                                                                                                                       |     |          | 6,000    |
| (Dividend received from B Ltd. on 6,000 shares)                                                                                                                                               |     |          |          |
| Reserve and Surplus                                                                                                                                                                           | Dr. | 60,000   |          |
| To Equity Dividend                                                                                                                                                                            |     |          | 60,000   |
| (Declaration of equity dividend @ 10%)                                                                                                                                                        |     |          |          |
| Equity Dividend                                                                                                                                                                               | Dr. | 60,000   |          |
| To Bank Account                                                                                                                                                                               |     |          | 60,000   |
| (Payment of equity dividend)                                                                                                                                                                  |     |          |          |
| Business Purchase Account                                                                                                                                                                     | Dr. | 3,60,000 |          |
| To Liquidator of B Ltd.                                                                                                                                                                       |     |          | 3,60,000 |
| (Consideration payable for the<br>business taken over from B Ltd.)                                                                                                                            |     |          |          |
| Fixed Assets (115% Rs. 2,50,000)                                                                                                                                                              | Dr. | 2,87,500 |          |
| Stock (90% Rs. 3,20,000)                                                                                                                                                                      | Dr. | 3,04,000 |          |
| Debtors                                                                                                                                                                                       | Dr. | 1,90,000 |          |
| Bills Receivable                                                                                                                                                                              | Dr. | 20,000   |          |
| Cash at Bank                                                                                                                                                                                  | Dr. | 15,000   |          |
| (Rs. 40,000 – Rs. 30,000 dividend paid<br>+ Rs. 5,000 dividend received)                                                                                                                      |     |          |          |
| To Provision for Bad Debts                                                                                                                                                                    |     |          | 9,500    |
| (5% of Rs.1,90,000)                                                                                                                                                                           |     |          |          |
| To Sundry Creditors                                                                                                                                                                           |     |          | 1,25,000 |
| To 12% Debentures in B Ltd.                                                                                                                                                                   |     |          | 1,62,000 |
| To Bills Payable                                                                                                                                                                              |     |          | 25,000   |
| To Business Purchase Account                                                                                                                                                                  |     |          | 3,90,000 |
| To Investments in B Ltd.                                                                                                                                                                      |     |          | 80,000   |
| To Capital Reserve (Balancing figure)                                                                                                                                                         |     |          | 25,000   |
| (Incorporation of various assets and liabilities taken over<br>from B Ltd. at agreed values and cancellation of<br>investment in B Ltd. account, profit being credited to<br>capital reserve) |     |          |          |
| Liquidator of B Ltd.                                                                                                                                                                          | Dr. | 3,60,000 |          |
| To Equity Share Capital                                                                                                                                                                       |     |          | 2,70,000 |
| To 10% Preference Share Capital                                                                                                                                                               |     |          | 90,000   |
| (Discharge of consideration for B Ltd.'s business)                                                                                                                                            |     |          |          |

## Advanced Accounting

|                                                                                                                         |     |          |          |
|-------------------------------------------------------------------------------------------------------------------------|-----|----------|----------|
| Capital Reserve                                                                                                         | Dr. | 30,000   |          |
| To Bank Account                                                                                                         |     |          | 30,000   |
| (Payment of liquidation expenses)                                                                                       |     |          |          |
| 12% Debentures in B Ltd. (Rs. 1,50,000 × 108%)                                                                          | Dr. | 1,62,000 |          |
| Discount on Issue of Debentures                                                                                         | Dr. | 18,000   |          |
| To 12% Debentures                                                                                                       |     |          | 1,80,000 |
| (Allotment of 12% Debentures to debenture holders at a discount of 10% to discharge the liability on B Ltd. debentures) |     |          |          |
| Sundry Creditors                                                                                                        | Dr. | 10,000   |          |
| To Sundry Debtors                                                                                                       |     |          | 10,000   |
| (Cancellation of mutual owing)                                                                                          |     |          |          |

### (b) Statement of Consideration payable by A Ltd.

For equity shares held by outsiders

Shares held by them 30,000 – 6,000 = 24,000

Shares to be allotted  $\frac{24,000}{6} \times 8 = 32,000$

as 5,000 shares are already will B Ltd; i.e. A Ltd. will now issue only 27,000 shares of Rs. 10 each i.e 2,70,000 Rs. (i).

For 10% preference shares, to be paid at 10% discount

Rs. 1,00,000  $\times \frac{90}{100}$  = 90,000 (ii)

Consideration amount [(i) + (ii)] 3,60,000

Note: It has been assumed that dividend on equity shares have been paid by both the companies.

### Question 28

The following are the Balance Sheets of RS Ltd. and XY Ltd. as on 31.3.2002:

| Rs. in '000s                                |                |                |                     |                |                |
|---------------------------------------------|----------------|----------------|---------------------|----------------|----------------|
| Liabilities                                 | RS Ltd.<br>Rs. | XY Ltd.<br>Rs. | Assets              | RS Ltd.<br>Rs. | XY Ltd.<br>Rs. |
| Share Capital:                              |                |                | Fixed Assets net of |                |                |
| Equity Shares of Rs. 100 each fully paid up | 2,000          | 1,000          | depreciation        | 2,700          | 850            |
| Reserves and Surplus                        | 800            | –              | Investments         | 700            | –              |
| 10% Debentures                              | 500            | –              | Sundry Debtors      | 400            | 150            |
| Loan from Financial                         |                |                | Cash and Bank       | 250            | –              |
|                                             |                |                | Profit and Loss     | –              | 800            |

## Company Accounts

|                   |              |              |         |              |              |
|-------------------|--------------|--------------|---------|--------------|--------------|
| Institutions      | 250          | 400          | Account |              |              |
| Bank Overdraft    | —            | 100          |         |              |              |
| Sundry Creditors  | 300          | 300          |         |              |              |
| Proposed Dividend | <u>200</u>   | <u>—</u>     |         |              |              |
| Total             | <u>4,050</u> | <u>1,800</u> | Total   | <u>4,050</u> | <u>1,800</u> |

It was decided that XY Ltd. will acquire the business of RS Ltd. for enjoying the benefit of carry forward of business loss. After acquisition, XY Ltd. will be renamed as XYZ Ltd. The following scheme has been approved for the merger:

- (i) XY Ltd. will reduce its shares to Rs. 10 and then consolidate 10 such shares into one share of Rs. 100 each (New Share).
- (ii) Financial institutions agreed to waive 15% of the loan of XY Ltd.
- (iii) Shareholders of RS Ltd. will be given one new share of XY Ltd. in exchange of every share held in RS Ltd.
- (iv) RS Ltd. will cancel 20% holding of XY Ltd. Investments were held at Rs. 250 thousands.
- (v) After merger the proposed dividend of RS Ltd. will be paid to the shareholders of RS Ltd.
- (vi) Authorised Capital of XY Ltd. will be raised accordingly to carry out the scheme.
- (vii) Sundry creditors of XY Ltd. includes payable to RS Ltd. Rs. 1,00,000.

Pass the necessary entries to implement the scheme in the books of RS Ltd. and XY Ltd. and prepare a Balance Sheet of XYZ Ltd. (16 marks)(May, 2003)

Answer

### Journal Entries in the books of RS Ltd.

|                                                                          |     | Dr.<br>Rs. | Cr.<br>Rs. |
|--------------------------------------------------------------------------|-----|------------|------------|
| 10% Debentures Account                                                   | Dr. | 500        |            |
| Loan from Financial Institutions Account                                 | Dr. | 250        |            |
| Sundry Creditors Account                                                 | Dr. | 300        |            |
| Proposed Dividend Account                                                | Dr. | 200        |            |
| Realisation Account                                                      | Dr. | 2,800      |            |
| To Fixed Assets Account                                                  |     |            | 2,700      |
| To Investments Account                                                   |     |            | 700        |
| To Sundry Debtors Account                                                |     |            | 400        |
| To Cash and Bank Account                                                 |     |            | 250        |
| (Transfer of assets and liabilities to realisation account)              |     |            |            |
| Share Capital Account                                                    | Dr. | 2,000      |            |
| Reserve and Surplus Account                                              | Dr. | 800        |            |
| To Equity Shareholders Account                                           |     |            | 2,800      |
| (Transfer of share capital, reserve and surplus to shareholders account) |     |            |            |

### Advanced Accounting

|                                                                                                                       |     |       |       |
|-----------------------------------------------------------------------------------------------------------------------|-----|-------|-------|
| Equity Shareholders Account<br>To Realisation Account<br>(Cancellation of 20% holding of XY Ltd. held as investments) | Dr. | 250   | 250   |
| Shares in XYZ Ltd.<br>To Realisation Account<br>(Issue of shares by XYZ Ltd. in the ratio of 1 : 1)                   | Dr. | 2,000 | 2,000 |
| Equity Shareholders Account<br>To Realisation Account<br>(Transfer of loss on realisation)                            | Dr. | 550   | 550   |
| Equity Shareholders Account<br>To Shares in XYZ Ltd.<br>(Distribution of Shares of XYZ Ltd. among the shareholders)   | Dr. | 2,000 | 2,000 |

### Journal Entries in the books of XY Ltd.

|                                                                                                                                                                                                                            |     |            | (Rs. '000) |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|------------|------------|
|                                                                                                                                                                                                                            |     | Dr.<br>Rs. | Cr.<br>Rs. |
| Equity Share Capital (Face value – Rs. 100) Account<br>To Equity Share Capital (Face value – Rs. 10) Account<br>To Reconstruction Account<br>(Face value of equity shares of Rs. 100 each reduced to Rs. 10 each)          | Dr. | 1,000      | 100<br>900 |
| Equity Share Capital (Face value – Rs. 10 each) Account<br>To Equity Share Capital Account<br>(Face value – Rs. 100 each)<br>(Consolidation of 10,000 equity shares of Rs. 10 each to 1,000 equity shares of Rs. 100 each) | Dr. | 100        | 100        |
| Loan from Financial Institutions Account<br>To Reconstruction Account<br>(Waiver of 15% of loan by financial institutions)                                                                                                 | Dr. | 60         | 60         |
| Reconstruction Account (900 + 60)<br>To Profit and Loss Account                                                                                                                                                            | Dr. | 960        | 800        |

## Company Accounts

|                                                                                                                                                                                         |     |       |       |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|-------|-------|
| To Capital Reserve                                                                                                                                                                      |     |       | 160   |
| (Utilisation of Reconstruction account balance to write off the Profit and Loss Account)                                                                                                |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |
| Proposed Dividend Account                                                                                                                                                               | Dr. | 200   |       |
| To Bank Account                                                                                                                                                                         |     |       | 200   |
| (Payment of Proposed dividend to shareholders of RS Ltd.)                                                                                                                               |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |
| Fixed Assets Account                                                                                                                                                                    | Dr. | 2,700 |       |
| Other Investments Account                                                                                                                                                               | Dr. | 450   |       |
| Sundry Debtors Account                                                                                                                                                                  | Dr. | 400   |       |
| Cash and Bank Account                                                                                                                                                                   | Dr. | 250   |       |
| To Reserves Account                                                                                                                                                                     |     |       | 570   |
| To 10% Debentures Account                                                                                                                                                               |     |       | 500   |
| To Loan from Financial Institutions Account                                                                                                                                             |     |       | 250   |
| To Sundry Creditors Account                                                                                                                                                             |     |       | 300   |
| To Proposed Dividend Account                                                                                                                                                            |     |       | 200   |
| To Business Purchase Account                                                                                                                                                            |     |       | 1,980 |
| (Incorporation of various assets and liabilities acquired from RS Ltd. after cancellation of investment held by RS Ltd. in XY Ltd., profit on acquisition credited to Reserves Account) |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |
| Business Purchase Account                                                                                                                                                               | Dr. | 1,980 |       |
| To Liquidator of RS Ltd.                                                                                                                                                                |     |       | 1,980 |
| (Consideration Payable on business acquired from RS Ltd.)                                                                                                                               |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |
| Liquidator of RS Ltd.                                                                                                                                                                   | Dr. | 1,980 |       |
| To Equity Share Capital of XYZ Ltd.                                                                                                                                                     |     |       | 1,980 |
| (Discharge of purchase consideration in the form of equity shares of XYZ Ltd.)                                                                                                          |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |
| Sundry Creditors Account                                                                                                                                                                | Dr. | 100   |       |
| To Sundry Debtors Account                                                                                                                                                               |     |       | 100   |
| (Cancellation of intercompany owings)                                                                                                                                                   |     |       |       |
| <hr/>                                                                                                                                                                                   |     |       |       |

## Advanced Accounting

### Balance Sheet of XYZ Ltd. as on 31st March, 2002 (immediately after acquisition)

(Rs. in 000's)

| Liabilities                      | Rs.          | Assets                           | Rs.          |
|----------------------------------|--------------|----------------------------------|--------------|
| Share Capital:                   |              | Fixed Assets net of depreciation | 3,550        |
| 20,800 Equity Shares @ Rs. 100   |              | Investments                      | 450          |
| each (1,980 + 20 + 80)           | 2,080        | Sundry Debtors                   | 450          |
| Capital Reserve                  | 160          |                                  |              |
| General Reserve                  | 570          |                                  |              |
| 10% Debentures                   | 500          |                                  |              |
| Loan from financial institutions | 590          |                                  |              |
| Bank Overdraft (100 – 250 + 200) | 50           |                                  |              |
| Sundry Creditors                 | <u>500</u>   |                                  |              |
|                                  | <u>4,450</u> |                                  | <u>4,450</u> |

#### Working Notes:

- Original Share Capital of XY Ltd.  
10,000 Equity Shares of Rs. 100 each 10,00,000  
Share Capital of XY Ltd. after Reduction  
10,000 Equity Shares of Rs. 10 each 1,00,000
- Share Capital of XY Ltd. after Reconsolidation  
1,000 Equity Shares of Rs. 100 each 1,00,000
- Reduced value of holdings of RS Ltd. in XY Ltd.  
RS Ltd. was holding 20% of XY Ltd., that is,  
2,000 Equity Shares of Rs. 100 each 2,00,000  
which has now reduced to 200 Equity Shares of Rs. 100 each 20,000
- Calculation of Purchase Consideration  
Equity Share Capital of RS Ltd. 20,000 Equity Shares of Rs. 100 each 20,00,000  
each  
Exchange Ratio = 1 : 1  
No. of Equity Shares to be given 20,000  
Less: No. of Equity Shares already held by RS Ltd. 200  
19,800  
  
Purchase consideration  
19,800 Equity Shares of Rs. 100 each 19,80,000
- Aggregate Reserves in the new company on acquisition  
Reserves of RS Ltd. acquired 8,00,000



## Company Accounts

|                                                                                   |               |                  |
|-----------------------------------------------------------------------------------|---------------|------------------|
| Less: Loss on investments held by RS Ltd.                                         |               |                  |
| Value of investments cancelled                                                    | 2,50,000      |                  |
| Less: Reduced value of shares of XY Ltd.                                          | <u>20,000</u> | <u>2,30,000</u>  |
| Amount of Reserves to be carried to Balance Sheet                                 |               | <u>5,70,000</u>  |
| 6. Share Capital in Combined Balance Sheet of XYZ Ltd.                            |               |                  |
| Holding of RS Ltd. (200 Equity Shares @ Rs. 100 each)                             |               | 20,000           |
| Other Existing Shares (800 Equity Shares of Rs. 100 each)                         |               | 80,000           |
| Given as Purchase Consideration (19,800 equity shares @ Rs.100 each)              |               | <u>19,80,000</u> |
|                                                                                   |               | <u>20,80,000</u> |
| 7. It has been assumed that the bank overdraft and cash balance can be netted of. |               |                  |

### Alternative Solution:

The candidates may pass a journal entry in the books of XY Ltd. for cancellation of shares held by RS Ltd.

In that case the first three entries in books of XY Ltd. will remain the same, further:-

|                                             |     |       | (Rs. '000) |
|---------------------------------------------|-----|-------|------------|
|                                             |     | Dr.   | Cr.        |
|                                             |     | Rs.   | Rs.        |
| Equity Share Capital Account                | Dr. | 20    |            |
| To Reconstruction Account                   |     |       | 20         |
| <hr/>                                       |     |       |            |
| Equity Share Capital (Rs.10) Account        | Dr. | 80    |            |
| To Equity Share Capital Account (Rs.100)    |     |       | 80         |
| <hr/>                                       |     |       |            |
| Reconstruction Account                      | Dr. | 980   |            |
| To Profit and Loss Account                  |     |       | 800        |
| To Capital Reserve                          |     |       | 180        |
| <hr/>                                       |     |       |            |
| Fixed Assets Account                        | Dr. | 2,700 |            |
| Other Investments Account                   | Dr. | 450   |            |
| Sundry Debtors Account                      | Dr. | 400   |            |
| Cash and Bank Account                       | Dr. | 250   |            |
| To Reserves Account                         |     |       | 550        |
| To 10% Debentures Account                   |     |       | 500        |
| To Loan from Financial Institutions Account |     |       | 250        |
| To Sundry Creditors Account                 |     |       | 300        |

## Advanced Accounting

|                               |     |       |
|-------------------------------|-----|-------|
| To Proposed Dividend Account  |     | 200   |
| To Business Purchase Account  |     | 2,000 |
| <hr/>                         |     |       |
| Business Purchase Account     | Dr. | 2,000 |
| To Liquidator of RS Ltd.      |     | 2,000 |
| <hr/>                         |     |       |
| Liquidator of RS Ltd.         | Dr. | 2,000 |
| To Equity Shares (Rs.10 each) |     | 2,000 |

Note: In the Balance Sheet, capital reserve will go up by Rs.20,000 and general reserve will come down by Rs. 20,000.

### Question 29

The following are the Balance Sheets of C Ltd. and D Ltd. on 31st March, 2003:

| Balance Sheets                              |                  |                  |                        |                  |                  |
|---------------------------------------------|------------------|------------------|------------------------|------------------|------------------|
| Liabilities                                 | C Ltd.<br>Rs.    | D Ltd.<br>Rs.    | Assets                 | C Ltd.<br>Rs.    | D Ltd.<br>Rs.    |
| Equity Shares of Rs.<br>100 each fully paid | 45,00,000        | 15,00,000        | Fixed Assets           | 30,00,000        | 1,50,000         |
| General Reserve                             | 4,00,000         | 3,00,000         | Investments            |                  |                  |
| Profit and Loss A/c                         | 7,34,000         | 30,000           | 3,000 shares in D Ltd. | 4,50,000         | —                |
| 14% Debentures                              | —                | 9,00,000         | 9,000 Shares in C Ltd. | —                | 15,00,000        |
| Current Liabilities                         | 6,00,000         | 2,70,000         | Debtors                | 8,70,000         | 4,50,000         |
|                                             |                  |                  | Stock                  | 14,40,000        | 6,30,000         |
|                                             |                  |                  | Bank Balance           | <u>4,74,000</u>  | <u>2,70,000</u>  |
|                                             | <u>62,34,000</u> | <u>30,00,000</u> |                        | <u>62,34,000</u> | <u>30,00,000</u> |

Stock of C Ltd. includes goods worth Rs. 3,00,000 purchased from D Ltd., which made a profit of 20% on selling price. As on 31.3.2003, C Ltd. owes to D Ltd. Rs. 1,20,000. C Ltd. absorbs D Ltd. on the basis of the intrinsic value of the shares of both companies as on 31st March, 2003. Before absorption C Ltd. has declared a dividend of 12%. Dividend tax is 10%.

Show the Balance Sheet of C Ltd. after the absorption of D Ltd. and the working for the number of shares issued.  
(16 marks)(November, 2003)

Answer

(a) (i) Computation of Net Assets excluding Inter-Company Investments.

|                 | C Ltd<br>Rs. | D Ltd<br>Rs. |
|-----------------|--------------|--------------|
| A Total Assets  |              |              |
| Tangible Assets | 57,84,000    | 15,00,000    |

### Company Accounts

|                         |                  |                  |
|-------------------------|------------------|------------------|
| Dividend Receivable     | -                | <u>1,08,000</u>  |
|                         | <u>57,84,000</u> | <u>16,08,000</u> |
| B. External Liabilities |                  |                  |
| Current Liabilities     | 6,00,000         | 2,70,000         |
| Proposed Dividend       | 5,40,000         | -                |
| Dividend Tax            | 54,000           | -                |
| 14% Debentures          | -                | <u>9,00,000</u>  |
|                         | <u>11,94,000</u> | <u>11,70,000</u> |
| C. Net Assets (A – B)   | <u>45,90,000</u> | <u>4,38,000</u>  |

(ii) Intrinsic value of equity shares.

Assume 'a' is the intrinsic value (net assets including inter company investments) of equity shares of C Ltd and 'b' is the intrinsic value of equity shares of D Ltd.

$$a = \text{Rs.} 45,90,000 + \frac{1}{5} \times b \quad (1)$$

$$b = \text{Rs.} 4,38,000 + \frac{1}{5} \times a \quad (2)$$

$$\text{or } b = \text{Rs.} 4,38,000 + \frac{1}{5} (45,90,000 + \frac{1}{5} \times b)$$

$$\text{or } b = \text{Rs.} 4,38,000 + 9,18,000 + \frac{b}{25}$$

$$\text{or } \frac{24}{25} \times b = \text{Rs.} 13,56,000$$

$$\text{or } b = \frac{\text{Rs.} 13,56,000}{24} \times 25 = \text{Rs.} 14,12,500$$

Putting the value of b in equation (1) we get,

$$\begin{aligned} a &= \text{Rs.} 45,90,000 + \frac{1}{5} \times 14,12,500 \\ &= \text{Rs.} 48,72,500 \end{aligned}$$

$$\text{Intrinsic value of share of C Ltd.} = \frac{\text{Rs.} 48,72,500}{45,000}$$

= Rs. 108.278 approximately

$$\text{Intrinsic value of share of D Ltd} = \frac{\text{Rs.} 14,12,500}{15,000} = \text{Rs.} 94.167 \text{ approximately.}$$

## Advanced Accounting

### (iii) Calculation of Purchase consideration

$$\begin{aligned} \text{Value of shares held by outside shareholders in D Ltd : } & \frac{\text{Rs. } 14,12,500 \times 12,000}{15,000} \\ & = \text{Rs } 11,30,000 \end{aligned}$$

Shares to be issued by C Ltd on the basis of intrinsic value of shares = Rs.11,30,000 x  $\frac{45,000}{48,72,500}$

|                                                  |           |                 |
|--------------------------------------------------|-----------|-----------------|
|                                                  | 48,72,500 | 10,436.12       |
| Less: Shares held by D Ltd                       |           | <u>9,000.00</u> |
| Number of shares to be issued                    |           | <u>1,436.12</u> |
| Total purchase price for outside shareholders    |           | Rs.             |
| Additional shares in C Ltd. (1,436 x Rs.108.278) |           | 1,55,487*       |
| Cash for fractional shares (0.12 x Rs. 108.278)  |           | 13*             |
| Value of 3000 shares held by C Ltd               |           | <u>2,82,500</u> |
|                                                  |           | <u>4,38,000</u> |

### (iv) General Reserve (C Ltd)

|                                                                            |                 |
|----------------------------------------------------------------------------|-----------------|
|                                                                            | Rs.             |
| As per Balance sheet                                                       | 4,00,000        |
| Less: Reduction in value of shares held in D Ltd (Rs. 4,50,000 - 2,82,500) | <u>1,67,500</u> |
|                                                                            | <u>2,32,500</u> |

### (v) Bank Balance

|                            | C Ltd.          | D Ltd.          |
|----------------------------|-----------------|-----------------|
|                            | Rs.             | Rs.             |
| As per Balance Sheet       | 4,74,000        | 2,70,000        |
| Add: Dividend received     | <u>—</u>        | <u>1,08,000</u> |
|                            | 4,74,000        | 3,78,000        |
| Less: Dividend             | 5,40,000        |                 |
| Dividend tax               | 54,000          |                 |
| Cash for fractional shares | <u>13</u>       | <u>—</u>        |
|                            | <u>5,94,013</u> |                 |
|                            | (1,20,013)      | <u>3,78,000</u> |

= Rs. 2,57,987.

### Balance Sheet of C Ltd (after absorption of D Ltd)

| Liabilities                                                         | Rs.       | Assets                              | Rs.           |
|---------------------------------------------------------------------|-----------|-------------------------------------|---------------|
| Share Capital :                                                     |           | Goodwill                            | 60,000        |
| Issued and Subscribed                                               |           | Other Fixed Assets                  | 31,50,000     |
| 46,436 shares of Rs.100 each fully paid                             |           | Current Assets, Loans and Advances: |               |
| (1436 shares allotted to vendors for consideration other than cash) | 46,43,600 | Stock                               | Rs. 20,70,000 |
| Reserves and Surplus:                                               |           | Less: Unrealised                    |               |

## Company Accounts

|                                                                    |                     |                                        |                     |
|--------------------------------------------------------------------|---------------------|----------------------------------------|---------------------|
| General Reserve                                                    | 2,32,500            | Profit (Goodwill) Rs. <u>60,000</u> ** | 20,10,000           |
| Profit and Loss Account<br>(Rs.7,34,000 – Rs.5,40,000 – Rs.54,000) | 1,40,000            | Bank Balance                           | 2,57,987            |
| Securities Premium<br>(Rs.1,55,487 – Rs.1,43,600)                  | 11,887              | Debtors                                | Rs.13,20,000        |
| Secured Loans:                                                     |                     | Less: Inter Co. dues                   | Rs. <u>1,20,000</u> |
| 14% Debentures                                                     | 9,00,000            |                                        | 12,00,000           |
| Current Liabilities and Provisions:                                |                     |                                        |                     |
| Current Liabilities                                                | Rs. 8,70,000        |                                        | <u>7,50,000</u>     |
| Less: Inter-Co. dues                                               | Rs. <u>1,20,000</u> |                                        | <u>66,77,987</u>    |

66,77,987

\* Appropriate figures have been considered

\*\*Alternatively this sum can also be adjusted against the balance in the Profit and Loss Account.

### Question 30

ABC Ltd. was incorporated on 1.5.2003 to take over the business of DEF and Co. from 1.1.2003. The Profit and Loss Account as given by ABC Ltd. for the year ending 31.12.2003 is as under:

#### Profit and Loss Account

|                                                            | Rs.              |                            | Rs.              |
|------------------------------------------------------------|------------------|----------------------------|------------------|
| To Rent and Taxes                                          | 90,000           | By Gross Profit            | 10,64,000        |
| To Salaries including<br>Manager's salary of Rs.<br>85,000 | 3,31,000         | By Interest on Investments | 36,000           |
| To Carriage Outwards                                       | 14,000           |                            |                  |
| To Printing and Stationery                                 | 18,000           |                            |                  |
| To Interest on Debentures                                  | 25,000           |                            |                  |
| To Sales Commission                                        | 30,800           |                            |                  |
| To Bad Debts (related to sales)                            | 91,000           |                            |                  |
| To Underwriting Commission                                 | 26,000           |                            |                  |
| To Preliminary Expenses                                    | 28,000           |                            |                  |
| To Audit Fees                                              | 45,000           |                            |                  |
| To Loss on Sale of Investments                             | 11,200           |                            |                  |
| To Net Profit                                              | <u>3,90,000</u>  |                            |                  |
|                                                            | <u>11,00,000</u> |                            | <u>11,00,000</u> |

Prepare a Statement showing allocation of pre-incorporation and post-incorporation profits after considering the following informations:

## Advanced Accounting

- (i) G.P. ratio was constant throughout the year.
- (ii) Sales for January and October were  $1\frac{1}{2}$  times the average monthly sales while sales for December were twice the average monthly sales.
- (iii) Bad Debts are shown after adjusting a recovery of Rs. 7,000 of Bad Debt for a sale made in July, 2000.
- (iv) Manager's salary was increased by Rs. 2,000 p.m. from 1.5.2003.
- (v) All investments were sold in April, 2003. (12 marks)(May, 2004)

### Answer

Pre-incorporation period is for four months, from 1st January, 2003 to 30th April, 2003. 8 months' period (from 1st May, 2003 to 31st December, 2003) is post-incorporation period.

### Profit and Loss Account

for the year ended 31st December, 2003

|                                | Pre-Inc          | Post –Inc       |                 | Pre-Inc         | Post inc        |
|--------------------------------|------------------|-----------------|-----------------|-----------------|-----------------|
|                                | Rs.              | Rs.             |                 | Rs.             | Rs.             |
| To Rent and Taxes              | 30,000           | 60,000          | By Gross Profit | 3,42,000        | 7,22,000        |
| To Salaries                    |                  |                 | By Interest on  |                 |                 |
| Manager's Salary               | 23,000           | 62,000          | Investments     | 36,000          | —               |
| Other Salaries                 | 82,000           | 1,64,000        | By Bad Debts    | 7,000           | —               |
|                                |                  |                 | Recovery        |                 |                 |
| To Printing and Stationery     | 6,000            | 12,000          |                 |                 |                 |
| To Audit fees                  | 15,000           | 30,000          |                 |                 |                 |
| To Carriage Outwards           | 4,500            | 9,500           |                 |                 |                 |
| To Sales Commission            | 9,900            | 20,900          |                 |                 |                 |
| To Bad Debts (91,000 + 7,000)  | 31,500           | 66,500          |                 |                 |                 |
| To Interest on Debentures      | —                | 25,000          |                 |                 |                 |
| To Underwriting Commission     | —                | 26,000          |                 |                 |                 |
| To Preliminary Expenses        | —                | 28,000          |                 |                 |                 |
| To Loss on sale of investments | 11,200           | —               |                 |                 |                 |
| To Net Profit                  | <u>1,71,900*</u> | <u>2,18,100</u> |                 |                 |                 |
|                                | <u>3,85,000</u>  | <u>7,22,000</u> |                 | <u>3,85,000</u> | <u>7,22,000</u> |

\*Pre-incorporation profit is a capital profit and will be transferred to Capital Reserve.

## Company Accounts

### Working Notes:

(i) Calculation of ratio of Sales

Let average monthly sales be x.

Thus Sales from January to April are  $4\frac{1}{2}x$  and sales from May to December are  $9\frac{1}{2}x$ .

Sales are in the ratio of  $9/2x : 19/2x$  or 9 : 19.

(ii) Gross profit, carriage outwards, sales commission and bad debts written off have been allocated in pre and post incorporation periods in the ratio of Sales i.e. 9 : 19.

(iii) Rent, salaries, printing and stationery, audit fees are allocated on time basis.

(iv) Interest on debentures, underwriting commission and preliminary expenses are allocated in post incorporation period.

(v) Interest on investments, loss on sale of investments and bad debt recovery are allocated in pre-incorporation period.

### Question 31

The Balance Sheet of Munna Ltd. on 31st March, 2005 is as under:

| Liabilities                             | Rs.              | Assets                  | Rs.              |
|-----------------------------------------|------------------|-------------------------|------------------|
| Authorised, issued equity share capital |                  | Goodwill                | 2,00,000         |
| 20,000 shares of Rs. 100 each           | 20,00,000        | Plant and machinery     | 18,00,000        |
| 10,000 preference shares (7%) of        |                  | Stock                   | 3,00,000         |
| Rs. 100 each                            | 10,00,000        | Debtors                 | 7,50,000         |
| Sundry creditors                        | 7,00,000         | Preliminary expenses    | 1,00,000         |
| Bank overdraft                          | 3,00,000         | Cash                    | 1,50,000         |
|                                         |                  | Profit and loss account | <u>7,00,000</u>  |
|                                         | <u>40,00,000</u> |                         | <u>40,00,000</u> |

Two years' preference dividends are in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend provided the capital base is reduced.

An internal reconstruction scheme as follows was agreed to by all concerned:

- Creditors agreed to forego 50% of the claim.
- Preference shareholders withdrew arrear dividend claim. They also agreed to lower their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reorganization in case equity shareholders' loss exceed 50% on the application of the scheme.
- Bank agreed to convert overdraft into term loan to the extent required for making current ratio equal to 2 : 1.
- Revalued figure for plant and machinery was accepted as Rs. 15,00,000.

### Advanced Accounting

- (v) Debtors to the extent of Rs. 4,00,000 were considered good.
- (vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reorganisation.

Show:

- (a) Total loss to be borne by the equity and preference shareholders for the reorganization;
- (b) Share of loss to the individual classes of shareholders;
- (c) New structure of share capital after reorganization;
- (d) Working capital of the reorganized Company; and
- (e) A proforma balance sheet after reorganization. (16 marks)(May, 2005)

Answer

- (a) Loss to be borne by Equity and Preference Shareholders

|                                                                   | Rs.              |
|-------------------------------------------------------------------|------------------|
| Profit and loss account (debit balance)                           | 7,00,000         |
| Preliminary expenses                                              | 1,00,000         |
| Goodwill                                                          | 2,00,000         |
| Plant and machinery (Rs. 18,00,000 – Rs. 15,00,000)               | 3,00,000         |
| Debtors (Rs. 7,50,000 – Rs. 4,00,000)                             | <u>3,50,000</u>  |
| Amount to be written off                                          | 16,50,000        |
| Less: 50% of sundry creditors                                     | <u>3,50,000</u>  |
| Total loss to be borne by the equity and preference shareholders* | <u>13,00,000</u> |

- (b) Share of loss to preference shareholders and equity shareholders

Total loss of Rs. 13,00,000 being more than 50% of equity share capital i.e. Rs.10,00,000.

Preference shareholders' share of loss = 20% of Rs. 10,00,000 = Rs. 2,00,000

Equity shareholders' share of loss (Rs. 13,00,000 – Rs. 2,00,000) = Rs. 11,00,000

Total loss Rs. 13,00,000

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\* Two years' preference dividend (arrears) have been ignored in the computation of loss to be borne by equity and preference shareholders.



## Company Accounts

(c) New structure of share capital after reorganisation

|                                                                                              |                  |
|----------------------------------------------------------------------------------------------|------------------|
| Equity shares:                                                                               | Rs.              |
| 20,000 equity shares of Rs. 45 each, fully paid up<br>(Rs. 20,00,000 – Rs. 11,00,000)        | 9,00,000         |
| Preference shares:                                                                           |                  |
| 10,000, 9% preference shares of Rs. 80 each, fully paid up<br>(Rs. 10,00,000 – Rs. 2,00,000) | <u>8,00,000</u>  |
|                                                                                              | <u>17,00,000</u> |

(d) Working capital of the reorganized company

|                            |               |                 |
|----------------------------|---------------|-----------------|
| Current Assets:            | Rs.           | Rs.             |
| Stock                      |               | 3,00,000        |
| Debtors                    |               | 4,00,000        |
| Cash                       |               | <u>1,50,000</u> |
|                            |               | <u>8,50,000</u> |
| Less: Current liabilities: |               |                 |
| Creditors                  | 3,50,000      |                 |
| Bank overdraft **          | <u>75,000</u> | <u>4,25,000</u> |
| Working capital            |               | <u>4,25,000</u> |

(e) Balance Sheet of Munna Ltd. (and reduced)  
as on 31st March, 2005

| Liabilities                                      | Rs.              | Assets              | Rs.              |
|--------------------------------------------------|------------------|---------------------|------------------|
| Share Capital Authorised<br>(issued and paid up) |                  | Fixed Assets        |                  |
| 20,000 equity shares of Rs. 45 each              | 9,00,000         | Plant and Machinery | 15,00,000        |
| 10,000, 9% preference shares of Rs. 80 each      | 8,00,000         | Current Assets      |                  |
| Unsecured loan                                   |                  | Stock               | 3,00,000         |
| Term loan with Bank                              | 2,25,000         | Debtors             | 4,00,000         |
| Current liabilities                              |                  | Cash                | 1,50,000         |
| Bank overdraft                                   | 75,000           |                     |                  |
| Creditors                                        | <u>3,50,000</u>  |                     |                  |
|                                                  | <u>23,50,000</u> |                     | <u>23,50,000</u> |

---

\*\* Current ratio shall be 2 : 1, i.e. total current liabilities shall be 50% of Rs. 8,50,000 (i.e. Rs. 3,00,000 + 4,00,000 + 1,50,000) = Rs. 4,25,000. Therefore, Bank overdraft = Rs. 75,000 (Rs. 4,25,000 less creditors Rs. 3,50,000).

## Advanced Accounting

### Question 32

The following are the Balance Sheets of Big Ltd. and Small Ltd. as at 31.3.06:

(Rs. In lakhs)

|                   | Big Ltd.    | Small Ltd.  |                                             | Big Ltd.    | Small Ltd.  |
|-------------------|-------------|-------------|---------------------------------------------|-------------|-------------|
|                   | Rs.         | Rs.         |                                             | Rs.         | Rs.         |
| Share Capital     | 40          | 15          | Sundry Assets<br>(including cost of shares) | 56          | 20          |
| Profit & Loss A/c | 7.5         | --          | Goodwill                                    | 4           | 5           |
| Sundry Creditors  | <u>12.5</u> | <u>12.5</u> | Profit and Loss A/c                         | <u>--</u>   | <u>2.5</u>  |
|                   | <u>60.0</u> | <u>27.5</u> |                                             | <u>60.0</u> | <u>27.5</u> |

Additional Information:

- The two companies agree to amalgamate and form a new company, Medium Ltd.
- Big Ltd. holds 10,000 shares in Small Ltd. acquired at a cost of Rs.2,50,000 and Small Ltd. holds 5,000 shares in Big Ltd. acquired at a cost of Rs.7,00,000.
- The shares of Big Ltd. are of Rs.100 and are fully paid and the shares of Small Ltd. are of Rs.50 each on which Rs.30 has been paid-up.
- It is agreed that the goodwill of Big Ltd. would be valued at Rs.1,50,000 and that of Small Ltd. at Rs.2,50,000.
- The shares which each company holds in the other are to be valued at book value having regard to the goodwill valuation decided as given in (iv).
- The new shares are to be of a nominal value of Rs.50 each credited as Rs.25 paid.

You are required to:

- Prepare the Balance Sheet of Medium Ltd., as at 31<sup>st</sup> March, 2006 after giving effect to the above transactions; and
- Prepare a statement showing the shareholdings in the new company attributable to the shareholders of the merged companies.

(16 Marks) (May, 2006)

Answer

- Balance Sheet of Medium Ltd. as on 31<sup>st</sup> March, 2006

| Liabilities                                                                               | Rs.              | Assets                                         | Rs.              |
|-------------------------------------------------------------------------------------------|------------------|------------------------------------------------|------------------|
| 1,82,000 shares of Rs.50/- each, Rs.25 paid up [Issued for consideration other than cash] | 45,50,000        | Goodwill<br>(Rs.1,50,000+Rs.2,50,000)          | 4,00,000         |
| Sundry Creditors                                                                          | <u>25,00,000</u> | Sundry Assets<br>(Rs. 53,50,000+ Rs.13,00,000) | <u>66,50,000</u> |
|                                                                                           | <u>70,50,000</u> |                                                | <u>70,50,000</u> |

## Company Accounts

### (ii) Statement of Shareholding in Medium Ltd.

|                                                                                                   | Big Ltd.<br>Rs.  | Small Ltd.<br>Rs. |
|---------------------------------------------------------------------------------------------------|------------------|-------------------|
| Total value of Assets                                                                             | 44,20,513        | 8,52,564          |
| Less: Pertaining to shares held by the other company                                              | <u>5,52,564</u>  | <u>1,70,513</u>   |
|                                                                                                   | <u>38,67,949</u> | <u>6,82,051</u>   |
| Rounded off to                                                                                    | 38,67,950        | 6,82,050          |
| Shares of new company (at Rs. 25 per share)                                                       | <u>1,54,718</u>  | <u>27,282</u>     |
| Total purchase consideration to be paid to Big Ltd and Small Ltd.<br>(Rs.38,67,950 + Rs.6,82,050) |                  | Rs. 45,50,000     |
| Number of shares in Big Ltd. (40,00,000/100)                                                      |                  | 40,000 shares     |
| Number of shares in Small Ltd. (15,00,000/30)                                                     |                  | 50,000 shares     |
| Holding of Small Ltd. in Big Ltd. (5,000/40,000)                                                  |                  | 1/8               |
| Holding of Big Ltd. in Small Ltd. (10,000/50,000)                                                 |                  | 1/5               |
| Number of shares held by outsiders in Big Ltd. (40,000 – 5,000) =                                 |                  | 35,000            |
| Number of shares held by outsiders in Small Ltd. (50,000 – 10,000)                                |                  | 40,000            |

#### Workings Note:

#### Calculation of Book Value of Shares

|                                                                            | Big Ltd<br>Rs.   | Small Ltd.<br>Rs. |
|----------------------------------------------------------------------------|------------------|-------------------|
| Goodwill                                                                   | 1,50,000         | 2,50,000          |
| Sundry Assets other than shares in other company<br>(56,00,000 – 2,50,000) | <u>53,50,000</u> |                   |
| (20,00,000 – 7,00,000)                                                     |                  | <u>13,00,000</u>  |
|                                                                            | 55,00,000        | 15,50,000         |
| Less: Sundry Creditors                                                     | <u>12,50,000</u> | <u>12,50,000</u>  |
|                                                                            | <u>42,50,000</u> | <u>3,00,000</u>   |

If "x" is the Book Value of Assets of Big Ltd and "y" of Small Ltd.

$$x = 42,50,000 + \frac{1}{5}y$$

$$y = 3,00,000 + \frac{1}{8}x$$

$$x = 42,50,000 + \frac{1}{5}(3,00,000 + \frac{1}{8}x)$$

### Advanced Accounting

$$= 42,50,000 + 60,000 + \frac{1}{40}x$$

$$\frac{39}{40}x = 43,10,000$$

$$x = 43,10,000 \times \frac{40}{39}$$

$$x = 44,20,513 \text{ (approx.)}$$

$$y = 3,00,000 + \frac{1}{8}(44,20,513)$$

$$= 3,00,000 + 5,52,564$$

$$= \text{Rs. } 8,52,564 \text{ (approx.)}$$

$$\text{Book Value of one share of Big Ltd.} = \frac{44,20,513}{40,000} = \text{Rs. } 110.513 \text{ (approx.)}$$

$$\text{Book Value of one share of Small Ltd.} = \frac{8,52,564}{50,000} = \text{Rs. } 17.05 \text{ (approx.)}$$

### Question 33

The summarized Balance sheets of X Ltd. and its subsidiary Y Ltd. as at 31.3.2005 were as follows:

| Liabilities                            | X Ltd.<br>Rs.      | Y Ltd.<br>Rs.    | Assets                               | X Ltd.<br>Rs.      | Y Ltd.<br>Rs.    |
|----------------------------------------|--------------------|------------------|--------------------------------------|--------------------|------------------|
| Share capital<br>(Share of Rs.10 each) | 50,00,000          | 10,00,000        | Fixed assets                         | 60,00,000          | 18,00,000        |
|                                        |                    |                  | Investment in Y Ltd. (60,000 shares) | 6,00,000           | ---              |
| General reserves                       | 50,00,000          | 20,00,000        | Sundry debtors                       | 35,00,000          | 5,00,000         |
| Profit and Loss account                | 20,00,000          | 15,00,000        | Inventories                          | 30,00,000          | 25,00,000        |
| Secured loan                           | 20,00,000          | 2,50,000         | Cash and bank                        | 39,00,000          | 2,00,000         |
| Current liabilities                    | <u>30,00,000</u>   | <u>2,50,000</u>  |                                      |                    |                  |
|                                        | <u>1,70,00,000</u> | <u>50,00,000</u> |                                      | <u>1,70,00,000</u> | <u>50,00,000</u> |

X Ltd. holds 60% of the paid-up capital of Y Ltd. and the balance is held by a foreign company. A memorandum of understanding has been entered into with the foreign company by X Ltd. to the following effect:

## Company Accounts

- (i) The shares held by the foreign company will be sold to X Ltd. at a price per share to be calculated by capitalizing the yield at 15%. Yield, for this purpose, would mean 50% of the average of pre-tax profits for the last 3 years, which were Rs.12 lakhs, 18 lakhs and 24 lakhs respectively. (Average tax rate was 40%).
- (ii) The actual cost of shares to the foreign company was Rs.4,40,000 only. Gains accruing to the foreign company are taxable at 20%. The tax payable will be deducted from the sale proceeds and paid to government by X. 50% of the consideration (after payment of tax) will be remitted to the foreign company by X Ltd. and also any cash for fractional shares allotted.
- (iii) For the balance of consideration, X Ltd. would issue its shares at their intrinsic value.

It was also decided that X Ltd. would absorb Y Ltd. Simultaneously by writing down the Fixed assets of Y Ltd. by 10%. The Balance Sheet figures included a sum of Rs.1,00,000 due by Y Ltd. to X Ltd. and stock of X Ltd. included stock of Rs.1,50,000 purchased from Y Ltd., who sold them at cost plus 20%.

The entire arrangement was approved and put through by all concern effective from 1.4.2005.

You are required to indicate how the above arrangements will be recorded in the books of X Ltd. and also prepare a Balance Sheet after absorption of Y Ltd. Workings should form part of your answer. (16 Marks)(Nov. 2006)

Answer

| X Ltd.<br>Balance Sheet as at 1 <sup>st</sup> April, 2005 |               |           |                                  |                 |           |
|-----------------------------------------------------------|---------------|-----------|----------------------------------|-----------------|-----------|
| Liabilities                                               | Amount (Rs.)  |           | Assets                           | Amount (Rs.)    |           |
| Share Capital:                                            |               |           |                                  |                 |           |
| Shares                                                    | 5,00,000      |           | Fixed Assets                     | 78,00,000       |           |
| Shares issued in lieu of purchase consideration           |               |           | Less :Revaluation loss           | <u>1,80,000</u> | 76,20,000 |
|                                                           | <u>33,466</u> |           |                                  |                 |           |
| (Shares of Rs.10 each)                                    | 5,33,466      | 53,34,660 | Sundry Debtors                   |                 |           |
|                                                           |               |           | (35,00,000+5,00,000)             | 40,00,000       |           |
| General Reserve                                           | 50,00,000     |           | Less: Mutual Debts               | <u>1,00,000</u> | 39,00,000 |
| Capital Reserve                                           | 13,20,000     |           |                                  |                 |           |
| Profit and Loss Account                                   |               |           | Inventories                      |                 |           |
|                                                           | 20,00,000     |           | (30,00,000+25,00,000)            | 55,00,000       |           |
| Less: unrealized profit on stock                          | <u>25,000</u> | 19,75,000 |                                  |                 |           |
| Securities Premium                                        |               |           | Less: Unrealised profit on stock | <u>25,000</u>   | 54,75,000 |
| (33,466×20)                                               |               | 6,69,320  |                                  |                 |           |
| Secured Loans                                             |               |           | Cash at Bank                     |                 | 27,03,980 |

## Advanced Accounting

|                        |                 |                    |                    |
|------------------------|-----------------|--------------------|--------------------|
| (20,00,000 + 2,50,000) |                 | 22,50,000          |                    |
| Current Liabilities    |                 |                    |                    |
| (30,00,000 + 2,50,000) | 32,50,000       |                    |                    |
| Less: Mutual Debts     | <u>1,00,000</u> | <u>31,50,000</u>   |                    |
|                        |                 | <u>1,96,98,980</u> | <u>1,96,98,980</u> |

### Working Notes:-

#### (1) Yield of Y Ltd.

$$\text{Average of Pre Tax Profit} = \frac{12 + 18 + 24}{3} = \text{Rs.18 lakhs}^*$$

$$\text{Yield} = 18 \times \frac{50}{100} = \text{Rs.9 lakhs}$$

#### (2) Price per share of Y Ltd:-

$$\text{Capitalised value of yield of Y Ltd.} = \frac{9 \text{ lakhs}}{15} \times 100 = 60 \text{ lakhs.}$$

$$\text{No. of shares} = 1,00,000$$

$$\text{Price per share} = \frac{60 \text{ lakhs}}{1 \text{ lakh}} = \text{Rs.60 per share}$$

#### (3) Purchase consideration for 40% of share capital of Y Ltd.

$$= 1,00,000 \times 60 \times \frac{40}{100} = \text{Rs.24,00,000}$$

#### (4) Calculation of intrinsic value of shares of X Ltd.

Total Assets excluding Investments in Y Ltd. Rs. 1,64,00,000

Value of Investment  $60,000 \times 60$  36,00,000

2,00,00,000

Less: Outside Liabilities:

Secured Loan 20,00,000

Current Liabilities 30,00,000 50,00,000

Net Assets 1,50,00,000

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\* By setting the trend, weighted average profit can also be calculated.

## Company Accounts

$$\begin{aligned}\text{Intrinsic value per share} &= \frac{\text{Net Assets}}{\text{No. of Shares}} \\ &= \frac{\text{Rs.1,50,00,000}}{5,00,000} = \text{Rs.30 per share}\end{aligned}$$

(5) Discharge of purchase consideration by X Ltd.

|                                                                                                                                                                                                                   | Equity share capital | Cash             | Total            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|------------------|------------------|
|                                                                                                                                                                                                                   | Rs.                  | Rs.              | Rs.              |
| (i) Payment of Tax $(24 - 4.40) \times \frac{20}{100} =$                                                                                                                                                          | ---                  | 3,92,000         | 3,92,000         |
| (ii) Issue of shares to foreign company<br>[50% of $(24 - 3.92) = 10.04$ lakhs<br>No. of shares issued by X Ltd.<br>$\frac{10,04,000}{30} = 33,466.6666$ shares<br>Value of shares capital $= 33,466 \times 30 =$ | 10,03,980            | ---              | 10,03,980        |
| (iii) Cash Payment [50% of $(24 - 3.92) = 10.04$ lakhs]                                                                                                                                                           | ---                  | 10,04,000        | 10,04,000        |
| (iv) Cash for fractional shares $= 0.6666 \times 30$                                                                                                                                                              | ---                  | 20               | 20               |
| Total                                                                                                                                                                                                             | <u>10,03,980</u>     | <u>13,96,020</u> | <u>24,00,000</u> |

(6) Calculation for Goodwill/Capital Reserve to X Ltd.

|                                                                                         | Rs.              |
|-----------------------------------------------------------------------------------------|------------------|
| Total of Assets as per Balance Sheet of Y Ltd.                                          | 50,00,000        |
| Less: 10% Reduction in the value of Fixed Assets<br>$(\frac{10}{100} \times 18,00,000)$ | <u>1,80,000</u>  |
|                                                                                         | 48,20,000        |
| Less: Secured Loan                                                                      | 2,50,000         |
| Current Liabilities                                                                     | <u>2,50,000</u>  |
| Net Assets                                                                              | 43,20,000        |
| Less: Purchase consideration (outside shareholders)                                     | <u>24,00,000</u> |
|                                                                                         | 19,20,000        |
| Less: Investment in Y Ltd. as per Balance Sheet of X Ltd.                               | <u>6,00,000</u>  |
| Capital Reserve                                                                         | <u>13,20,000</u> |

## Advanced Accounting

### (7) Cash and Bank Balance of X Ltd. after acquisition of shares

|                                         |                  |
|-----------------------------------------|------------------|
|                                         | Rs.              |
| Opening Balance (X Ltd.)                | 39,00,000        |
| Cash and Bank Balance of Y Ltd.         | <u>2,00,000</u>  |
|                                         | 41,00,000        |
| Less: Remittance to the foreign company | <u>10,04,020</u> |
|                                         | 30,95,980        |
| Less: T.D.S. paid to Government         | <u>3,92,000</u>  |
|                                         | <u>27,03,980</u> |

(8) Unrealised profit included in stock of X Ltd. =  $1,50,000 \times \frac{20}{120} = \text{Rs.} 25,000$

### Question 34

The following are the Balance sheets (as at 31.3.2006) of A Ltd. and B Ltd.:

| Liabilities                          | A Ltd.<br>Rs. | B. Ltd.<br>Rs. | Assets           | A Ltd.<br>Rs. | B. Ltd.<br>Rs. |
|--------------------------------------|---------------|----------------|------------------|---------------|----------------|
| Share Capital:                       |               |                | Fixed Assets     | 50,00,000     | 30,00,000      |
| Equity Shares of Rs.10 each          | 36,00,000     | 18,00,000      | Investments      | 5,00,000      | 5,00,000       |
| 10% Preference shares of Rs.100 each | 12,00,000     | -              | Current Assets   |               |                |
|                                      |               |                | Stock            | 18,00,000     | 12,00,000      |
|                                      |               |                | Debtors          | 15,00,000     | 12,00,000      |
|                                      |               |                | Bills receivable | 50,000        | 10,000         |
| 12% Preference shares of Rs.100 each | -             | 6,00,000       | Cash at Bank     | 1,50,000      | 90,000         |
| Reserve and Surplus:                 |               |                |                  |               |                |
| Statutory Reserve                    | 1,00,000      | 1,00,000       |                  |               |                |
| General Reserve                      | 25,00,000     | 17,00,000      |                  |               |                |
| Secured Loan                         |               |                |                  |               |                |
| 15% Debentures                       | 5,00,000      | -              |                  |               |                |



## Company Accounts

|                     |                  |                  |                  |                  |
|---------------------|------------------|------------------|------------------|------------------|
| 12% Debentures      | -                | 5,00,000         |                  |                  |
| Current Liabilities |                  |                  |                  |                  |
| Sundry creditors    | 10,80,000        | 12,80,000        |                  |                  |
| Bills payable       | <u>20,000</u>    | <u>20,000</u>    |                  |                  |
|                     | <u>90,00,000</u> | <u>60,00,000</u> | <u>90,00,000</u> | <u>60,00,000</u> |

Contingent liabilities for bills receivable discounted Rs.20,000.

(A) The following additional information is provided to you:

|                                                | A Ltd.    | B Ltd.   |
|------------------------------------------------|-----------|----------|
|                                                | Rs.       | Rs.      |
| Profit before Interest and Tax                 | 14,75,000 | 7,80,000 |
| Rate of Income-tax                             | 40%       | 40%      |
| Preference dividend                            | 1,20,000  | 72,000   |
| Equity dividend                                | 3,60,000  | 2,70,000 |
| Balance profit transferred to Reserve account. |           |          |

- (B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.
- (C) A Ltd proposes to absorb business of B Ltd. as on 31.3.2006. The agreed terms for absorption are:
- (i) 12% Preference shareholders of B Ltd. will receive 10% Preference shares of A Ltd. sufficient to increase their present income by 20%.
  - (ii) The Equity shareholders of B Ltd. will receive equity shares of A Ltd. on the following terms:
    - (a) The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of A Ltd. based on the results of 2005-06 of both the Companies.
    - (b) The market price of Equity shares of A Ltd. is Rs.40 per share.
    - (c) The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.
    - (d) In addition to Equity shares, 10% Preference shares of A Ltd. will be issued to the equity shareholders of B Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2005-2006.
  - (iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 15% debentures in A Ltd. issued at a discount of 10%.

### Advanced Accounting

- (iv) Rs.16,000 is to be paid by A Ltd. to B Ltd. for liquidation expenses. Sundry Creditors of B Ltd. include Rs.20,000 due to A Ltd. Bills receivable discounted by A Ltd. were all accepted by B Ltd.
- (v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.
- (vi) Statutory reserve has to be maintained for two more years.
- (vii) For the next two years no increase in the rate of equity dividend is anticipated.
- (viii) Liquidation expense is to be considered as part of purchase consideration.

You are required to:

- (i) Find out the purchase consideration.
- (ii) Give journal entries in the books of A Ltd.
- (iii) Give the Balance Sheet as at 31.3.2006 after absorption. (16 Marks)(May, 2007)

Answer

|                                                     |               |
|-----------------------------------------------------|---------------|
| (i) Computation of Purchase Consideration           | Rs.           |
| For Preference Shareholders                         |               |
| Present Income of Preference Shareholders of B Ltd. | 72,000        |
| Add : Required 20% increase                         | <u>14,400</u> |
|                                                     | <u>86,400</u> |

10% Preference Shares to be issued of Rs. 8,64,000 (86,400/10x 100)

For Equity Shareholders

Valuation of Equity Shares of B Ltd. =

Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of A Ltd.  
x 60/100)

$$= 1,80,000 \times \left( \text{Rs.} 2 \times 20 \times \frac{60}{100} \right) = 1,80,000 \times 24 = \text{Rs.} 43,20,000$$

Issue of Equity Shares

No. of Equity Shares to be issued at 80% of Market Price i.e.

80% of Rs.40 = Rs.32

$$\frac{43,20,000}{32} = 1,35,000 \text{ shares}$$

Equity Share Capital = 1,35,000 x Rs.10 = Rs.13,50,000

## Company Accounts

|                                                                           |                     |                 |
|---------------------------------------------------------------------------|---------------------|-----------------|
| Securities Premium = 1,35,000 x Rs. 22 =                                  | <u>Rs.29,70,000</u> |                 |
|                                                                           | <u>Rs.43,20,000</u> |                 |
| Issue of Preference Shares                                                |                     | Rs.             |
| Present Equity Dividend                                                   |                     | 2,70,000        |
| Less: Expected Equity Dividend from A Ltd.                                |                     |                 |
| (13,50,000 x $\frac{10}{100}$ )                                           |                     | <u>1,35,000</u> |
| Loss in income                                                            |                     | <u>1,35,000</u> |
| 10% Preference Shares to be issued of Rs. 13,50,000<br>(1,35,000/10x 100) |                     |                 |
| Purchase Consideration                                                    |                     |                 |
| Preference Shares Capital [Rs.8,64,000 + Rs.13,50,000]                    | 22,14,000           |                 |
| Equity Share Capital (1,35,000 shares of Rs.10 each at Rs.32 per share)   | 43,20,000           |                 |
| Liquidation Expenses (in cash)                                            | <u>16,000</u>       |                 |
|                                                                           | <u>65,50,000</u>    |                 |

(ii)

### Journal Entries in the Books of A Ltd.

| Particulars                                                                    | Dr. (Rs.)     | Cr. (Rs.) |
|--------------------------------------------------------------------------------|---------------|-----------|
| 1. Fixed Assets A/c                                                            | Dr. 10,00,000 |           |
| To Revaluation Reserve                                                         |               | 10,00,000 |
| (Being Revaluation of Fixed assets at 20% above book value)                    |               |           |
| 2. Business Purchase A/c                                                       | Dr. 65,50,000 |           |
| To Liquidator of B Ltd.                                                        |               | 65,50,000 |
| (Being purchase consideration payable for the business taken over from B Ltd.) |               |           |
| 3. Fixed Assets A/c                                                            | Dr. 36,00,000 |           |
| Investment A/c                                                                 | Dr. 5,00,000  |           |
| Stock A/c                                                                      | Dr. 10,80,000 |           |
| Debtors A/c                                                                    | Dr. 12,00,000 |           |
| Bills Receivable A/c                                                           | Dr. 10,000    |           |
| Cash at Bank A/c                                                               | Dr. 90,000    |           |

## Advanced Accounting

|    |                                                                                                                                         |     |           |           |
|----|-----------------------------------------------------------------------------------------------------------------------------------------|-----|-----------|-----------|
|    | Goodwill A/c (Balancing figure)                                                                                                         | Dr. | 19,10,000 |           |
|    | To 12% Debentures in B Ltd.                                                                                                             |     |           | 5,40,000  |
|    | To Creditors                                                                                                                            |     |           | 12,80,000 |
|    | To Bills Payable                                                                                                                        |     |           | 20,000    |
|    | To Business Purchase A/c                                                                                                                |     |           | 65,50,000 |
|    | (Being incorporation of different assets and liabilities of B Ltd. taken over at agreed values and balance debited to goodwill account) |     |           |           |
| 4. | Liquidator of B Ltd.                                                                                                                    | Dr. | 65,50,000 |           |
|    | To Equity Share Capital A/c                                                                                                             |     |           | 13,50,000 |
|    | To Securities Premium A/c                                                                                                               |     |           | 29,70,000 |
|    | To Preference Share Capital A/c                                                                                                         |     |           | 22,14,000 |
|    | To Bank A/c                                                                                                                             |     |           | 16,000    |
|    | (Being discharge of consideration for B Ltd's business)                                                                                 |     |           |           |
| 5. | 12% Debentures in B Ltd.                                                                                                                | Dr. | 5,40,000  |           |
|    | Discount on issue of Debentures                                                                                                         | Dr. | 60,000    |           |
|    | To 15% Debentures                                                                                                                       |     |           | 6,00,000  |
|    | (Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of B Ltd. debentures)               |     |           |           |
| 6. | Sundry Creditors A/c                                                                                                                    | Dr. | 20,000    |           |
|    | To Sundry Debtors A/c                                                                                                                   |     |           | 20,000    |
|    | (Being cancellation of Mutual owing)                                                                                                    |     |           |           |
| 7. | Amalgamation Adjustment A/c                                                                                                             | Dr. | 1,00,000  |           |
|    | To Statutory Reserve A/c                                                                                                                |     |           | 1,00,000  |
|    | (Being statutory reserve account is maintained under statutory requirements)                                                            |     |           |           |
| 8. | Securities Premium A/c                                                                                                                  | Dr. | 60,000    |           |
|    | To Discount on issue of Debentures A/c                                                                                                  |     |           | 60,000    |
|    | (Being discount on issue of Debentures written off out of securities premium)                                                           |     |           |           |

## Company Accounts

(iii) Balance Sheet of A Ltd (after absorption of B Ltd.)  
as on 31.3.2006

| Liabilities                 | Amount<br>Rs.      | Assets                     | Amount<br>Rs.      |
|-----------------------------|--------------------|----------------------------|--------------------|
| Share Capital:              |                    | Fixed Assets:              |                    |
| 4,95,000 Equity Shares of   | 49,50,000          | Goodwill                   | 19,10,000          |
| Rs. 10 each fully paid      |                    | Other Fixed Assets         | 96,00,000          |
| (1,35,000 shares have       |                    | (60,00,000+36,00,000)      |                    |
| been allotted as fully paid |                    | Investment                 |                    |
| up for consideration other  |                    | (5,00,000+5,00,000)        | 10,00,000          |
| than cash)                  |                    | Current Assets: Stock      |                    |
| 10% Preference Shares of    | 34,14,000          | (18,00,000+10,80,000)      | 28,80,000          |
| Rs.100 each fully paid      |                    |                            |                    |
| Reserve & Surplus:          |                    | Debtors                    |                    |
| Statutory Reserve           | 2,00,000           | (15,00,000+12,00,000-      | 26,80,000          |
| Revaluation Reserve         | 10,00,000          | 20,000)                    |                    |
| General Reserve             | 25,00,000          | Bills Receivable           | 60,000             |
| Securities Premium          | 29,10,000          | (50,000+10,000)            |                    |
| Secured Loan:               |                    | Cash at Bank               | 2,24,000           |
| 15% Debentures              | 11,00,000          | (1,50,000 + 90,000-16,000) |                    |
| (5,00,000 + 6,00,000)       |                    | Amalgamation Adjustment    |                    |
| Current Liabilities and     |                    | A/c                        | 1,00,000           |
| Provisions: Creditors       |                    |                            |                    |
| (10,80,000+12,80,000-       | 23,40,000          |                            |                    |
| 20,000)                     |                    |                            |                    |
| Bills Payable               |                    |                            |                    |
| (20,000 + 20,000)           | <u>40,000</u>      |                            |                    |
|                             | <u>1,84,54,000</u> |                            | <u>1,84,54,000</u> |

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

## Advanced Accounting

Working Notes:

### 1. Calculation of EPS & P/E ratio

|                                            | A Ltd.          | B Ltd.          |
|--------------------------------------------|-----------------|-----------------|
|                                            | Rs.             | Rs.             |
| Profit before Interest and Tax             | 14,75,000       | 7,80,000        |
| Less: Interest on debentures               | <u>75,000</u>   | <u>60,000</u>   |
| Profit before tax                          | 14,00,000       | 7,20,000        |
| Less: Tax @ 40%                            | <u>5,60,000</u> | <u>2,88,000</u> |
|                                            | 8,40,000        | 4,32,000        |
| Less: Preference Dividend                  | <u>1,20,000</u> | <u>72,000</u>   |
| Earnings available for equity shareholders | <u>7,20,000</u> | <u>3,60,000</u> |
| Number of shares                           | 3,60,000 shares | 1,80,000 shares |
| EPS (Earnings/ No. of shares)              | 2               | 2               |
| Market Price                               | Rs.40           | Not given       |
| P/E ratio                                  | 40/2 = 20       | N.A.            |

### 2. Computation of Goodwill/Capital Reserve on absorption:

|                                 |                 | Rs.              |
|---------------------------------|-----------------|------------------|
| Purchase Consideration          |                 | 65,50,000        |
| Fixed Assets taken over         | 30,00,000       |                  |
| Add: Increase by 20%            | <u>6,00,000</u> | 36,00,000        |
| Investments                     |                 | 5,00,000         |
| Current Assets:                 |                 |                  |
| Stock                           | 12,00,000       |                  |
| Less: Reduction in value by 10% | <u>1,20,000</u> |                  |
|                                 | 10,80,000       |                  |
| Debtors                         | 12,00,000       |                  |
| B/R                             | 10,000          |                  |
| Cash at Bank                    | <u>90,000</u>   | <u>23,80,000</u> |
|                                 |                 | 64,80,000        |
| Less: Outside Liabilities:      |                 |                  |

## Company Accounts

|                           |               |                  |                  |
|---------------------------|---------------|------------------|------------------|
| 12% Debentures at premium | 5,40,000      |                  |                  |
| Sundry Creditors          | 12,80,000     |                  |                  |
| Bills Payable             | <u>20,000</u> | <u>18,40,000</u> | <u>46,40,000</u> |
| Goodwill                  |               |                  | <u>19,10,000</u> |

### Question 35

The Balance Sheets of Strong Ltd. and Weak Ltd. as on 31.03.2007 is as below:

#### Balance Sheet as on 31.03.2007

| Liabilities                        | Strong Ltd.<br>Rs. | Weak Ltd.<br>Rs. | Assets                           | Strong Ltd.<br>Rs. | Weak Ltd.<br>Rs. |
|------------------------------------|--------------------|------------------|----------------------------------|--------------------|------------------|
| Equity Share Capital (Rs.100 each) | 50,00,000          | 30,00,000        | Fixed Assets other than Goodwill | 30,00,000          | 20,00,000        |
| Reserve                            | 4,00,000           | 2,00,000         | Stock                            | 8,00,000           | 6,00,000         |
| P/L A/c                            | 6,00,000           | 4,00,000         | Debtors                          | 14,00,000          | 9,00,000         |
| Creditors                          | 5,00,000           | 3,00,000         | Cash & Bank                      | 12,00,000          | 3,50,000         |
|                                    |                    |                  | Preliminary Expenses             | <u>1,00,000</u>    | <u>50,000</u>    |
|                                    | <u>65,00,000</u>   | <u>39,00,000</u> |                                  | <u>65,00,000</u>   | <u>39,00,000</u> |

Strong Ltd. takes over Weak Ltd. on 01.07.07. No Balance Sheet of Weak Ltd. is available as on that date. It is however estimated that Weak Ltd. earns estimated profit of Rs.2,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets, during April-June, 2007.

Estimated profit of Strong Ltd. during these 3 months is Rs.4,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets.

Both the companies have declared and paid 10% dividend within this 3 months' period. Goodwill of Weak Ltd. is valued at Rs.2,00,000 and Fixed Assets are valued at Rs.1,00,000 above the estimated book value. Purchase consideration is to be satisfied by Strong Ltd. by shares at par. Ignore Income-tax.

You are required to calculate the following:

- (i) No. of shares to be issued by Strong Ltd. to Weak Ltd. against purchase consideration;
- (ii) Net Current Assets of Strong Ltd. and Weak Ltd. as on 01.07.2007;
- (iii) P/L A/c balance of the Strong Ltd. as on 01.07.2007;
- (iv) Fixed Assets as on 01.07.2007;
- (v) Balance Sheet of Strong Ltd. as on 01.07.2007 after take over of Weak Ltd.

(16 Marks) (Nov. 2007)

## Advanced Accounting

Answer

- (i) Number of shares to be issued by Strong Ltd. to Weak Ltd. against purchase consideration

| Weak Ltd.                      | Rs.               | Rs.              |
|--------------------------------|-------------------|------------------|
| Goodwill                       |                   | 2,00,000         |
| Fixed Assets                   | 20,00,000         |                  |
| Less: Depreciation             | <u>50,000</u>     |                  |
|                                | 19,50,000         |                  |
| Add: Appreciation              | <u>1,00,000</u>   | 20,50,000        |
| Stock                          |                   | 6,00,000         |
| Debtors                        |                   | 9,00,000         |
| Cash and Bank balances         | 3,50,000          |                  |
| Add: Profit after depreciation | 2,00,000          |                  |
| Add: Depreciation (non-cash)   | <u>50,000</u>     | 2,50,000         |
|                                |                   |                  |
| Less: Dividend                 | <u>(3,00,000)</u> | <u>3,00,000</u>  |
|                                |                   | 40,50,000        |
| Less: Creditors                |                   | <u>3,00,000</u>  |
| Purchase Consideration         |                   | <u>37,50,000</u> |

- (ii) Calculation of Net Current Assets as on 01.07.2007

|                                 | Strong Ltd.      | Weak Ltd.        |
|---------------------------------|------------------|------------------|
|                                 | Rs.              | Rs.              |
| Current assets:                 |                  |                  |
| Stock                           | 8,00,000         | 6,00,000         |
| Debtors                         | 14,00,000        | 9,00,000         |
| Cash and Bank                   | 12,00,000        | 3,50,000         |
| Less: Dividend                  | (5,00,000)       | (3,00,000)       |
| Add: Profit before depreciation | <u>4,75,000</u>  | <u>3,00,000</u>  |
|                                 | 33,75,000        | 18,00,000        |
| Less: Creditors                 | <u>5,00,000</u>  | <u>3,00,000</u>  |
|                                 | <u>28,75,000</u> | <u>15,00,000</u> |



## Company Accounts

(iii) Profit and Loss Account balance of Strong Ltd. as on 1.07.2007

|                                                                | Rs.             |
|----------------------------------------------------------------|-----------------|
| P & L A/c balance as on 31.03.2007                             | 6,00,000        |
| Less: Dividend paid                                            | <u>5,00,000</u> |
|                                                                | 1,00,000        |
| Add: Estimated profit for 3 months after charging depreciation | <u>4,00,000</u> |
|                                                                | <u>5,00,000</u> |

(iv) Fixed Assets as on 01.07.2007

|                                                               |                  |
|---------------------------------------------------------------|------------------|
| Fixed Assets of Strong Ltd. as on 31.03.2007                  | 30,00,000        |
| Less: Depreciation for 3 months                               | <u>75,000</u>    |
|                                                               | 29,25,000        |
| Fixed assets taken over of Weak Ltd. as on 31.03.2007         | 20,00,000        |
| Less: Proportionate depreciation for 3 months on fixed assets | <u>50,000</u>    |
|                                                               | 19,50,000        |
| Add: Appreciation above the estimated book value              | <u>1,00,000</u>  |
|                                                               | <u>20,50,000</u> |
|                                                               | <u>49,75,000</u> |

(v) Balance Sheet of Strong Ltd. as on 01.07.2007 (after Take Over)

| Liabilities             | Rs.                | Assets                 | Rs.                |
|-------------------------|--------------------|------------------------|--------------------|
| Equity Share capital:   |                    | Goodwill               | 2,00,000           |
| 87500 (50,000+ 37,500)  |                    | Fixed assets           | 49,75,000          |
| shares of Rs.100 each   | 87,50,000          | [as computed in (iv)]  |                    |
| Reserves                | 4,00,000           | Stock                  | 14,00,000          |
| Profit and Loss Account | 5,00,000           | (8,00,000 + 6,00,000)  |                    |
| [as computed in (iii)]  |                    | Debtors                | 23,00,000          |
| Creditors               | 8,00,000           | (14,00,000 + 9,00,000) |                    |
| (5,00,000 + 3,00,000)   |                    | Cash and Bank          |                    |
|                         |                    | (11,75,000+ 3,00,000)  | 14,75,000          |
|                         |                    | Preliminary expenses   | <u>1,00,000</u>    |
|                         | <u>1,04,50,000</u> |                        | <u>1,04,50,000</u> |

## Advanced Accounting

### Question 36

T. Ltd. and V. Ltd. propose to amalgamate. Their balance sheets as at 31<sup>st</sup> March, 2008 were as follows:

| Liabilities                 | T. Ltd.<br>Rs.   | V. Ltd.<br>Rs.  | Assets                                                         | T. Ltd.<br>Rs.   | V. Ltd.<br>Rs.  |
|-----------------------------|------------------|-----------------|----------------------------------------------------------------|------------------|-----------------|
| Share capital:              |                  |                 | Fixed assets                                                   |                  |                 |
| Equity shares of Rs.10 each | 15,00,000        | 6,00,000        | Less: Depreciation                                             | 12,00,000        | 3,00,000        |
| General reserve             | 6,00,000         | 60,000          | Investments (face value of Rs.3 lakhs, 6% tax free G.P. notes) | 3,00,000         | -               |
| Profit & Loss A/c           | 3,00,000         | 90,000          | Stock                                                          | 6,00,000         | 3,90,000        |
| Creditors                   | 3,00,000         | 1,50,000        | Debtors                                                        | 5,10,000         | 1,80,000        |
|                             |                  |                 | Cash and bank balances                                         | <u>90,000</u>    | <u>30,000</u>   |
|                             | <u>27,00,000</u> | <u>9,00,000</u> |                                                                | <u>27,00,000</u> | <u>9,00,000</u> |

Their net profits (after taxation) were as follows:

| Year    | T. Ltd.  | V. Ltd.  |
|---------|----------|----------|
| 2005-06 | 3,90,000 | 1,35,000 |
| 2006-07 | 3,75,000 | 1,20,000 |
| 2007-08 | 4,50,000 | 1,68,000 |

Normal trading profit may be considered as 15% on closing capital invested. Goodwill may be taken as 4 years' purchase of average super profits. The stock of T. Ltd. and V. Ltd. are to be taken at Rs.6,12,000 and Rs.4,26,000 respectively for the purpose of amalgamation. W. Ltd. is formed for the purpose of amalgamation of two companies.

- Suggest a scheme of capitalization of W. Ltd. and ratio of exchange of shares; and
- Draft the opening balance sheet of W. Ltd. (16 Marks) (May, 2008)<sup>£</sup>

<sup>£</sup> The question involves the application of calculation of goodwill. Therefore, students are advised to go through this problem after preparing Chapter 3.

## Company Accounts

Answer

(a) Scheme of capitalization of W. Ltd. and ratio of exchange of shares

Computation of Net Assets of amalgamating companies

|                            | T. Ltd.          | V. Ltd.         |
|----------------------------|------------------|-----------------|
|                            | Rs.              | Rs.             |
| Goodwill (W.N.2)           | 3,19,200         | 1,21,200        |
| Fixed Assets               | 12,00,000        | 3,00,000        |
| 6% investments (Non-trade) | 3,00,000         | -               |
| Stock                      | 6,12,000         | 4,26,000        |
| Debtors                    | 5,10,000         | 1,80,000        |
| Cash and Bank Balances     | <u>90,000</u>    | <u>30,000</u>   |
|                            | 30,31,200        | 10,57,200       |
| Less: Creditors            | <u>3,00,000</u>  | <u>1,50,000</u> |
| Net Assets                 | <u>27,31,200</u> | <u>9,07,200</u> |
| No. of Equity shares       | 1,50,000         | 60,000          |
| Intrinsic value of a share | Rs. 18.208       | Rs. 15.12       |

No of shares to be issued by W. Ltd to

T. Ltd  $1,50,000 \times 18.208/10$  2,73,120 shares

V. Ltd  $60,000 \times 15.12/10$  90,720 shares

In total 2,73,120 + 90,720 i.e. 3,63,840 shares will be issued by W. Ltd.

Ratio of exchange of shares will be as follows:

1. Holders of 1,50,000 equity shares of T Ltd. will get 2,73,120 shares in W. Ltd.
2. Similarly, holders of 60,000 equity shares of V Ltd. will get 90,720 shares in W. Ltd.

(b) Opening Balance Sheet of W. Ltd.

| Liabilities                                                                    | Rs.       | Assets                                      | Rs.       |
|--------------------------------------------------------------------------------|-----------|---------------------------------------------|-----------|
| Share Capital:                                                                 |           | Fixed Assets:                               |           |
| 3,63,840 Equity shares of Rs. 10 each                                          | 36,38,400 | Goodwill (W.N.2)<br>(3,19,200 + 1,21,200)   | 4,40,400  |
| (Issued for consideration other than cash, pursuant to scheme of amalgamation) |           | Other fixed Assets<br>(12,00,000+ 3,00,000) | 15,00,000 |

### Advanced Accounting

|                      |                  |                                         |                  |
|----------------------|------------------|-----------------------------------------|------------------|
| Current Liabilities: |                  | Investments in 6% Tax free G.P. Notes   | 3,00,000         |
| Creditors            | 4,50,000         | Current Assets:                         |                  |
|                      |                  | Stock (6,12,000 + 4,26,000)             | 10,38,000        |
|                      |                  | Debtors (5,10,000 + 1,80,000)           | 6,90,000         |
|                      |                  | Cash and bank balance (90,000 + 30,000) | <u>1,20,000</u>  |
|                      | <u>40,88,400</u> |                                         | <u>40,88,400</u> |

#### Working Notes:

- Calculation of closing trading capital employed on the basis of net assets

|                        | T. Ltd.          | V. Ltd.         |
|------------------------|------------------|-----------------|
|                        | Rs.              | Rs.             |
| Fixed Assets           | 12,00,000        | 3,00,000        |
| Stock                  | 6,12,000         | 4,26,000        |
| Debtors                | 5,10,000         | 1,80,000        |
| Cash and Bank Balances | <u>90,000</u>    | <u>30,000</u>   |
|                        | 24,12,000        | 9,36,000        |
| Less: Creditors        | <u>3,00,000</u>  | <u>1,50,000</u> |
| Net Assets             | <u>21,12,000</u> | <u>7,86,000</u> |

- Calculation of value of goodwill

| (i) Average Trading Profit             | T. Ltd.          | V. Ltd.         |
|----------------------------------------|------------------|-----------------|
|                                        | Rs.              | Rs.             |
| 2005-06                                | 3,90,000         | 1,35,000        |
| 2006-07                                | 3,75,000         | 1,20,000        |
| 2007-08                                | <u>4,50,000</u>  | <u>1,68,000</u> |
| Profit after tax                       | <u>12,15,000</u> | <u>4,23,000</u> |
| Profit before tax (40%)*               | 20,25,000        | 7,05,000        |
| Add : Under valuation of closing stock | <u>12,000</u>    | <u>36,000</u>   |

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\* Tax rate of 40% has been assumed. The candidates may assume some other tax rate and give the solution accordingly.

**Company Accounts**

|                                                                      |                  |                 |
|----------------------------------------------------------------------|------------------|-----------------|
|                                                                      | <u>20,37,000</u> | <u>7,41,000</u> |
| Average of 3 years' profit before tax                                | 6,79,000         | 2,47,000        |
| Less: Income from non-trade investments<br>(3,00,000 x 6%)           | <u>18,000</u>    | <u>-</u>        |
| Average profit before tax                                            | 6,61,000         | 2,47,000        |
| Less: 40% tax                                                        | <u>2,64,400</u>  | <u>98,800</u>   |
| Average profit after tax                                             | <u>3,96,600</u>  | <u>1,48,200</u> |
| <br>(ii) Super Profits                                               |                  |                 |
| Average trading profit                                               | 3,96,600         | 1,48,200        |
| Less: Normal Profit                                                  |                  |                 |
| T. Ltd. Rs. 21,12,000 x 15%                                          | 3,16,800         |                 |
| V. Ltd Rs. 7,86,000 x 15%                                            | <u>      </u>    | <u>1,17,900</u> |
|                                                                      | <u>79,800</u>    | <u>30,300</u>   |
| <br>(iii) Value of goodwill at 4 years' purchase of<br>super profits |                  |                 |
|                                                                      | <u>3,19,200</u>  | <u>1,21,200</u> |

**Question 37**

The following are the Balance Sheets of Andrew Ltd. and Barry Ltd., as at 31.12.2007:

**Andrew Ltd.**

(in Rs.'000s)

| Liabilities                                      |               | Assets                                      |               |
|--------------------------------------------------|---------------|---------------------------------------------|---------------|
| Share capital                                    |               | Fixed assets                                | 3,400         |
| 3,00,000 Equity shares of Rs.10 each             | 3,000         | Stock (pledged with secured loan creditors) | 18,400        |
| 10,000 Preference shares of Rs.100 each          | 1,000         | Other Current assets                        | 3,600         |
| General reserve                                  | 400           | Profit and Loss account                     | 16,600        |
| Secured loans (secured against pledge of stocks) | 16,000        |                                             |               |
| Unsecured loans                                  | 8,600         |                                             |               |
| Current liabilities                              | <u>13,000</u> |                                             |               |
|                                                  | <u>42,000</u> |                                             | <u>42,000</u> |

## Advanced Accounting

| Barry Ltd.                           |               |                |               |
|--------------------------------------|---------------|----------------|---------------|
|                                      |               | (in Rs.'000s)  |               |
| Liabilities                          |               | Assets         |               |
| Share capital                        |               | Fixed assets   | 6,800         |
| 1,00,000 Equity shares of Rs.10 each | 1,000         | Current assets | 9,600         |
| General reserve                      | 2,800         |                |               |
| Secured loans                        | 8,000         |                |               |
| Current liabilities                  | 4,600         |                |               |
|                                      | <u>16,400</u> |                | <u>16,400</u> |

Both the companies go into liquidation and Charlie Ltd., is formed to take over their businesses. The following information is given:

- All Current assets of two companies, except pledged stock are taken over by Charlie Ltd. The realisable value of all Current assets are 80% of book values in case of Andrew Ltd. and 70% for Barry Ltd. Fixed assets are taken over at book value.
- The break up of Current liabilities is as follows:

|                                                                                                                                               | Andrew Ltd.<br>Rs. | Barry Ltd.<br>Rs. |
|-----------------------------------------------------------------------------------------------------------------------------------------------|--------------------|-------------------|
| Statutory liabilities (including Rs.22 lakh in case of Andrew Ltd. in case of a claim not having been admitted shown as contingent liability) | 72,00,000          | 10,00,000         |
| Liability to employees                                                                                                                        | 30,00,000          | 18,00,000         |

The balance of Current liability is miscellaneous creditors.

- Secured loans include Rs.16,00,000 accrued interest in case of Barry Ltd.
- 2,00,000 equity shares of Rs.10 each are allotted by Charlie Ltd. at par against cash payment of entire face value to the shareholders of Andrew Ltd. and Barry Ltd. in the ratio of shares held by them in Andrew Ltd. and Barry Ltd.
- Preference shareholders are issued Equity shares worth Rs.2,00,000 in lieu of present holdings.
- Secured loan creditors agree to continue the balance amount of their loans to Charlie Ltd. after adjusting value of pledged security in case of Andrew Ltd. and after waiving 50% of interest due in the case of Barry Ltd.
- Unsecured loans are taken over by Charlie Ltd. at 25% of Loan amounts.
- Employees are issued fully paid Equity shares in Charlie Ltd. in full settlement of their dues.

## Company Accounts

- (i) Statutory liabilities are taken over by Charlie Ltd. at full values and miscellaneous creditors are taken over at 80% of the book value.

Show the opening Balance Sheet of Charlie Ltd. Workings should be part of the answer.

(16 Marks) (Nov. 2008)

Answer

Balance sheet of Charlie Ltd. as at 31<sup>st</sup> December, 2007

|                                                                                   |               | (in Rs. '000s)                |               |
|-----------------------------------------------------------------------------------|---------------|-------------------------------|---------------|
| Liabilities                                                                       | Rs.           | Assets                        | Rs.           |
| Share Capital                                                                     |               | Goodwill (W.N.4)              | 9,470         |
| Authorised                                                                        |               | Other Fixed Assets            |               |
|                                                                                   |               | (3,400 + 6,800)               | 10,200        |
| Shares of Rs.10 each                                                              |               | Current Assets(2,880 + 6,720) | 9,600         |
| Issued, subscribed & Paid up:                                                     |               | Cash at Bank                  | 2,000         |
| 7,00,000 equity shares of Rs.10 each, fully paid up (W.N. 5)                      | 7,000         |                               |               |
| (of the above 5,00,000 shares have been issued for consideration other than cash) |               |                               |               |
| Secured loans (1,280 + 7,200)                                                     | 8,480         |                               |               |
| Unsecured Loans (25% of 8,600)                                                    | 2,150         |                               |               |
| Current Liabilities                                                               |               |                               |               |
| (7,200 + 1,000 + 4,000 +1,440))                                                   | 13,640        |                               |               |
|                                                                                   | <u>31,270</u> |                               | <u>31,270</u> |

Working Notes:

1. Value of miscellaneous creditors taken over by Charlie Ltd. (in Rs. '000s)

|                             | Andrew Ltd.  | Barry Ltd.   |
|-----------------------------|--------------|--------------|
|                             | Rs.          | Rs.          |
| Given in balance sheet      | 13,000       | 4,600        |
| Less: Statutory liabilities | 5,000        | 1,000        |
| Liability to employees      | <u>3,000</u> | <u>1,800</u> |
| Miscellaneous creditors     | <u>5,000</u> | <u>1,800</u> |
| 80% thereof                 | <u>4,000</u> | <u>1,440</u> |

## Advanced Accounting

### 2. Value of total liabilities taken over by Charlie Ltd.

|                                       | Andrew Ltd.   |               | Barry Ltd.   |               |
|---------------------------------------|---------------|---------------|--------------|---------------|
|                                       | Rs.           | Rs.           | Rs.          | Rs.           |
| Current liabilities                   |               |               |              |               |
| Statutory liabilities                 | 7,200         |               | 1,000        |               |
| Liability to employees                | 3,000         |               | 1,800        |               |
| Miscellaneous creditors (W.N.1)       | <u>4,000</u>  | 14,200        | <u>1,440</u> | 4,240         |
| Secured loans                         |               |               |              |               |
| Given in Balance sheet                | 16,000        |               | 8,000        |               |
| Interest waived                       | -             |               | <u>800</u>   | 7,200         |
| Value of Stock (80% of Rs.184 lakhs)  | <u>14,720</u> | 1,280         |              |               |
| Unsecured Loans (25% of Rs. 86 lakhs) |               | <u>2,150</u>  |              | -             |
|                                       |               | <u>17,630</u> |              | <u>11,440</u> |

### 3. Assets taken over by Charlie Ltd.

|                                                       | Andrew Ltd.  | Barry Ltd.    |
|-------------------------------------------------------|--------------|---------------|
|                                                       | Rs.          | Rs.           |
| Fixed Assets (Assumed on book value basis)            | 3,400        | 6,800         |
| Current Assets 80% and 70% respectively of book value | <u>2,880</u> | <u>6,720</u>  |
|                                                       | <u>6,280</u> | <u>13,520</u> |

### 4. Goodwill / Capital Reserve on amalgamation

|                                                       |            |                 |
|-------------------------------------------------------|------------|-----------------|
| Liabilities taken over (W.N. 2)                       | 17,630     | 11,440          |
| Equity shares to be issued to Preference Shareholders | <u>200</u> | -               |
|                                                       | A          | 17,830          |
| Less: total assets taken over (W.N. 3)                | B          | <u>6,280</u>    |
|                                                       | A-B        | <u>11,550</u>   |
|                                                       | Goodwill   | Capital Reserve |
| Net Goodwill                                          | 9,470      |                 |



**Company Accounts**

5. Equity shares issued by Charlie Ltd.

|                                               |                               | Number          |
|-----------------------------------------------|-------------------------------|-----------------|
| (i) For Cash                                  |                               | 200000          |
| For consideration other than cash             |                               |                 |
| (ii) In Discharge of Liabilities to Employees | 4,80,000                      |                 |
| (iii) To Preference shareholders              | <u>20,000</u>                 | <u>5,00,000</u> |
|                                               |                               | <u>7,00,000</u> |
| Value of shares                               | Rs.10x 7,00,000= Rs. 70 Lakhs |                 |

## Advanced Accounting

NOTE

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Topics covered:

- Valuation of Business (Q. No. 1, 2)
- Valuation of Goodwill (Q. Nos. 3 to 8 )
- Valuation of Shares (Q. Nos. 9 to 20)

## Advanced Accounting

### Question 1

The Balance Sheets of R Ltd. for the years ended on 31.3.2000, 31.3.2001 and 31.3.2002 are as follows:

|                                                  | 31.3.2000        | 31.3.2001        | 31.3.2002        |
|--------------------------------------------------|------------------|------------------|------------------|
|                                                  | Rs.              | Rs.              | Rs.              |
| Liabilities                                      |                  |                  |                  |
| 3,20,000 Equity Shares of Rs. 10 each fully paid | 32,00,000        | 32,00,000        | 32,00,000        |
| General Reserve                                  | 24,00,000        | 28,00,000        | 32,00,000        |
| Profit and Loss Account                          | 2,80,000         | 3,20,000         | 4,80,000         |
| Creditors                                        | <u>12,00,000</u> | <u>16,00,000</u> | <u>20,00,000</u> |
|                                                  | <u>70,80,000</u> | <u>79,20,000</u> | <u>88,80,000</u> |

|                                             | 31.3.2000        | 31.3.2001        | 31.3.2002        |
|---------------------------------------------|------------------|------------------|------------------|
|                                             | Rs.              | Rs.              | Rs.              |
| Assets                                      |                  |                  |                  |
| Goodwill                                    | 20,00,000        | 16,00,000        | 12,00,000        |
| Building and Machinery (Less: Depreciation) | 28,00,000        | 32,00,000        | 32,00,000        |
| Stock                                       | 20,00,000        | 24,00,000        | 28,00,000        |
| Debtors                                     | 40,000           | 3,20,000         | 8,80,000         |
| Bank Balance                                | <u>2,40,000</u>  | <u>4,00,000</u>  | <u>8,00,000</u>  |
|                                             | <u>70,80,000</u> | <u>79,20,000</u> | <u>88,80,000</u> |

Actual valuation were as under:

|                                                                                                                                   | 31.3.2000 | 31.3.2001 | 31.3.2002 |
|-----------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|-----------|
|                                                                                                                                   | Rs.       | Rs.       | Rs.       |
| Building and Machinery                                                                                                            | 36,00,000 | 40,00,000 | 44,00,000 |
| Stock                                                                                                                             | 24,00,000 | 28,00,000 | 32,00,000 |
| Net Profit (including opening balance) after writing off depreciation and goodwill, tax provision and transfer to General Reserve | 8,40,000  | 12,40,000 | 16,40,000 |

Capital employed in the business at market values at the beginning of 1999–2000 was Rs. 73,20,000, which included the cost of goodwill. The normal annual return on Average Capital employed in the line of business engaged by R Ltd. is 12½%.

The balance in the General Reserve account on 1st April, 1999 was Rs. 20 lakhs.

The goodwill shown on 31.3.2000 was purchased on 1.4.1999 for Rs. 20,00,000 on which date the balance in the Profit and Loss Account was Rs. 2,40,000. Find out the average capital employed each year.

## Valuation

Goodwill is to be valued at 5 years purchase of super profits (Simple average method). Also find out the total value of the business as on 31.3.2002. (16 marks) (November, 2003)

Answer

Note:

1. Since goodwill has been paid for, it is taken as part of capital employed. Capital employed at the end of each year is shown below.
2. Assumed that the building and machinery figure as revalued is after considering depreciation.

|                                   | 31.3.2000          | 31.3.2001          | 31.3.2002          |
|-----------------------------------|--------------------|--------------------|--------------------|
|                                   | Rs.                | Rs.                | Rs.                |
| Goodwill                          | 20,00,000          | 16,00,000          | 12,00,000          |
| Building and Machinery (revalued) | 36,00,000          | 40,00,000          | 44,00,000          |
| Stock (revalued)                  | 24,00,000          | 28,00,000          | 32,00,000          |
| Debtors                           | 40,000             | 3,20,000           | 8,80,000           |
| Bank Balance                      | <u>2,40,000</u>    | <u>4,00,000</u>    | <u>8,00,000</u>    |
| Total Assets                      | 82,80,000          | 91,20,000          | 1,04,80,000        |
| Less: Creditors                   | <u>12,00,000</u>   | <u>16,00,000</u>   | <u>20,00,000</u>   |
| Closing Capital                   | 70,80,000          | 75,20,000          | 84,80,000          |
| Opening Capital                   | <u>73,20,000</u>   | <u>70,80,000</u>   | <u>75,20,000</u>   |
|                                   | <u>1,44,00,000</u> | <u>1,46,00,000</u> | <u>1,60,00,000</u> |
| Average Capital                   | 72,00,000          | 73,00,000          | 80,00,000          |

Maintainable profit has to be found out after making adjustments as given below:

|                                                 | 31.3.2000                                        | 31.3.2001       | 31.3.2002        |
|-------------------------------------------------|--------------------------------------------------|-----------------|------------------|
|                                                 | Rs.                                              | Rs.             | Rs.              |
| Net Profit as given                             | 8,40,000                                         | 12,40,000       | 16,40,000        |
| Less: Opening Balance                           | <u>2,40,000</u>                                  | <u>2,80,000</u> | <u>3,20,000</u>  |
|                                                 | 6,00,000                                         | 9,60,000        | 13,20,000        |
| Add: Under valuation of closing stock           | <u>4,00,000</u>                                  | <u>4,00,000</u> | <u>4,00,000</u>  |
|                                                 | 10,00,000                                        | 13,60,000       | 17,20,000        |
| Less: Adjustment for valuation in opening stock | —                                                | <u>4,00,000</u> | <u>4,00,000</u>  |
|                                                 | 10,00,000                                        | 9,60,000        | 13,20,000        |
| Add: Goodwill written-off                       | —                                                | <u>4,00,000</u> | <u>4,00,000</u>  |
|                                                 | 10,00,000                                        | 13,60,000       | 17,20,000        |
| Add: Transfer to Reserves                       | <u>4,00,000</u>                                  | <u>4,00,000</u> | <u>4,00,000</u>  |
|                                                 | 14,00,000                                        | 17,60,000       | 21,20,000        |
| Less: 12½% Normal Return                        | <u>9,00,000</u>                                  | <u>9,12,500</u> | <u>10,00,000</u> |
| Super Profit                                    | <u>5,00,000</u>                                  | <u>8,47,500</u> | <u>11,20,000</u> |
| Average super profits                           | = (Rs.5,00,000 + Rs.8,47,500 + Rs.11,20,000) / 3 |                 |                  |

## Advanced Accounting

$$= 24,67,500 / 3 = \text{Rs } 8,22,500$$

$$\text{Goodwill} = 5 \text{ years purchase} = \text{Rs. } 8,22,500 \times 5 = \text{Rs. } 41,12,500.$$

|                              |                    |
|------------------------------|--------------------|
|                              | Rs.                |
| Total Net Assets (31/3/2002) | 84,80,000          |
| Less: Goodwill               | <u>12,00,000</u>   |
|                              | 72,80,000          |
| Add: Goodwill                | <u>41,12,500</u>   |
| Value of Business            | <u>1,13,92,500</u> |

### Question 2

Find out the average capital employed of ND Ltd. from its Balance sheet as at 31<sup>st</sup> March, 2006:

| Liabilities                         | (Rs. in lakhs) | Assets                | (Rs. in lakhs) |
|-------------------------------------|----------------|-----------------------|----------------|
| Share Capital:                      |                | Fixed Assets:         |                |
| Equity shares of Rs.10 each         | 50.00          | Land and buildings    | 25.00          |
| 9% Pref. shares fully paid up       | 10.00          | Plant and machinery   | 80.25          |
| Reserve and Surplus:                |                | Furniture and fixture | 5.50           |
| General reserve                     | 12.00          | Vehicles              | 5.00           |
| Profit and Loss                     | 20.00          | Investments           | 10.00          |
| Secured loans:                      |                | Current Assets:       |                |
| 16% debentures                      | 5.00           | Stock                 | 6.75           |
| 16% Term loan                       | 18.00          | Sundry Debtors        | 4.90           |
| Cash credit                         | 13.30          | Cash and bank         | 10.40          |
| Current Liabilities and Provisions: |                | Preliminary expenses  | 0.50           |
| Sundry creditors                    | 2.70           |                       |                |
| Provision for taxation              | 6.40           |                       |                |
| Proposed dividend on:               |                |                       |                |
| Equity shares                       | 10.00          |                       |                |
| Preference shares                   | <u>0.90</u>    |                       |                |
|                                     | <u>148.30</u>  |                       | <u>148.30</u>  |

Non-trade investments were 20% of the total investments.

Balances as on 1.4.2005 to the following accounts were:

Profit and Loss account Rs.8.70 lakhs, General reserve Rs.6.50 lakhs.

(8 Marks)(November 2006)

## Valuation

Answer

### Computation of Average Capital employed

|                                             | (Rs. in Lakhs) |              |
|---------------------------------------------|----------------|--------------|
| Total Assets as per Balance Sheet           |                | 148.30       |
| Less: Preliminary Expenses                  | 0.50           |              |
| Non-trade investments (20% of Rs. 10 lakhs) | <u>2.00</u>    | <u>2.50</u>  |
|                                             |                | 145.80       |
| Less: Outside Liabilities:                  |                |              |
| 16% Debentures                              | 5.00           |              |
| 16% Term Loan                               | 18.00          |              |
| Cash Credit                                 | 13.30          |              |
| Sundry Creditors                            | 2.70           |              |
| Provision for Taxation                      | <u>6.40</u>    | <u>45.40</u> |
| Capital Employed as on 31.03.2006           |                | 100.40       |
| Less: ½ of profit earned:                   |                |              |
| Increase in reserve balance                 | 5.50           |              |
| Increase in Profit & Loss A/c               | 11.30          |              |
| Proposed Dividend                           | <u>10.90</u>   |              |
|                                             | 27.70 X 50 %   | <u>13.85</u> |
| Average capital employed                    |                | <u>86.55</u> |

### Question 3

The Balance Sheets of X Ltd. are as follows:

|                                          | (Rs. in lakhs)  |                 |
|------------------------------------------|-----------------|-----------------|
| Liabilities                              | As at 31.3.1996 | As at 31.3.1997 |
| Share Capital                            | 1,000.0         | 1,000.0         |
| General Reserve                          | 800.0           | 850.0           |
| Profit and Loss Account                  | 120.0           | 175.0           |
| Term Loans                               | 370.0           | 330.0           |
| Sundry Creditors                         | 70.0            | 90.0            |
| Provision for Tax                        | 22.5            | 25.0            |
| Proposed Dividend                        | <u>200.0</u>    | <u>250.0</u>    |
|                                          | <u>2,582.5</u>  | <u>2,720.0</u>  |
| Assets                                   |                 |                 |
| Fixed Assets and Investments (Non-trade) | 1,600.0         | 1,800.0         |

## Advanced Accounting

|               |                |                |
|---------------|----------------|----------------|
| Stock         | 550.0          | 600.0          |
| Debtors       | 340.0          | 220.0          |
| Cash and Bank | <u>92.5</u>    | <u>100.0</u>   |
|               | <u>2,582.5</u> | <u>2,720.0</u> |

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.1996 Rs. 2,200 lakhs and on 31.3.1997 Rs. 2,532.8 lakhs.
2. Current cost of stock on 31.3.1996 Rs. 670 lakhs and on 31.3.1997 Rs. 750 lakhs.
3. Non-trade investments in 10% government securities Rs. 490 lakhs.
4. Debtors include foreign exchange debtors amounting to \$ 70,000 recorded at the rate of \$ 1 = Rs. 17.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
5. Creditors include foreign exchange creditors amounting to \$ 1,20,000 recorded at the rate of \$ 1 = Rs. 16.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
6. Profit included Rs. 120 lakhs being government subsidy which is not likely to recur.
7. Rs. 247 lakhs being the last instalment of R and D cost were written off the profit and loss account. This expenditure is not likely to recur.
8. Tax rate during 1996-97 was 50% effective future tax rate is estimated at 40%.
9. Normal rate of return is expected at 15%.

Based on the information furnished, Mr. Iral, a director contends that the company does not have any goodwill. Examine his contention. (20 marks)(November, 1997)

Answer

|                                                               | (Rs. in lakhs)     |                    |
|---------------------------------------------------------------|--------------------|--------------------|
| (1) Average Capital employed                                  |                    |                    |
|                                                               | As at<br>31.3.1996 | As at<br>31.3.1997 |
| Current cost of fixed assets other than non trade investments | 2,200.0            | 2,532.8            |
| Current cost of stock                                         | 670.0              | 750.0              |
| Debtors                                                       | 340.0              | 222.8              |
| Cash and Bank                                                 | <u>92.5</u>        | <u>100.0</u>       |
|                                                               | 3,302.5            | 3,605.6            |
| Less: Outside Liabilities:                                    |                    |                    |
| Term loans                                                    | 370.0              | 330.0              |
| Sundry creditors                                              | 70.0               | 96.0               |
| Tax provision                                                 | <u>22.5</u>        | <u>25.0</u>        |
|                                                               | <u>462.5</u>       | <u>451.0</u>       |



|                                                                           |               | <b>Valuation</b> |
|---------------------------------------------------------------------------|---------------|------------------|
| Capital Employed                                                          | 2,840.0       | 3,154.6          |
| Average Capital Employed at current value = $\frac{2,840.0 + 3,154.6}{2}$ |               | 2,997.3          |
| (2) Future maintainable profit                                            |               |                  |
| Increase in General Reserve                                               |               | 50               |
| Increase in Profit and Loss Account                                       |               | 55               |
| Proposed Dividend                                                         |               | <u>250</u>       |
| Profit after tax                                                          |               | <u>355</u>       |
| Pre-tax profit = $\frac{355}{1 - 0.5}$                                    |               | 710.00           |
| Less: Non-trading income                                                  | 49.00         |                  |
| Exchange loss on creditors [1.2 lakhs × (21.5 – 16.5)]                    | 6.00          |                  |
| Subsidy                                                                   | <u>120.00</u> |                  |
|                                                                           |               | <u>175.00</u>    |
|                                                                           |               | 535.00           |
| Add: Exchange gain on debtors [0.7 lakhs × (21.5 – 17.5)]                 | 2.80          |                  |
| R & D costs                                                               | 247.00        |                  |
| Stock adjustment                                                          | <u>30.00</u>  |                  |
|                                                                           |               | <u>279.80</u>    |
| Adjusted pre-tax profit                                                   |               | 814.80           |
| Less: Tax @ 40%                                                           |               | <u>325.92</u>    |
| Future maintainable profit                                                |               | <u>488.88</u>    |

#### Valuation of Goodwill

(Rs. in lakhs)

|                                                                                      |                 |
|--------------------------------------------------------------------------------------|-----------------|
| (1) Capitalisation Method                                                            |                 |
| Capitalised value of future maintainable profit $\left( \frac{488.88}{0.15} \right)$ | 3,259.20        |
| Less: Average Capital Employed                                                       | <u>2,997.30</u> |
| Goodwill                                                                             | <u>261.90</u>   |
| (2) Super Profit Method                                                              |                 |
| Future Maintainable Profit                                                           | 488.88          |
| Normal Profit @ 15% on average capital employed                                      | <u>449.60</u>   |
| Goodwill                                                                             | <u>39.28</u>    |

Under capitalisation method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

## Advanced Accounting

### Working Notes:

|                                                                                    | (Rs. in lakhs) |
|------------------------------------------------------------------------------------|----------------|
| (1) Stock adjustment                                                               |                |
| Difference between current cost and historical cost of closing stock               | 150.00         |
| Difference between current cost and historical cost of opening stock               | <u>120.00</u>  |
|                                                                                    | <u>30.00</u>   |
| (2) Debtors' adjustment                                                            |                |
| Value of foreign exchange debtors at the closing exchange rate (\$ 70,000 × 21.5)  | 15.05          |
| Value of foreign exchange debtors at the original exchange rate (\$ 70,000 × 17.5) | <u>12.25</u>   |
|                                                                                    | <u>2.80</u>    |
| (3) Creditors' adjustment                                                          |                |
| Foreign exchange creditors at the closing exchange rate (\$ 1,20,000 × 21.5)       | 25.80          |
| Foreign exchange creditors at the original exchange rate (\$ 1,20,000 × 16.5)      | <u>19.80</u>   |
|                                                                                    | <u>6.00</u>    |

### Question 4

Briefly discuss methods of valuation of intangible assets. (4 marks)(May, 2005)

#### Answer

Valuation of intangible assets is a complex exercise, as the non-physical form of intangible assets pose the difficulty of identifying the future economic benefits that the enterprise can expect to derive from them. There are three main approaches for valuing intangible assets:

- (1) Cost approach: In cost approach, historical expenditure incurred in developing the asset is aggregated. Cost is measured by purchase price, where the asset has been acquired recently.
- (2) Market value approach: In comparable market value approach, intangible assets are valued with reference to transactions involving similar assets that have cropped up recently in similar markets. This approach is possible when there is an active market in which arm's length transactions have occurred recently involving comparable intangible assets and adequate information of terms of transactions is available.
- (3) Economic value approach: This approach is based on the cash flows or earnings attributable to those assets and the capitalization thereof, at an appropriate discount rate or multiple. Some of the key parameters used in this approach are projected revenues, projected earnings, discount rate, rate of return etc. The information required can be derived from either internal sources, external sources or both. Under this approach, the valuer has to identify cash flows or earnings directly

## Valuation

associated with the intangible assets like the cash flows arising from the exploitation of a patent or copyright, licensing of an intangible asset etc. This approach can be put to practice only if cash flows arising from the intangible assets are identifiable from the management accounts and budgets, forecasts or plans of the company. In most situations of valuation of intangible assets, the economic based approach is used, because of the uniqueness of intangible assets and the lack of comparable market data for the use of market value approach.

### Question 5

On the basis of the following information, calculate the value of goodwill of Gee Ltd. at three years' purchase of super profits, if any, earned by the company in the previous four completed accounting years.

#### Balance Sheet of Gee Ltd. as at 31st March, 2004

| Liabilities                                                           | Rs. in lakhs | Assets                     | Rs. in lakhs |
|-----------------------------------------------------------------------|--------------|----------------------------|--------------|
| Share Capital:                                                        |              | Goodwill                   | 310          |
| Authorised                                                            | <u>7,500</u> | Land and Buildings         | 1,850        |
| Issued and Subscribed                                                 |              | Machinery                  | 3,760        |
| 5 crore equity shares of Rs.<br>10 each, fully paid up                | 5,000        | Furniture and Fixtures     | 1,015        |
| Capital Reserve                                                       | 260          | Patents and Trade Marks    | 32           |
| General Reserve                                                       | 2,543        | 9% Non-trading Investments | 600          |
| Surplus i.e. credit balance of Profit<br>and Loss (appropriation) A/c | 477          | Stock                      | 873          |
| Trade Creditors                                                       | 568          | Debtors                    | 614          |
| Provision for Taxation (net)                                          | 22           | Cash in hand and at Bank   | 546          |
| Proposed Dividend for 2002-2003                                       | <u>750</u>   | Preliminary Expenses       | 20           |
|                                                                       | <u>9,620</u> |                            | <u>9,620</u> |

The profits before tax of the four years have been as follows:

| Year ended 31st March | Profit before tax in lakhs of Rupees |
|-----------------------|--------------------------------------|
| 2000                  | 3,190                                |
| 2001                  | 2,500                                |
| 2002                  | 3,108                                |
| 2003                  | 2,900                                |

The rate of income tax for the accounting year 1999-2000 was 40%. Thereafter it has been 38% for all the years so far. But for the accounting year 2003-2004 it will be 35%.

## Advanced Accounting

In the accounting year 1999-2000, the company earned an extraordinary income of Rs. 1 crore due to a special foreign contract. In August, 2000 there was an earthquake due to which the company lost property worth Rs. 50 lakhs and the insurance policy did not cover the loss due to earthquake or riots.

9% Non-trading investments appearing in the above mentioned Balance Sheet were purchased at par by the company on 1st April, 2001.

The normal rate of return for the industry in which the company is engaged is 20%. Also note that the company's shareholders, in their general meeting have passed a resolution sanctioning the directors an additional remuneration of Rs. 50 lakhs every year beginning from the accounting year 2003-2004. (16 marks)(May, 2004)

Answer

(1) Capital employed as on 31st March, 2004

Refer to 'Note')

|                              |           | Rs. in lakhs |
|------------------------------|-----------|--------------|
| Land and Buildings           |           | 1,850        |
| Machinery                    |           | 3,760        |
| Furniture and Fixtures       |           | 1,015        |
| Patents and Trade Marks      |           | 32           |
| Stock                        |           | 873          |
| Debtors                      |           | 614          |
| Cash in hand and at Bank     |           | <u>546</u>   |
|                              |           | 8,690        |
| Less: Trade creditors        | 568       |              |
| Provision for taxation (net) | <u>22</u> | <u>590</u>   |
|                              |           | <u>8,100</u> |

(2) Future maintainable profit

(Amounts in lakhs of rupees)

|                                                     | 1999-2000    | 2000-2001    | 2001-2002    | 2002-2003    |
|-----------------------------------------------------|--------------|--------------|--------------|--------------|
|                                                     | Rs.          | Rs.          | Rs.          | Rs.          |
| Profit before tax                                   | 3,190        | 2,500        | 3,108        | 2,900        |
| Less: Extra-ordinary income due to foreign contract | 100          |              |              |              |
| Add: Loss due to earthquake                         |              | 50           |              |              |
| Less: Income from non-trading investments           |              |              | <u>54</u>    | <u>54</u>    |
|                                                     | <u>3,090</u> | <u>2,550</u> | <u>3,054</u> | <u>2,846</u> |

As there is no trend, simple average profits will be considered for calculation of goodwill.

Total adjusted trading profits for the last four years = Rs. (3,090 + 2,550 + 3,054 + 2,846)  
= Rs. 11,540 lakhs

## Valuation

|                                                                                        | Rs. in lakhs        |
|----------------------------------------------------------------------------------------|---------------------|
| Average trading profit before tax = $\left( \frac{\text{Rs. 11,540 lakhs}}{4} \right)$ | 2,885               |
| Less: Additional remuneration to directors                                             | 50                  |
| Less: Income tax @ 35%(approx.)                                                        | <u>992</u> (Approx) |
|                                                                                        | <u>1,843</u>        |
| (3) Valuation of goodwill on super profits basis                                       |                     |
| Future maintainable profits                                                            | 1,843               |
| Less: Normal profits (20% of Rs. 8,100 lakhs)                                          | <u>1,620</u>        |
| Super Profits                                                                          | <u>223</u>          |

Goodwill at 3 years' purchase of super profits = 3 x Rs. 223 lakhs = Rs. 669 lakhs

Note:

In the above solution, goodwill has been calculated on the basis of closing capital employed (i.e. on 31<sup>st</sup> March, 2004). Goodwill should be calculated on the basis of 'average capital employed' and not 'actual capital employed' as no trend is being observed in the previous years' profits. The average capital employed cannot be calculated in the absence of details about profits for the year ended 31st March, 2004. Since the current year's profit has not been given in the question, goodwill has been calculated on the basis of capital employed as on 31st March, 2004.

### Question 6

The following Balance Sheet of X Ltd. is given:

X Ltd.

#### Balance Sheet as on 31st March, 2005

| Liabilities                             | Rs. Assets                            | Rs.                         |
|-----------------------------------------|---------------------------------------|-----------------------------|
| 5,000 shares of Rs. 100 each fully paid | 50,00,000 Goodwill                    | 4,00,000                    |
|                                         | Land and building at cost             | 32,00,000                   |
| Bank overdraft                          | 18,60,000 Plant and machinery at cost | 28,00,000                   |
| Creditors                               | 21,10,000 Stock                       | 32,00,000                   |
| Provision for taxation                  | 5,10,000 Debtors considered good      | 20,00,000                   |
| Profit and Loss Appropriation A/c       | <u>21,20,000</u>                      | <u>                    </u> |
|                                         | <u>1,16,00,000</u>                    | <u>1,16,00,000</u>          |

In 1986 when the company commenced operation the paid up capital was same. The Loss/Profit for each of the last 5 years was – years 2000-2001 – Loss (Rs. 5,50,000); 2001-2002 Rs. 9,82,000; 2002-2003 Rs. 11,70,000; 2003-2004 Rs. 14,50,000; 2004-2005 Rs. 17,00,000;

## Advanced Accounting

Although income-tax has so far been paid @ 40% and the above profits have been arrived at on the basis of such tax rate, it has been decided that with effect from the year 2004-2005 the Income-tax rate of 45% should be taken into consideration. 10% dividend in 2001-2002 and 2002-2003 and 15% dividend in 2003-2004 and 2004-2005 have been paid. Market price of shares of the company on 31st March, 2005 is Rs. 125. With effect from 1st April, 2005 Managing Director's remuneration has been approved by the Government to be Rs. 8,00,000 in place of Rs. 6,00,000. The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at Rs. 4,00,000 per annum for the next five years.

Ascertain goodwill at 3 year's purchase of super profit (for calculation of future maintainable profit weighted average is to be taken). (16 marks)(May, 2005)

Answer

| (i) | Future Maintainable Profit |                   |                                   |
|-----|----------------------------|-------------------|-----------------------------------|
|     | Year                       | Profit (P)<br>Rs. | Weight (W)<br>Product (PW)<br>Rs. |
|     | 2001-2002                  | 9,82,000          | 1                                 |
|     | 2002-2003                  | 11,70,000         | 2                                 |
|     | 2003-2004                  | 14,50,000         | 3                                 |
|     | 2004-2005                  | 17,00,000         | <u>4</u>                          |
|     |                            |                   | <u>10</u>                         |
|     |                            |                   | <u>1,44,72,000</u>                |

$$\text{Weighted average annual profit (after tax)} = \frac{\sum PW}{\sum W} = \text{Rs. } \frac{1,44,72,000}{10} = \underline{\underline{14,47,200}}$$

$$\text{Weighted average annual profit before tax} \left( \text{Rs. } 14,47,200 \times \frac{100}{60} \right) = \underline{\underline{24,12,000}}$$

$$\text{Less: Increase in Managing Director's remuneration} = \underline{\underline{2,00,000}}$$

$$\text{Add: Saving in cost of materials} = \underline{\underline{4,00,000}}$$

$$\text{Less: Taxation @ 45\%} = \underline{\underline{11,75,400}}$$

$$\text{Future maintainable profit} = \underline{\underline{14,36,600}}$$

| (ii)                | Average Capital Employed |           |
|---------------------|--------------------------|-----------|
|                     | Rs.                      | Rs.       |
| Assets:             |                          |           |
| Land and Buildings  |                          | 32,00,000 |
| Plant and Machinery |                          | 28,00,000 |
| Stock               |                          | 32,00,000 |

|                                                        |                 | <b>Valuation</b> |
|--------------------------------------------------------|-----------------|------------------|
| Sundry Debtors                                         |                 | <u>20,00,000</u> |
|                                                        |                 | 1,12,00,000      |
| Less: Outside liabilities:                             |                 |                  |
| Bank overdraft                                         | 18,60,000       |                  |
| Creditors                                              | 21,10,000       |                  |
| Provision for taxation                                 | <u>5,10,000</u> | <u>44,80,000</u> |
| Capital employed at the end of the year                |                 | 67,20,000        |
| Add: Dividend @ 15% paid during the year               |                 | <u>7,50,000</u>  |
|                                                        |                 | 74,70,000        |
| Less: Half of the profit (after tax) for the year i.e. |                 |                  |
| Rs. 17,00,000 × ½                                      |                 | <u>8,50,000</u>  |
| Average capital employed                               |                 | <u>66,20,000</u> |

(iii)

#### Normal Profit

$$\text{Average dividend for the last 4 years} \left( \frac{10 + 10 + 15 + 15}{4} \right) = 12.5\%$$

Market price of share Rs. 125

$$\text{Normal rate of return} = \frac{12.5}{125} \times 100 = 10\%$$

Normal profit (10% of Rs. 66,20,000) = Rs. 6,62,000

(iv)

#### Valuation of goodwill

|                                                                   | Rs.              |
|-------------------------------------------------------------------|------------------|
| Future maintainable profit                                        | 14,36,600        |
| Less: Normal profit                                               | <u>6,62,000</u>  |
| Super profit                                                      | <u>7,74,600</u>  |
| Goodwill at 3 years' purchase of super profits (Rs. 7,74,600 × 3) | <u>23,23,800</u> |

#### Question 7

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

| Liabilities     | As at<br>31.3.2004<br>Rs. in<br>lakhs | As at<br>31.3.2005<br>Rs. in<br>lakhs | Assets         | As at<br>31.3.2004<br>Rs. in<br>lakhs | As at<br>31.3.2005<br>Rs. in<br>lakhs |
|-----------------|---------------------------------------|---------------------------------------|----------------|---------------------------------------|---------------------------------------|
| Share capital   | 500                                   | 500                                   | Fixed assets   | 550                                   | 650                                   |
| General reserve | 400                                   | 425                                   | 10% investment | 250                                   | 250                                   |

### Advanced Accounting

|                         |              |              |                   |              |              |
|-------------------------|--------------|--------------|-------------------|--------------|--------------|
| Profit and Loss account | 60           | 90           | Stock             | 260          | 300          |
| 18% term loan           | 180          | 165          | Debtors           | 170          | 110          |
| Sundry creditors        | 35           | 45           | Cash at bank      | 46           | 45           |
| Provision for tax       | 11           | 13           | Fictitious assets | 10           | 8            |
| Proposed dividend       | <u>100</u>   | <u>125</u>   |                   |              |              |
|                         | <u>1,286</u> | <u>1,363</u> |                   | <u>1,286</u> | <u>1,363</u> |

Additional information:

- (i) Replacement values of Fixed assets were Rs.1,100 lakhs on 31.3.04 and Rs.1,250 lakhs on 31.3.2005 respectively.
- (ii) Rate of depreciation adopted on Fixed assets was 5% p.a.
- (iii) 50% of the stock is to be valued at 120% of its book value.
- (iv) 50% of investments were trade investments.
- (v) Debtors on 31<sup>st</sup> March, 2005 included foreign debtors of \$35,000 recorded in the books at Rs.35 per U.S. Dollar. The closing exchange rate was \$ 1= Rs.39.
- (vi) Creditors on 31<sup>st</sup> March, 2005 included foreign creditors of \$60,000 recorded in the books at \$ 1 = Rs.33. The closing exchange rate was \$ 1 = Rs.39.
- (vii) Profits for the year 2004-05 included Rs.60 lakhs of government subsidy which was not likely to recur.
- (viii) Rs.125 lakhs of Research and Development expenditure was written off to the Profit and Loss Account in the current year. This expenditure was not likely to recur.
- (ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.
- (x) Tax rate during 2004-05 was 50%, effective future tax rate will be 40%.
- (xi) Normal rate of return expected is 15%.

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

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

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

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

(16 Marks)(November 2006)



## Valuation

### Answer

| 1. Calculation of Capital employed (CE) | Rs. in lakhs   |                |
|-----------------------------------------|----------------|----------------|
|                                         | As on 31.3.04  | As on 31.3.05  |
| Replacement Cost of Fixed Assets        | 1100.00        | 1250.00        |
| Trade Investment (50%)                  | 125.00         | 125.00         |
| Current cost of stock                   |                |                |
| $130 + 130 \times \frac{120}{100}$      | 286.00         |                |
| $150 + 150 \times \frac{120}{100}$      |                | 330.00         |
| Debtors                                 | 170.00         | 111.40         |
| Cash-at-Bank                            | <u>46.00</u>   | <u>45.00</u>   |
| Total (A)                               | <u>1727.00</u> | <u>1861.40</u> |
| Less: Outside Liabilities               |                |                |
| 18% term loan                           | 180.00         | 165.00         |
| Sundry creditors                        | 35.00          | 48.60          |
| Provision for tax                       | <u>11.00</u>   | <u>13.00</u>   |
| Total (B)                               | <u>226.00</u>  | <u>226.60</u>  |
| Capital employed (A-B)                  | <u>1501.00</u> | <u>1634.80</u> |

$$\begin{aligned} \text{Average Capital employed at current value} &= \frac{\text{CE as on 31.3.2004} + \text{CE as on 31.3.2005}}{2} \\ &= \frac{1501 + 1634.80}{2} = 1567.90 \text{ Lakhs}^* \end{aligned}$$

| 2. Future Maintainable Profit          | Rs. in Lakhs |
|----------------------------------------|--------------|
| Increase in General Reserve            | 25           |
| Increase in Profit and Loss Account    | 30           |
| Proposed Dividends                     | <u>125</u>   |
| Profit After Tax                       | <u>180</u>   |
| Pre-Tax Profit = $\frac{180}{1 - 0.5}$ | 360          |

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

|                                                             |                           |
|-------------------------------------------------------------|---------------------------|
| Closing capital employed as on 31.3.2005                    | Rs. 1,634.80 lakhs        |
| Less: $\frac{1}{2}$ of actual post tax profit for 2004-2005 | <u>Rs. 90.00 lakhs</u>    |
| Average capital employed                                    | <u>Rs. 1,544.80 lakhs</u> |

### Advanced Accounting

|                                                                                                                             |              |                |
|-----------------------------------------------------------------------------------------------------------------------------|--------------|----------------|
| Less: Fictitious Assets written off (10 – 8)                                                                                | 2.00         |                |
| Non-Trading investment income (10% of Rs.125)                                                                               | 12.50        |                |
| Subsidy                                                                                                                     | 60.00        |                |
| Exchange Loss on creditors [0.6 lakhs × (39-33)]                                                                            | 3.60         |                |
| Additional Depreciation on increase in value of Fixed Assets (current year) $(1250 - 650 = 600 \times \frac{5}{100})$ i.e., | <u>30.00</u> | <u>108.10</u>  |
|                                                                                                                             |              | 251.90         |
| Add: Exchange Gain on Debtors [0.35 lakhs × (39-35)]                                                                        | 1.40         |                |
| Research and development expenses written off                                                                               | 125.00       |                |
| Stock Adjustment (30-26)                                                                                                    | <u>4.00</u>  | <u>130.40</u>  |
|                                                                                                                             |              | 382.30         |
| Add: Expected increase of 10%                                                                                               |              | <u>38.23</u>   |
| Future Maintainable Profit before Tax                                                                                       |              | 420.53         |
| Less: Tax @ 40% (40% of Rs.420.53)                                                                                          |              | <u>168.21</u>  |
| Future Maintainable Profit                                                                                                  |              | <u>252.32</u>  |
| 3. Valuation of Goodwill                                                                                                    |              | Rs. in lakhs   |
| (i) According to Capitalisation of Future Maintainable Profit Method                                                        |              |                |
| Capitalised value of Future Maintainable Profit                                                                             |              |                |
| $= \frac{256.28}{15} \times 100$                                                                                            |              | 1,682.13       |
| Less: Average capital employed                                                                                              |              | <u>1567.90</u> |
| Value of Goodwill                                                                                                           |              | <u>114.23</u>  |
| Or                                                                                                                          |              |                |
| (ii) According to Capitalisation of Super Profit Method                                                                     |              | Rs. In lakhs   |
| Future Maintainable Profit                                                                                                  |              | 252.32         |
| Less: Normal Profit @ 15% on average capital employed (1567.90 × 15%)                                                       |              | <u>235.19</u>  |
| Super Profit                                                                                                                |              | <u>17.13</u>   |
| Capitalised value of super profit $\frac{17.13}{15} \times 100$ i.e. Goodwill                                               |              | 114.2          |

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

## Valuation

|                                                                                    |                |
|------------------------------------------------------------------------------------|----------------|
| Leverage Effect on Goodwill                                                        | Rs. in lakhs   |
| Future Maintainable Profit on equity fund                                          | 252.32         |
| Future Maintainable Profit on Long-term Trading Capital employed                   |                |
| Future Maintainable Profit After Tax                                               | 252.32         |
| Add: Interest on Long-term Loan (Term Loan)                                        |                |
| (After considering Tax) $165 \times 18\% = 29.7 \times \frac{50}{100}$             | <u>14.85</u>   |
|                                                                                    | 267.17         |
| Average capital employed (Equity approach)                                         | 1567.90        |
| Add: 18% Term Loan $(180+165)/2$                                                   | <u>172.50</u>  |
| Average capital employed (Long-term Fund approach)                                 | <u>1740.40</u> |
| Value of Goodwill                                                                  |                |
| (A) Equity Approach                                                                |                |
| Capitalised value of Future Maintainable Profit = $\frac{252.32}{15} \times 100 =$ | 1682.13        |
| Less: Average capital employed                                                     | <u>1567.90</u> |
| Value of Goodwill                                                                  | <u>114.23</u>  |
| (B) Long-Term Fund Approach                                                        |                |
| Capitalised value of Future Maintainable Profit = $\frac{267.17}{12} \times 100 =$ | 2226.42        |
| Less: Average capital employed                                                     | <u>1740.40</u> |
| Value of Goodwill                                                                  | <u>486.02</u>  |

Comments on Leverage effect of Goodwill:

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

Working Notes:

|                                                                               |              |
|-------------------------------------------------------------------------------|--------------|
| (1) Stock adjustment                                                          | Rs. in lakhs |
| (i) Excess current cost of closing stock over its Historical cost (330 – 300) | 30.00        |
| (ii) Excess current cost of opening stock over its Historical cost (286-260)  | <u>26.00</u> |
| (iii) Difference [(i– ii)]                                                    | <u>4.00</u>  |

## Advanced Accounting

### (2) Debtors' adjustment

|                                                                                    |              |
|------------------------------------------------------------------------------------|--------------|
| (i) Value of foreign exchange debtors at the closing exchange rate (\$35,000×39)   | 13.65        |
| (ii) Value of foreign exchange debtors at the original exchange rate (\$35,000×35) | <u>12.25</u> |
| (iii) Difference [(i) – (ii)]                                                      | <u>1.40</u>  |

### (3) Creditors' adjustment

|                                                                                     |              |
|-------------------------------------------------------------------------------------|--------------|
| (i) Value of foreign exchange creditors at the closing exchange rate (\$60,000×39)  | 23.40        |
| (ii) Value of foreign exchange creditors at the original exchange rate(\$60,000×33) | <u>19.80</u> |
| (iii) Difference [(i) – (ii)]                                                       | <u>3.60</u>  |

## Question 8

The Balance Sheet of Domestic Ltd. as on 31<sup>st</sup> March, 2007 is as under:

(All figures are in lacs)

| Liabilities                                                | Rs.          | Assets                                                    | Rs.          |
|------------------------------------------------------------|--------------|-----------------------------------------------------------|--------------|
| Equity Shares Rs.10 each                                   | 3,000        | Goodwill                                                  | 744          |
| Reserves (including provision for taxation of Rs.300 lacs) | 1,000        | Premises and Land at cost                                 | 400          |
| 5% Debentures                                              | 2,000        | Plant and Machinery                                       | 3,000        |
| Secured Loans                                              | 200          | Motor Vehicles                                            | 40           |
| Sundry Creditors                                           | 300          | (purchased on 1.10.06)                                    |              |
| Profit & Loss A/c                                          |              | Raw materials at cost                                     | 920          |
| Balance from previous B/S Rs.32                            |              | Work-in-progress at cost                                  | 130          |
| Profit for the year (After taxation) <u>Rs.1,100</u>       | 1,132        | Finished Goods at cost                                    | 180          |
|                                                            |              | Book Debts                                                | 400          |
|                                                            |              | Investment (meant for replacement of Plant and Machinery) | 1,600        |
|                                                            |              | Cash at Bank and Cash in hand                             | 192          |
|                                                            |              | Discount on Debentures                                    | 10           |
|                                                            |              | Underwriting Commission                                   | <u>16</u>    |
|                                                            | <u>7,632</u> |                                                           | <u>7,632</u> |

The resale value of Premises and Land is Rs.1,200 lacs and that of Plant and Machinery is Rs.2,400 lacs. Depreciation @ 20% is applicable to Motor Vehicles. Applicable depreciation

## Valuation

on Premises and Land is 2%, and that on Plant and Machinery is 10%. Market value of the Investments is Rs.1,500 lacs. 10% of book debts is bad. In a similar company the market value of equity shares of the same denomination is Rs.25 per share and in such company dividend is consistently paid during last 5 years @ 20%. Contrary to this, Domestic Ltd. is having a marked upward or downward trend in the case of dividend payment.

Past 5 years' profits of the company were as under:

|         |                          |
|---------|--------------------------|
| 2001-02 | Rs.67 lacs               |
| 2002-03 | (-) Rs.1,305 lacs (loss) |
| 2003-04 | Rs.469 lacs              |
| 2004-05 | Rs.546 lacs              |
| 2005-06 | Rs.405 lacs              |

The unusual negative profitability of the company during 2002-03 was due to the lock out in the major manufacturing unit of the company which happened in the beginning of the second quarter of the year 2001-02 and continued till the last quarter of 2002-03.

Value the Goodwill of the Company on the basis of 4 years' purchase of the Super Profit. (Necessary assumption for adjustment of the Company's inconsistency in regard to the dividend payment, may be made by the examinee). (12 Marks) (Nov. 07)

Answer

### 1. Calculation of capital employed

|                                                                      |               |
|----------------------------------------------------------------------|---------------|
| Present value of assets:                                             | Rs. (in lacs) |
| Premises and land                                                    | 1,200         |
| Plant and machinery                                                  | 2,400         |
| Motor vehicles (book value less depreciation for $\frac{1}{2}$ year) | 36            |
| Raw materials                                                        | 920           |
| Work-in-progress                                                     | 130           |
| Finished goods                                                       | 180           |
| Book debts (400 x 90%)                                               | 360           |
| Investments                                                          | 1,500         |
| Cash at bank and in hand                                             | <u>192</u>    |
|                                                                      | 6,918         |
| Less: Liabilities:                                                   |               |
| Provision for taxation                                               | 300           |
| 5% Debentures                                                        | 2,000         |
| Secured loans                                                        | 200           |

## Advanced Accounting

|    |                                                                    |            |              |
|----|--------------------------------------------------------------------|------------|--------------|
|    | Sundry creditors                                                   | <u>300</u> | <u>2,800</u> |
|    | Total capital employed on 31.3.07                                  |            | <u>4,118</u> |
| 2. | Profit available for shareholders for the year 2006-07             |            |              |
|    | Profit for the year as per Balance Sheet                           |            | 1,100        |
|    | Less: Depreciation to be considered                                |            |              |
|    | Premises and land                                                  | 24*        |              |
|    | Plant & machinery                                                  | 240*       |              |
|    | Motor vehicles                                                     | <u>4</u>   | <u>268</u>   |
|    |                                                                    |            | 832          |
|    | Less: Bad debts                                                    |            | <u>40</u>    |
|    | Profit for the year 2006-07                                        |            | <u>792</u>   |
| 3. | Average capital employed                                           |            |              |
|    | Total capital employed                                             |            | 4118         |
|    | Less: $\frac{1}{2}$ of profit for the current year [Refer point 2] |            | <u>396</u>   |
|    | Average capital employed                                           |            | <u>3722</u>  |

Rs. (in lacs)

|    |                                                         |            |            |
|----|---------------------------------------------------------|------------|------------|
| 4. | Average profit to determine Future Maintainable Profits |            |            |
|    | Profit for the year 2006-07                             | 792        |            |
|    | Profit for the year 2005-06                             | 405        |            |
|    | Profit for the year 2004-05                             | 546        |            |
|    | Profit for the year 2003-04                             | <u>469</u> |            |
|    |                                                         | 2212 / 4   | <u>553</u> |

5. Calculation of General Expectation:
- Domestic Ltd. pays Rs.2 as dividend (20%) for each share of Rs.10.
- Market value of equity shares of the same denomination is Rs.25 which fetches dividend of 20%.
- Therefore, share of Rs.10 (Face value of shares of Domestic Ltd.) is expected to fetch  $(20/25) \times 10 = 8\%$  return.
- Since Domestic Ltd. is not having a stable record in payment of dividend, in its case

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\* Depreciation on premises and land and plant and machinery have been provided on the basis of assumption that the same has not been provided for earlier.

## Valuation

the expectation may be assumed to be slightly higher, say 10%.

|    |                                                                        |               |
|----|------------------------------------------------------------------------|---------------|
| 6. | Calculation of super profit                                            | Rs. (in lacs) |
|    | Future maintainable profit [See point 4]                               | 553           |
|    | Normal profit (10% of average capital employed as computed in point 3) | <u>372.2</u>  |
|    | Super Profit                                                           | <u>180.8</u>  |
| 7. | Valuation of Goodwill                                                  |               |
|    | Goodwill at 4 years' purchase of Super Profit                          | 723.20        |

Notes:

- (1) It is evident from the Balance Sheet that depreciation was not charged to Profit & Loss Account.
- (2) It is assumed that provision for taxation already made is sufficient.
- (3) While considering past profits for determining average profit, the years 2001-02 and 2002-03 have been left out, as during these years normal business was hampered.

Question 9

Write short Note on capital market information-P/E ratio, yield ratio and market value/book value of shares. (9 marks) (November, 1997)

Answer

Capital market information-P/E ratio, yield ratio and market value/book value of shares: Frequently share prices data are punched with the accounting data to generate new set of information. These are (i) Price-Earning Ratio, (ii) Yield Ratio, (iii) Market Value/Book Value per share.

$$\text{Price - Earnings Ratio (P/E Ratio)} = \frac{\text{Average Share Price}}{\text{EPS}}$$

(Sometimes it is also calculated with reference to closing share price)

$$\text{P/E Ratio} = \frac{\text{Closing Share Price}}{\text{EPS}}$$

It indicates the pay back period to the investors or prospective investors. The P/E ratio can be interpreted on a comparison with the industry P/E. A low P/E in comparison to the Industry can indicate that there are prospects for growth in share price and hence could be an indicator to buy/hold the shares. A high P/E ratio in comparison to the Industry can be an indicator to sell the shares.

$$\text{Yield} = \frac{\text{Dividend}}{\text{Average Share Price}} \times 100$$

## Advanced Accounting

$$\text{or } \frac{\text{Dividend}}{\text{Closing Share Price}} \times 100$$

This ratio indicates return on investment; this may be on average investment or closing investment. Dividend (%) indicates return on paid up value of shares. But yield (%) is the indicator of true return in which share capital is taken at its market value.

$$\frac{\text{Market Value per share}}{\text{Book Value per share}} = \frac{\text{Average Share Price}}{\text{Net Worth/No. of Equity Shares}}$$

$$\text{or } \frac{\text{Closing Share Price}}{\text{Net Worth/No. of Equity Shares}}$$

This ratio indicates market response of the shareholders' investment. Undoubtedly, higher the ratio, better is the shareholders' position in terms of return and capital gains.

### Question 10

Yogesh Ltd. showed the following performance over 5 years ended 31st March, 1997:

| Ended 31st March | *Net profit before tax |     | Prior period adjustment | Remarks                                 |
|------------------|------------------------|-----|-------------------------|-----------------------------------------|
|                  | Rs.                    |     | Rs.                     |                                         |
| 1993             | 4,00,000               | (-) | 1,00,000                | Relating to 1991-92                     |
| 1994             | 3,50,000               | (-) | 2,50,000                | Relating equally to 1991-92 and 1992-93 |
| 1995             | 6,50,000               | (+) | 1,50,000                | Relating to 1993-94                     |
| 1996             | 5,50,000               | (-) | 1,75,000                | Relating to 1993-94                     |
| 1997             | 6,00,000               | (-) | 1,00,000                | Relating to 1993-94                     |
|                  |                        | (+) | 25,000                  | Relating to 1995-96                     |

\*Net profit before tax is after debiting or crediting the figures of loss (-) or Gains (+) mentioned under the columns for prior period adjustments.

The net worth of the business as per the balance sheet of 31st March, 1992 is Rs. 6,00,000 backed by 10,000 fully paid equity shares of Rs. 10 each. Reserves and surplus constitute the balance net worth. Yogesh Ltd. has not declared any dividend till date.

You are asked to value equity shares on:

- (a) Yield basis as on 31.3.1997 : Assuming:
  - (i) 40% rate of tax
  - (ii) anticipated after tax yield of 20%.
  - (iii) differential weightage of 1 to 5 being given for the five years starting on 1.4.1992 for the actual profits of the respective years.
- (b) Net asset basis as per corrected balance sheets for each of the six years ended 31.3.1997.



## Valuation

Looking to the performance of the company over the 5 years period, would you invest in the company?  
(15 marks) (May, 1997)

Answer

(a) Valuation of Shares on Yield basis  
as on 31st March, 1997

| Year ended | Profits  | Adjustments |          | Revised  | Tax       | After tax | Weight    | Weighted         |
|------------|----------|-------------|----------|----------|-----------|-----------|-----------|------------------|
| 31st March | as given | Increase    | Decrease | Profits  | Provision | Profits   |           | profits          |
|            | Rs.      | Rs.         | Rs.      | Rs.      | Rs.       | Rs.       |           | Rs.              |
| 1993       | 4,00,000 | 1,00,000    | 1,25,000 | 3,75,000 | 1,50,000  | 2,25,000  | 1         | 2,25,000         |
| 1994       | 3,50,000 | 2,50,000    | 1,00,000 | 4,75,000 | 1,90,000  | 2,85,000  | 2         | 5,70,000         |
|            |          | 1,50,000    | 1,75,000 |          |           |           |           |                  |
| 1995       | 6,50,000 | Nil         | 1,50,000 | 5,00,000 | 2,00,000  | 3,00,000  | 3         | 9,00,000         |
| 1996       | 5,50,000 | 1,75,000    | Nil      | 7,50,000 | 3,00,000  | 4,50,000  | 4         | 18,00,000        |
|            |          | 25,000      |          |          |           |           |           |                  |
| 1997       | 6,00,000 | 1,00,000    | 25,000   | 6,75,000 | 2,70,000  | 4,05,000  | <u>5</u>  | <u>20,25,000</u> |
|            |          |             |          |          |           |           | <u>15</u> | <u>55,20,000</u> |

$$\text{Weighted average profit (after tax)} = \frac{\text{Rs. } 55,20,000}{15} = \text{Rs. } 3,68,000$$

$$\text{Value of business} = \frac{\text{Rs. } 3,68,000}{20\%} = \text{Rs. } 18,40,000$$

$$\text{Value of equity share} = \frac{\text{Rs. } 18,40,000}{10,000} = \text{Rs. } 184$$

(b) Valuation of Shares on Net Asset Basis

|      |                                          |                          |                 |
|------|------------------------------------------|--------------------------|-----------------|
| (i)  | Revised Net worth as on 31st March, 1992 | Rs.                      | Rs.             |
|      | Net worth                                |                          | 6,00,000        |
|      | Less: Adjustments since made during      |                          |                 |
|      | 1992-93                                  | 1,00,000                 |                 |
|      | 1993-94                                  | <u>1,25,000</u>          |                 |
|      |                                          | 2,25,000                 |                 |
|      | Less: Relief from tax @ 40%              | <u>90,000</u>            |                 |
|      |                                          |                          | <u>1,35,000</u> |
|      |                                          |                          | <u>4,65,000</u> |
| (ii) | Net asset value                          | (No. of shares = 10,000) |                 |
|      | As on 31st March                         | Rs.                      | Rs.             |
|      | 1992: Revised net worth                  | 4,65,000                 |                 |

### Advanced Accounting

|       |                                           |                  |        |
|-------|-------------------------------------------|------------------|--------|
|       | Value per share                           |                  | 46.50  |
| 1993: | Revised net worth as on 31.3.1992         | 4,65,000         |        |
|       | Add: After tax revised profits of 1992-93 | <u>2,25,000</u>  |        |
|       | Net worth as on 31.3.1993                 | <u>6,90,000</u>  |        |
|       | Value per share                           |                  | 69.00  |
| 1994: | Revised net worth as on 31.3.1993         | 6,90,000         |        |
|       | Add: After tax revised profits of 1993-94 | <u>2,85,000</u>  |        |
|       | Net worth as on 31.3.1994                 | <u>9,75,000</u>  |        |
|       | Value per share                           |                  | 97.50  |
| 1995: | Revised net worth as on 31.3.1994         | 9,75,000         |        |
|       | Add: After tax revised profits of 1994-95 | <u>3,00,000</u>  |        |
|       | Net worth as on 31.3.1995                 | <u>12,75,000</u> |        |
|       | Value per share                           |                  | 127.50 |
| 1996: | Revised net worth as on 31.3.1995         | 12,75,000        |        |
|       | Add: After tax revised profits of 1995-96 | <u>4,50,000</u>  |        |
|       | Net worth as on 31.3.1996                 | <u>17,25,000</u> |        |
|       | Value per share                           |                  | 172.50 |
| 1997: | Revised net worth as on 31.3.1996         | 17,25,000        |        |
|       | Add: After tax revised profits of 1996-97 | <u>4,05,000</u>  |        |
|       | Net worth as on 31.3.1997                 | <u>21,30,000</u> |        |
|       | Value per share                           |                  | 213.00 |

### Performance Appraisal

| Revised net worth as on 31st March |           | Profit during the year ended 31st March |          | Return on net worth |
|------------------------------------|-----------|-----------------------------------------|----------|---------------------|
|                                    | Rs.       |                                         | Rs.      | %                   |
| 1992                               | 4,65,000  | 1993                                    | 2,25,000 | 48.39               |
| 1993                               | 6,90,000  | 1994                                    | 2,85,000 | 41.30               |
| 1994                               | 9,75,000  | 1995                                    | 3,00,000 | 30.77               |
| 1995                               | 12,75,000 | 1996                                    | 4,50,000 | 35.29               |
| 1996                               | 17,25,000 | 1997                                    | 4,05,000 | 23.48               |

## Valuation

The company's return has fallen from 48.39% to 23.48%. This may be perhaps due to the fact that the company has been ploughing back its profits without having adequate reinvestment opportunities. Unless the company has profitable investment opportunities, it may not be advisable to invest in the company.

Note: Return on net worth may also be calculated on the basis of average net worth during the relevant year.

### Question 11

Capital structure of Lot Ltd. as at 31.3.1998 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:

- (a) Profit after tax covers fixed interest and fixed dividends at least 3 times.
- (b) Capital gearing ratio is .75.
- (c) 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. (15 marks)(November, 1998)

### Answer

|      |                                                                 |                 |
|------|-----------------------------------------------------------------|-----------------|
| (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> |

## Advanced Accounting

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

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

### (iii) Capital gearing ratio:

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

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

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

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> | <u>1,50,000</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

## Valuation

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.

### Question 12

The Balance Sheet of RNR Limited as on 31.12.1999 is as follows :

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

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

After tax, profits and dividend rates were as follows :

| Year | PAT<br>(Rs. in Lakhs) | Dividend % |
|------|-----------------------|------------|
| 1996 | 3.0                   | 11%        |
| 1997 | 3.5                   | 12%        |
| 1998 | 4.0                   | 13%        |
| 1999 | 4.1                   | 14%        |

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

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

- (i) Determine the break-up value and market value of both kinds of shares. (6 marks)
- (ii) What should be the fair value of shares, if controlling interest is being sold ?

(10 marks) (May 2001)

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Answer

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

Market value of shares :

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

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

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

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

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

Market value of shares :

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

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

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

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

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

\* (Transfer to reserves has been ignored)

Working Notes:

(Rs. in lakhs)

- (a) Calculation of average capital employed  
Fixed assets

24.00

## Valuation

|                                                                    |          |              |
|--------------------------------------------------------------------|----------|--------------|
| Other tangible assets                                              |          | 3.00         |
| Intangible assets                                                  |          | <u>3.00</u>  |
|                                                                    |          | 30.00        |
| Less : Liabilities                                                 | 10       |              |
| Bonus                                                              | <u>1</u> | <u>11.00</u> |
|                                                                    |          | 19.00        |
| Less : $\frac{1}{2}$ of profits [ $\frac{1}{2}$ (4.1 – Bonus 1.0)] |          | <u>1.55</u>  |
| Average capital employed                                           |          | <u>17.45</u> |

(b) Calculation of super profit

|                      |                                                         |              |
|----------------------|---------------------------------------------------------|--------------|
| Average profit       | $= \frac{1}{4} (3 + 3.5 + 4 + 4.1 - \text{Bonus } 1.0)$ |              |
|                      | $= \frac{1}{4} \times 13.6$                             | 3.400        |
| Less : Normal profit | $= 10 \% \text{ of Rs. } 17.45 \text{ lakhs}$           | <u>1.745</u> |
| Super profit         |                                                         | <u>1.655</u> |

(c) Calculation of goodwill

|                                           |                                                                     |
|-------------------------------------------|---------------------------------------------------------------------|
| 3 Years' purchase of average super-profit | $= 3 \times 1.655 = \text{Rs. } 4.965 \text{ lakhs}$                |
| Increase in value of goodwill             | $= \frac{1}{2} (\text{book value} + 3 \text{ years' super profit})$ |
|                                           | $= \frac{1}{2} (5 + 4.965)$                                         |
|                                           | $= \text{Rs. } 4.9825 \text{ lakhs}$                                |

|                                          |              |
|------------------------------------------|--------------|
| Net assets as revalued including         |              |
| book value of goodwill                   | 24.00        |
| Add : Increase in goodwill (rounded-off) | <u>4.98</u>  |
| Net assets available for shareholders    | <u>28.98</u> |

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

### Question 13

Following are the information of two companies for the year ended 31st March, 2002 :

| Particulars                     | Company A | Company B |
|---------------------------------|-----------|-----------|
| Equity Shares of Rs. 10 each    | 8,00,000  | 10,00,000 |
| 10% Pref. Shares of Rs. 10 each | 6,00,000  | 4,00,000  |
| Profit after tax                | 3,00,000  | 3,00,000  |

Assume the Market expectation is 18% and 80% of the Profits are distributed.

(i) What is the rate you would pay to the Equity Shares of each Company ?

(a) If you are buying a small lot.

### Advanced Accounting

- (b) If you are buying controlling interest shares.
- (ii) If you plan to invest only in preference shares which company's preference shares would you prefer ?
- (iii) Would your rates be different for buying small lot, if the company 'A' retains 30% and company 'B' 10% of the profits? (12 marks) (November, 2002)

Answer

- (i) (a) Buying a small lot of equity shares: If the purpose of valuation is to provide data base to aid a decision of buying a small (non-controlling) position of the equity of the companies, dividend capitalisation method is most appropriate. Under this method, value of equity share is given by:

$$\frac{\text{Dividend per share}}{\text{Market capitalisation rate}} \times 100$$

$$\text{Company A : Rs. } \frac{2.4}{18} \times 100 = \text{Rs. } 13.33$$

$$\text{Company B : Rs. } \frac{208}{18} \times 100 = \text{Rs. } 11.56$$

- (b) Buying controlling interest equity shares

If the purpose of valuation is to provide data base to aid a decision of buying controlling interest in the company, EPS capitalisation method is most appropriate. Under this method, value of equity is given by:

$$\frac{\text{Earning per share (EPS)}}{\text{Market capitalisation rate}} \times 100$$

$$\text{Company A : Rs. } \frac{3}{18} \times 100 = \text{Rs. } 16.67$$

$$\text{Company B : Rs. } \frac{2.6}{18} \times 100 = \text{Rs. } 14.44$$

- (ii) Preference Dividend coverage ratios of both companies are to be compared to make such decision.

Preference dividend coverage ratio is given by:

$$\frac{\text{Profit after tax}}{\text{Preference Dividend}} \times 100$$

$$\text{Company A : } \frac{\text{Rs. } 3,00,000}{\text{Rs. } 60,000} = 5 \text{ times}$$

$$\text{Company B : } \frac{\text{Rs. } 3,00,000}{\text{Rs. } 40,000} = 7.5 \text{ times}$$

If we are planning to invest only in preference shares, we would prefer shares of B Company



## Valuation

as there is more coverage for preference dividend.

- (iii) Yes, the rates will be different for buying a small lot of equity shares, if the company 'A' retains 30% and company 'B' 10% of profits.

The new rates will be calculated as follows:

$$\text{Company A : Rs. } \frac{2.1}{18} \times 100 = \text{Rs. } 11.67$$

$$\text{Company B : Rs. } \frac{2.34}{18} \times 100 = \text{Rs. } 13.00$$

Working Notes:

1. Computation of earning per share and dividend per share (companies distribute 80% of profits)

|                                               | Company A       | Company B       |
|-----------------------------------------------|-----------------|-----------------|
| Profit before tax                             | 3,00,000        | 3,00,000        |
| Less: Preference dividend                     | <u>60,000</u>   | <u>40,000</u>   |
| Earnings available to equity shareholders (A) | <u>2,40,000</u> | <u>2,60,000</u> |
| Number of Equity Shares (B)                   | 80,000          | 1,00,000        |
| Earning per share (A/B)                       | 3.0             | 2.60            |
| Retained earnings 20%                         | 48,000          | 52,000          |
| Dividend declared 80% (C)                     | 1,92,000        | 2,08,000        |
| Dividend per share (C/B)                      | 2.40            | 2.08            |

2. Computation of dividend per share (Company A retains 30% and Company B 10% of profits)

|                                            |          |          |
|--------------------------------------------|----------|----------|
| Earnings available for Equity Shareholders | 2,40,000 | 2,60,000 |
| Number of Equity Shares                    | 80,000   | 1,00,000 |
| Retained Earnings                          | 72,000   | 26,000   |
| Dividend Distribution                      | 1,68,000 | 2,34,000 |
| Dividend per share                         | 2.10     | 2.34     |

### Question 14

The following is the Balance Sheet of N Ltd. as on 31st March, 2002:

| Balance Sheet                                    |           |          |           |
|--------------------------------------------------|-----------|----------|-----------|
| Liabilities                                      | Rs.       | Assets   | Rs.       |
| 4,00,000 Equity shares of Rs. 10 each fully paid | 40,00,000 | Goodwill | 4,00,000  |
|                                                  |           | Building | 24,00,000 |

## Advanced Accounting

|                                                               |                    |                      |                    |
|---------------------------------------------------------------|--------------------|----------------------|--------------------|
| 13.5% Redeemable preference shares of Rs. 100 each fully paid | 20,00,000          | Machinery            | 22,00,000          |
| General Reserve                                               | 16,00,000          | Furniture            | 10,00,000          |
| Profit and Loss Account                                       | 3,20,000           | Vehicles             | 18,00,000          |
| Bank Loan (Secured against fixed assets)                      | 12,00,000          | Investments          | 16,00,000          |
| Bills Payable                                                 | 6,00,000           | Stock                | 11,00,000          |
| Creditors                                                     | 31,00,000          | Debtors              | 18,00,000          |
|                                                               |                    | Bank Balance         | 3,20,000           |
|                                                               |                    | Preliminary Expenses | 2,00,000           |
|                                                               | <u>1,28,20,000</u> |                      | <u>1,28,20,000</u> |

Further information:

- Return on capital employed is 20% in similar businesses.
- Fixed assets are worth 30% more than book value. Stock is overvalued by Rs. 1,00,000, Debtors are to be reduced by Rs. 20,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.
- Trade investments were purchased on 1.4.2001. 50% of non-Trade Investments were purchased on 1.4.2000 and the rest on 1.4.1999. Non-Trade Investments yielded 15% return on cost.
- In 1999-2000 new machinery costing Rs. 2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.
- In 2000-2001 furniture with a book value of Rs. 1,00,000 was sold for Rs. 60,000.
- For calculating goodwill two years purchase of super profits based on simple average profits of last four years are to be considered. Profits of last four years are as under:  
1998-1999 Rs. 16,00,000, 1999-2000 Rs. 18,00,000, 2000-2001 Rs. 21,00,000, 2001-2002 Rs. 22,00,000.
- Additional depreciation provision at the rate of 10% on the additional value of Plant and Machinery alone may be considered for arriving at average profit.

Find out the intrinsic value of the equity share. Income-tax and Dividend tax are not to be considered. (16 marks)(May 2003)

Answer

Calculation of intrinsic value of equity shares of N Ltd.

### 1. Calculation of Goodwill

#### (i) Capital employed

| Fixed Assets                             | Rs.       | Rs. |
|------------------------------------------|-----------|-----|
| Building                                 | 24,00,000 |     |
| Machinery (Rs. 22,00,000 + Rs. 1,45,800) | 23,45,800 |     |

## Valuation

|                                                          |                  |                  |                  |                  |
|----------------------------------------------------------|------------------|------------------|------------------|------------------|
| Furniture                                                | 10,00,000        |                  |                  |                  |
| Vehicles                                                 | <u>18,00,000</u> |                  |                  |                  |
|                                                          | 75,45,800        |                  |                  |                  |
| Add: 30% increase                                        | <u>22,63,740</u> |                  |                  |                  |
|                                                          | 98,09,540        |                  |                  |                  |
| Trade investments (Rs.16,00,000 × 10% × 90%)             | 1,44,000         |                  |                  |                  |
| Debtors (Rs. 18,00,000 – Rs. 20,000)                     | 17,80,000        |                  |                  |                  |
| Stock (Rs. 11,00,000 – Rs. 1,00,000)                     | 10,00,000        |                  |                  |                  |
| Bank balance                                             | <u>3,20,000</u>  | 1,30,53,540      |                  |                  |
| Less: Outside liabilities                                |                  |                  |                  |                  |
| Bank Loan                                                | 12,00,000        |                  |                  |                  |
| Bills payable                                            | 6,00,000         |                  |                  |                  |
| Creditors                                                | <u>31,00,000</u> | <u>49,00,000</u> |                  |                  |
| Capital employed                                         |                  | <u>81,53,540</u> |                  |                  |
| (ii) Future maintainable profit                          |                  |                  |                  |                  |
| Calculation of average profit                            |                  |                  |                  |                  |
|                                                          | 1998-99          | 1999-2000        | 2000-2001        | 2001-2002        |
|                                                          | Rs.              | Rs.              | Rs.              | Rs.              |
| Profit given                                             | 16,00,000        | 18,00,000        | 21,00,000        | 22,00,000        |
| Add: Capital expenditure of machinery charged to revenue |                  | 2,00,000         |                  |                  |
| Loss on sale of furniture                                | <u>        </u>  | <u>        </u>  | <u>40,000</u>    | <u>        </u>  |
|                                                          | 16,00,000        | 20,00,000        | 21,40,000        | 22,00,000        |
| Less: Depreciation on machinery                          |                  | 20,000           | 18,000           | 16,200           |
| Income from non-trade investments                        |                  | 1,08,000         | 2,16,000         | 2,16,000         |
| Reduction in value of stock                              |                  |                  |                  | 1,00,000         |
| Bad debts                                                | <u>        </u>  | <u>        </u>  | <u>        </u>  | <u>20,000</u>    |
| Adjusted profit                                          | <u>16,00,000</u> | <u>18,72,000</u> | <u>19,06,000</u> | <u>18,47,800</u> |

## Advanced Accounting

|                                                                                                                 |                  |                  |
|-----------------------------------------------------------------------------------------------------------------|------------------|------------------|
|                                                                                                                 |                  | Rs.              |
| Total adjusted profit for four years (1998-1999 to 2001-2002)                                                   |                  | 72,25,800        |
| Average profit (Rs. 72,25,800/4)                                                                                |                  | 18,06,450        |
| Less: Depreciation at 10% on additional value of machinery<br>(22,00,000 + 1,45,800) × 30/100 i.e. Rs. 7,03,740 |                  | <u>70,374</u>    |
| Adjusted average profit                                                                                         |                  | <u>17,36,076</u> |
| (iii) Normal Profit                                                                                             |                  |                  |
| 20% on capital employed i.e. 20% on Rs. 81,53,540                                                               |                  | Rs.16,30,708     |
| (iv) Super profit                                                                                               |                  |                  |
| Expected profit – normal profit                                                                                 |                  |                  |
| Rs. 17,36,076 – Rs. 16,30,708 = Rs. 1,05,368                                                                    |                  |                  |
| (v) Goodwill                                                                                                    |                  |                  |
| 2 years' purchase of super profit                                                                               |                  |                  |
| Rs. 1,05,368 × 2 = Rs. 2,10,736                                                                                 |                  |                  |
| 2. Net assets available to equity shareholders                                                                  |                  |                  |
|                                                                                                                 | Rs.              | Rs.              |
| Goodwill as calculated in 1(v) above                                                                            |                  | 2,10,736         |
| Sundry fixed assets                                                                                             |                  | 98,09,540        |
| Trade and Non-trade investments                                                                                 |                  | 15,84,000        |
| Debtors                                                                                                         |                  | 17,80,000        |
| Stock                                                                                                           |                  | 10,00,000        |
| Bank balance                                                                                                    |                  | <u>3,20,000</u>  |
|                                                                                                                 |                  | 1,47,04,276      |
| Less: Outside liabilities                                                                                       |                  |                  |
| Bank loan                                                                                                       | 12,00,000        |                  |
| Bills payable                                                                                                   | 6,00,000         |                  |
| Creditors                                                                                                       | <u>31,00,000</u> | 49,00,000        |
| Preference share capital                                                                                        |                  | <u>20,00,000</u> |
| Net assets for equity shareholders                                                                              |                  | <u>78,04,276</u> |

## Valuation

### 3. Valuation of equity shares

$$\begin{aligned}\text{Value of equity share} &= \frac{\text{Net assets available to equity shareholders}}{\text{Number of equity shares}} \\ &= \frac{\text{Rs. 78,04,276}}{4,00,000} \\ &= \text{Rs. 19.51}\end{aligned}$$

Note:

1. Depreciation on the overall increased value of assets (worth 30% more than book value) has not been considered. Depreciation on the additional value of only plant and machinery has been considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.
2. Loss on sale of furniture has been taken as non-recurring or extraordinary item.
3. It has been assumed that preference dividend has been paid till date.

### Question 15

The Capital Structure of M/s XYZ Ltd., on 31st March, 2003 was as follows:

|                                                         | Rs.       |
|---------------------------------------------------------|-----------|
| Equity Capital                                          | 18,00,000 |
| 12% Preference Capital                                  | 5,00,000  |
| 12% Secured Debentures                                  | 5,00,000  |
| Reserves                                                | 5,00,000  |
| Profit earned before Interest and Taxes during the year | 7,20,000  |
| Tax Rate                                                | 40%       |

Generally the return on equity shares of this type of Industry is 15%.

Subject to:

- (a) The profit after tax covers Fixed Interest and Fixed Dividends at least 4 times.
- (b) The Debt Equity ratio is at least 2;
- (c) Yield on shares is calculated at 60% of distributed profits and 10% of undistributed profits;

The Company has been paying regularly an Equity dividend of 15%.

The risk premium for Dividends is generally assumed at 1%.

Find out the value of Equity shares of the Company. (16 marks)(November, 2004)

## Advanced Accounting

Answer

|                                                                                       |                 |
|---------------------------------------------------------------------------------------|-----------------|
| Calculation of profit after tax (PAT)                                                 | Rs.             |
| Profit before interest & tax (PBIT)                                                   | 7,20,000        |
| Less: Debenture interest (Rs. 5,00,000 × 12/100)                                      | <u>60,000</u>   |
| Profit before tax (PBT)                                                               | 6,60,000        |
| Less: Tax @ 40%                                                                       | <u>2,64,000</u> |
| Profit after tax (PAT)                                                                | 3,96,000        |
| Less: Preference dividend $\left( \text{Rs. } 5,00,000 \times \frac{12}{100} \right)$ | 60,000          |
| Equity dividend $\left( \text{Rs. } 18,00,000 \times \frac{15}{100} \right)$          | <u>2,70,000</u> |
| Retained earnings (undistributed profit)                                              | <u>3,30,000</u> |
|                                                                                       | <u>66,000</u>   |

Calculation of Interest and Fixed Dividend Coverage

$$\begin{aligned} &= \frac{\text{PAT} + \text{Debenture interest}}{\text{Debenture interest} + \text{Preference dividend}} \\ &= \frac{\text{Rs. } 3,96,000 + 60,000}{\text{Rs. } 60,000 + 60,000} \\ &= \frac{\text{Rs. } 4,56,000}{\text{Rs. } 1,20,000} = 3.8 \text{ times} \end{aligned}$$

Calculation of Debt Equity Ratio

$$\begin{aligned} \text{Debt Equity Ratio} &= \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}} \\ &= \frac{\text{Debentures}}{\text{Preference share capital} + \text{Equity share capital} + \text{Reserves}} \\ &= \frac{\text{Rs. } 5,00,000}{\text{Rs. } 5,00,000 + 18,00,000 + 5,00,000} \\ \text{Debt Equity Ratio} &= \frac{\text{Rs. } 5,00,000}{\text{Rs. } 28,00,000} = .179 \end{aligned}$$

The ratio is less than the prescribed ratio.

Calculation of Yield on Equity Shares

Yield on equity shares is calculated at 60% of distributed profits and 10% of undistributed

## Valuation

profits:

|                                                  |                 |
|--------------------------------------------------|-----------------|
| 60% of distributed profits (60% of Rs. 2,70,000) | 1,62,000        |
| 10% of undistributed profits (10% of Rs. 66,000) | <u>6,600</u>    |
|                                                  | <u>1,68,600</u> |

$$\begin{aligned}
 \text{Yields on equity shares} &= \frac{\text{Yield on shares}}{\text{Equity share capital}} \times 100 \\
 &= \frac{\text{Rs. 1,68,600}}{\text{Rs. 18,00,000}} \times 100 \\
 &= 9.37\%
 \end{aligned}$$

Calculation of Expected Yield on Equity Shares

|                                                                          |              |
|--------------------------------------------------------------------------|--------------|
| Normal return expected                                                   | 15%          |
| Add: Risk premium for low interest and fixed dividend coverage (3.8 < 4) | 1%*          |
| Risk for debt equity ratio not required                                  | <u>Nil**</u> |
|                                                                          | <u>16%</u>   |

Value of an Equity Share

$$\begin{aligned}
 &= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid up value of a share} \\
 &= \frac{9.37}{16} \times 100 = \text{Rs. 58.56}
 \end{aligned}$$

- \* When interest and fixed dividend coverage is lower than the prescribed norm, the riskiness of equity investors is high. They should claim additional risk premium over and above the normal rate of return. Hence, the additional risk premium of 1% has been added.
- \*\* The debt equity ratio is lower than the prescribed ratio, that means outside funds (Debts) are lower as compared to shareholders' funds. Therefore, the risk is less for equity shareholders. Therefore, no risk premium is required to be added in this case.

### Question 16

The following abridged Balance Sheet as at 31st March, 2005 pertains to Glorious Ltd.

| Liabilities                                          | Rs. in lakhs | Assets             | Rs. in lakhs |
|------------------------------------------------------|--------------|--------------------|--------------|
| Share Capital:                                       |              | Goodwill, at cost  | 420          |
| 180 lakh Equity shares of Rs. 10 each, fully paid up | 1,800        | Other Fixed Assets | 11,166       |
|                                                      |              | Current Assets     | 2,910        |
| 90 lakh Equity shares of Rs. 10                      |              | Loans and Advances | 933          |

### Advanced Accounting

|                                                     |               |                           |               |
|-----------------------------------------------------|---------------|---------------------------|---------------|
| each, Rs. 8 paid up                                 | 720           | Miscellaneous Expenditure | 171           |
| 150 lakh Equity shares of Rs. 5 each, fully paid-up | 750           |                           |               |
| Reserves and Surplus                                | 5,628         |                           |               |
| Secured Loans                                       | 4,500         |                           |               |
| Current Liabilities                                 | 1,242         |                           |               |
| Provisions                                          | <u>960</u>    |                           |               |
|                                                     | <u>15,600</u> |                           | <u>15,600</u> |

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

- Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;
- Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industry is 15%, whereas Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

- Value per share on the basis of EPS.

For the year ended 31st March, 2005 the company has earned Rs. 1,371 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of Rs. 10 of a Company in the same industry is Rs. 2.

(16 Marks) (November. 2005)

### Answer

|                                                                |              |              |
|----------------------------------------------------------------|--------------|--------------|
| (i) Intrinsic value on the basis of book values                | Rs. in lakhs | Rs. in lakhs |
| Goodwill                                                       |              | 420          |
| Other Fixed Assets                                             |              | 11,166       |
| Current Assets                                                 |              | 2,910        |
| Loans and Advances                                             |              | <u>933</u>   |
|                                                                |              | 15,429       |
| Less: Secured loans                                            | 4,500        |              |
| Current liabilities                                            | 1,242        |              |
| Provisions                                                     | <u>960</u>   | <u>6,702</u> |
|                                                                |              | 8,727        |
| Add: Notional call on 90 lakhs equity shares @ Rs. 2 per share |              | <u>180</u>   |
|                                                                |              | <u>8,907</u> |



## Valuation

Equivalent number of equity shares of Rs. 10 each.

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

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

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

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

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

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

(ii) Valuation on dividend yield basis:

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

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

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

(iii) Valuation on the basis of EPS:

Profit after tax = Rs. 1,371 lakhs

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

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

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

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

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

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

## Advanced Accounting

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

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

### Question 17

The directors of a public limited company are considering the acquisition of the entire share capital of an existing company X Ltd engaged in a line of business suited to them. The directors feel that acquisition of X will not create any further risk to their business interest.

The following is the Balance Sheet of X Ltd., as at 31<sup>st</sup> December, 2005:

| Liabilities                                      | Rs.              | Assets                 | Rs.              |
|--------------------------------------------------|------------------|------------------------|------------------|
| Share Capital:                                   |                  | Fixed assets           | 6,00,000         |
| 4,000 equity shares of Rs.100 each fully paid-up | 4,00,000         | Current assets:        |                  |
| General reserve                                  | 3,00,000         | Stock                  | 2,00,000         |
| Bank overdraft                                   | 2,40,000         | Sundry debtors         | 3,40,000         |
| Sundry creditors                                 | <u>3,00,000</u>  | Cash and bank balances | 1,00,000         |
|                                                  | <u>12,40,000</u> |                        | <u>12,40,000</u> |

X's financial records for the past five years were as under:

|                        | 2005          | 2004          | 2003           | 2002           | 2001          |
|------------------------|---------------|---------------|----------------|----------------|---------------|
|                        | Rs.           | Rs.           | Rs.            | Rs.            | Rs.           |
| Profits                | 80,000        | 74,000        | 70,000         | 60,000         | 62,000        |
| Extra ordinary item(s) | <u>3,500</u>  | <u>4,000</u>  | <u>(6,000)</u> | <u>(8,000)</u> | <u>1,000</u>  |
|                        | 83,500        | 78,000        | 64,000         | 52,000         | 61,000        |
| Dividends              | <u>48,000</u> | <u>40,000</u> | <u>40,000</u>  | <u>32,000</u>  | <u>32,000</u> |
|                        | <u>35,500</u> | <u>38,000</u> | <u>24,000</u>  | <u>20,000</u>  | <u>29,000</u> |

Additional information:

- There were no changes in the issued capital of X during this period.
- The estimated values of X Ltd.'s assets on 31.12.2005 are:

## Valuation

|              | Replacement cost<br>Rs. | Realisable value<br>Rs. |
|--------------|-------------------------|-------------------------|
| Fixed assets | 8,00,000                | 5,40,000                |
| Stock        | 3,00,000                | 3,20,000                |

- (iii) It is anticipated that 1% of the debtors may prove to be difficult to be realized.
- (iv) The cost of capital to the acquiring company is 10%.
- (v) The current return of an investment of the acquiring company is 10%. Quoted companies with similar businesses and activities as X have a P/E ratio approximating to 8, although these companies tend to be larger than X.

Required:

Estimate the value of the total equity capital of X Ltd., on 31.12.2005 using each of the following bases:

- (a) Balance sheet value
- (b) Replacement cost
- (c) Realisable value
- (d) Gordon's dividend growth model
- (e) P/E ratio model.

(16 Marks)( May, 2006)

Answer

|     |                        | Rs.             | Rs.                       |
|-----|------------------------|-----------------|---------------------------|
| (a) | Balance Sheet Value    |                 |                           |
|     | Capital                | 4,00,000        |                           |
|     | Reserve                | <u>3,00,000</u> | 7,00,000                  |
| (b) | Replacement cost value |                 |                           |
|     | Capital                | 4,00,000        |                           |
|     | Reserve                | 3,00,000        |                           |
|     | Appreciation:          |                 |                           |
|     | Fixed assets           | 2,00,000        |                           |
|     | Stock                  | <u>1,00,000</u> | <u>3,00,000</u> 10,00,000 |
| (c) | Realizable value       |                 |                           |
|     | Capital                | 4,00,000        |                           |
|     | Reserve                | 3,00,000        |                           |
|     | Appreciation in stock  | 1,20,000        |                           |

## Advanced Accounting

|                              |                |          |
|------------------------------|----------------|----------|
| Depreciation in fixed assets | (60,000)       |          |
| Book debts (Bad)*            | <u>(3,400)</u> | 7,56,600 |

### (d) Gordon's dividend growth model

The formula to be used is  $P = \frac{E(1-b)}{k-br}$

Where

- P Price of share
- E Earning per share
- b retention ratio
- k cost of capital
- br growth rate
- r rate of return on investment.

Profits retained: Rs.35,500 + 38,000 + 24,000 + 20,000 + 29,000 = Rs. 1,46,500

Profits earned: Rs.83,500 + 78,000 + 64,000 + 52,000 + 61,000 = Rs. 3,38,500

Retention ratio:  $\frac{\text{Rs.1,46,500}}{\text{Rs.3,38,500}} = 0.43$

$$\begin{aligned} \text{Return on investment for the year 2005} &= \frac{\text{Rs.80,000}}{4,00,000 + 3,00,000 + \frac{1}{2} \text{ of } 35,500} \times 100 \\ &= \frac{80,000}{7,17,750} \times 100 = 11.14 \end{aligned}$$

$$\begin{aligned} \text{Growth rate} &= \text{Return on investment} \times \text{retention ratio} \\ &= 11.14 \times 0.43 = 4.79 \% \end{aligned}$$

$$\text{Average profits} = \frac{\text{Rs.3,38,500}}{5} = \text{Rs.67,700}$$

$$\text{Market value} = \frac{\text{Rs.67,700}(1-.43)}{0.10 - 0.0479} = \frac{\text{Rs.67,700} \times 0.57}{.0521} = \text{Rs.7,40,672 (approx.)}$$

### (e) P/E ratio model

Comparable quoted companies have a P/E ratio of 8. X Ltd. is prima facie small company.

If a P/E ratio of 6 is adopted, the valuation will be  $80,000 \times 6 = \text{Rs.4,80,000}$

If a P/E ratio of 7 were to be adopted, the valuation will be  $80,000 \times 7 = \text{Rs.5,60,000}$

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\* It has been assumed that estimated bad debts would not be relevant for estimating values under bases (a) and (b).

## Valuation

### Question 18

P Limited is considering the acquisition of R Limited. The financial data at the time of acquisition being:

|                                     | P Limited | R Limited |
|-------------------------------------|-----------|-----------|
| Net profit after tax (Rs. in lakhs) | 60        | 12        |
| Number of shares (lakhs)            | 12        | 5         |
| Earning per share (Rs.)             | 5         | 2.40      |
| Market price per share (Rs.)        | 150       | 48        |
| Price earning ratio                 | 30        | 20        |

It is expected that the net profit after tax of the two companies would continue to be Rs.72 lakhs even after the amalgamation.

Explain the effect on EPS of the merged company under each of the following situations:

- (i) P Ltd. offers to pay Rs.60 per share to the shareholders of R Ltd.
- (ii) P Ltd. offers to pay Rs.78 per share to the shareholders of R Ltd.

The amount in both cases is to be paid in the form of shares of P Ltd.

(10 marks) (November 2006)

### Answer

- (i) In this case, P Ltd. offers to pay Rs.60 per share.

The share exchange ratio would be  $\frac{60}{150} = 0.4$

It means, P Ltd. would give 0.4 shares for every one share of R Ltd. In other words, P Ltd. would give 2 shares for 5 shares of R Ltd.

The total number of shares to be issued by P Ltd. to R Ltd.

$$= 5,00,000 \times 0.4 = 2,00,000 \text{ shares}$$

or

$$5,00,000 \times \frac{2}{5} = 2,00,000 \text{ shares}$$

Total number of shares of P Ltd. after acquisition of R Ltd.

$$= 12,00,000 + 2,00,000 = 14,00,000 \text{ shares}$$

Calculation of E.P.S. of the amalgamated company

$$= \frac{\text{Total Net Profit after Interest and Tax}}{\text{Total Number of shares}}$$

$$= \frac{72,00,000}{14,00,000} = \text{Rs.5.14 per share}$$

## Advanced Accounting

After amalgamation, The EPS of P Ltd., will improve from Rs.5 to Rs.5.14 whereas EPS of former shareholders of R Ltd would reduce from present 2.40 per share to  $5.14 \times 0.4 = \text{Rs.}2.056$  per share after merger.

- (ii) In this case, P Ltd. offers Rs.78 per share to the shareholders of R Ltd.

The Exchange Ratio would be  $\frac{78}{150} = 0.52$  shares of P Ltd. for each share of R Ltd. In other words, P Ltd would give 52 shares for per 100 shares of R Ltd.

P Ltd would issue  $5,00,000 \times 0.52 = 2,60,000$  shares to shareholders of R Ltd.

$$\text{E.P.S. of the Merged Company} = \frac{72,00,000}{12,00,000 + 2,60,000} = 4.93$$

After Merger, there is a dilution in the E.P.S., of P Ltd. from 5 to 4.93.

After Merger E.P.S. of former shareholders of R Ltd.

$$= 4.93 \times 0.52 = 2.56$$

There is a gain of Re. 0.16 in E.P.S. of merged company in comparison to E.P.S. of R Ltd. of Rs.2.40 before merger.

Comments:

Initial increase in and decrease in earnings per share are possible in both cases of Merger. Generally, the dilution in E.P.S. will occur wherever the Price Earnings ratio of acquired company calculated on the basis of price paid exceed the P/E ratio of acquired company and vice-versa.

In Situation (i) - The price offered by P Ltd. per share of R Ltd. is Rs.60 and E.P.S. of R Ltd. is 2.4, which would become the earnings of P Ltd. after merger.

$$\text{Price Earning (P/E) Ratio of P Ltd. after merger} = \frac{60}{2.40} = 25. \text{ It is lower than the P/E}$$

Ratio of P Ltd. before merger i.e., 30, the E.P.S. of P Ltd. after merger increases to Rs.5.14.

In Situation (ii) - The price earnings (P/E) ratio offered for Merger is  $\frac{78}{2.4} = 32.5$  which is higher than P/E Ratio of P Ltd. before Merger. Hence, the E.P.S. of P Ltd after merger would get diluted.

## Valuation

### Question 19

The following is the Balance Sheet (as at 31<sup>st</sup> December, 2006) of Sun Ltd.:

| Liabilities                                           | Rs.       | Assets                 | Rs.       |
|-------------------------------------------------------|-----------|------------------------|-----------|
| Share Capital:                                        |           | Fixed Assets:          |           |
| 80,000 Equity shares of Rs.10 each fully paid up      | 8,00,000  | Goodwill               | 1,00,000  |
| 50,000 Equity shares of Rs.10 each Rs.8 paid up       | 4,00,000  | Plant and Machinery    | 8,00,000  |
| 36,000 Equity shares of Rs.5 each fully paid up       | 1,80,000  | Land and Building      | 10,00,000 |
| 30,000 Equity shares of Rs.5 each Rs.4 paid-up        | 1,20,000  | Furniture and Fixtures | 1,00,000  |
| 3,000 10% Preference shares of Rs.100 each fully paid | 3,00,000  | Vehicles               | 2,00,000  |
| Reserve and Surplus:                                  |           | Investments            | 3,00,000  |
| General reserve                                       | 1,40,000  | Current Assets:        |           |
| Profit and Loss account                               | 2,10,000  | Stock                  | 2,10,000  |
| Secured Loan: 12% Debenture                           | 2,00,000  | Debtors                | 1,95,000  |
| Unsecured Loan: 15% Term loan                         | 1,50,000  | Prepaid Expenses       | 40,000    |
| Deposits                                              | 1,00,000  | Advances               | 45,000    |
| Current Liabilities:                                  |           | Cash and Bank balance  | 2,00,000  |
| Bank Loan                                             | 50,000    | Preliminary Expenses   | 10,000    |
| Creditors                                             | 1,50,000  |                        |           |
| Outstanding expenses                                  | 20,000    |                        |           |
| Provision for tax                                     | 2,00,000  |                        |           |
| Proposed Dividend:                                    |           |                        |           |
| Equity                                                | 1,50,000  |                        |           |
| Preference                                            | 30,000    |                        |           |
|                                                       | 32,00,000 |                        | 32,00,000 |

Additional Information:

- (1) In 2004 a new machinery costing Rs.50,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same).

### Advanced Accounting

- (2) Stock is overvalued by Rs.10,000 in 2005. Debtors are to be reduced by Rs.5,000 in 2006, some old furniture (Book value Rs.10,000) was disposed of for Rs.6,000.
- (3) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of Fixed assets except machinery is not to be considered for valuation of goodwill.
- (4) Of the investment 20 per cent is trading and the balance is non-trading. All trade investments are to be valued at 20 per cent below cost. Trade investment were purchased on 1<sup>st</sup> January, 2006. 50 percent of the non-trade investments were acquired on 1<sup>st</sup> January, 2005 and the rest on 1<sup>st</sup> January, 2004. A uniform rate of dividend of 10 percent is earned on all investments.
- (5) Expected increase in expenditure without commensurate increase in selling price is Rs.20,000.
- (6) Research and Development expenses anticipated in future Rs.30,000 per annum.
- (7) In a similar business a normal return on capital employed is 10%.
- (8) Profit (after tax) are as follows:  
In 2004 – Rs.2,10,000, in 2005 – Rs.1,90,000 and in 2006 – Rs.2,00,000.
- (9) Current income tax rate is 50%, expected income tax rate will be 40%.

From the above, ascertain the ex-dividend and cum-dividend intrinsic value for different categories of Equity shares. For this purpose goodwill may be taken as 3 years purchase of super profits. Depreciation is charged on machinery @ 10% on reducing system.

(16 Marks) (May, 2007)

Answer

#### Computation of Value of Shares:

|                                                | Rs.              |
|------------------------------------------------|------------------|
| Value of Net Assets (As computed for Goodwill) | 21,02,073        |
| Value of Goodwill [Refer W.N.3]                | 11,406           |
| Non-trade investments                          | <u>2,40,000</u>  |
|                                                | 23,53,479        |
| Less: Preference Share Capital                 | 3,00,000         |
| Proposed Dividend of Preference shares         | 30,000           |
| Proposed Dividend of Equity shares             | <u>1,50,000</u>  |
| Net Assets available for Equity Shareholders   | <u>18,73,479</u> |



## Valuation

### Computation of Number of Equivalent Equity Shares:

| Equity shares                                                    | No. of Equivalent Shares                      |
|------------------------------------------------------------------|-----------------------------------------------|
| 80,000 shares + 50,000 shares =<br>1,30,000 shares of Rs.10 each | $1,30,000 \times \frac{10}{10}$<br>1,30,000   |
| 36,000 shares + 30,000 shares =<br>66,000 shares of Rs.5 each    | $66,000 \times \frac{5}{10}$<br><u>33,000</u> |
| Total Equivalent Equity Shares of Rs.10 each                     | <u>1,63,000</u>                               |

Calculation of Ex-Dividend intrinsic value of different categories of Equity Shares of Sun Ltd.

Net Assets available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

= Rs.18,73,479 + (50,000 × 2 + 30,000 × 1)

= Rs.18,73,479 + 1,00,000 + 30,000 = Rs.20,03,479

Computation of Ex-Dividend value per Equity Share

(i) Value of Rs.10 fully paid Equity Share =  $\frac{20,03,479}{1,63,000}$  = Rs.12.29 per share (approx.)

(ii) Value of Rs.8 paid-up Equity Share = 12.29 - 2 = Rs.10.29 per share (approx.)

(iii) Value of Rs.5 fully paid-up Equity Share =  $12.29 \times \frac{5}{10}$  = Rs.6.15 per share (approx.)

(iv) Value of Rs.4 paid-up Equity Share = 6.15 - 1 = Rs.5.15 per share (approx.)

Calculation of Cum-Dividend intrinsic value of different categories of Equity Shares of Sun Ltd.

Value of Net Assets (including proposed dividend on equity shares) = Rs.18,73,479 + 1,50,000  
= Rs.20,23,479

Net assets (including dividend) available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

= Rs.20,23,479 + (50,000 × 2 + 30,000 × 1)

= Rs.20,23,479 + 1,00,000 + 30,000 = Rs.21,53,479

Computation of Cum-Dividend value per share\*

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\* **Note:** Candidates can also arrive at the cum-dividend value of shares by calculating the percentage of proposed dividend of equity shares to paid-up capital and adding that percentage of paid-up value of each share to ex-dividend value of equity shares.

## Advanced Accounting

- (i) Value of Rs.10 fully paid Equity Share =  $\frac{21,53,479}{1,63,000}$  = Rs.13.21 per share (approx.)
- (ii) Value of Rs.8 paid-up Equity Share =  $13.21 - 2$  = Rs.11.21 per share (approx.)
- (iii) Value of Rs.5 fully paid-up Equity Share =  $13.21 \times \frac{5}{10}$  = Rs.6.605 per share (approx.)
- (iv) Value of Rs.4 paid-up Equity Share =  $6.605 - 1$  = Rs.5.605 per share (approx.)

### Working Notes:

#### 1. Calculation of Average Capital Employed

|                                                                           | Rs.             |
|---------------------------------------------------------------------------|-----------------|
| Fixed Assets:                                                             |                 |
| Plant and Machinery (including Rs.36,450 for a Machine charged in 2004)   | 8,36,450        |
| Land and Building                                                         | 10,00,000       |
| Furniture & Fixtures (1,00,000-4,000)                                     | 96,000          |
| Vehicles                                                                  | <u>2,00,000</u> |
|                                                                           | 21,32,450       |
| Add: Appreciation @ 5%                                                    | <u>1,06,623</u> |
|                                                                           | 22,39,073       |
| Trade Investment $(3,00,000 \times \frac{20}{100}) \times \frac{80}{100}$ | 48,000          |
| Current Assets:                                                           |                 |
| Stock                                                                     | 2,10,000        |
| Debtors (1,95,000-5,000)                                                  | 1,90,000        |
| Prepaid Expenses                                                          | 40,000          |
| Advances                                                                  | 45,000          |
| Cash & Bank Balance                                                       | <u>2,00,000</u> |
|                                                                           | 29,72,073       |
| Less: Outside Liabilities:                                                |                 |
| 12% Debentures                                                            | 2,00,000        |
| 15% Term Loan                                                             | 1,50,000        |
| Deposits                                                                  | 1,00,000        |
| Bank Loan                                                                 | 50,000          |
| Creditors                                                                 | 1,50,000        |
| Outstanding Expenses                                                      | 20,000          |
| Provision for Tax                                                         | <u>2,00,000</u> |
|                                                                           | <u>8,70,000</u> |
| Capital employed at the end of the year i.e. Net Assets                   | 21,02,073       |

## Valuation

|                                                                        |                 |                  |
|------------------------------------------------------------------------|-----------------|------------------|
| Less: $\frac{1}{2}$ of the current year's Accounting Profit after Tax: |                 |                  |
| Profit before Tax                                                      | 3,80,950        |                  |
| Less: Tax 40%* of Rs.3,80,950                                          | <u>1,52,380</u> |                  |
|                                                                        | <u>2,28,570</u> |                  |
| 50% of Rs.2,28,570                                                     |                 | <u>1,14,285</u>  |
| Average capital employed                                               |                 | <u>19,87,788</u> |

## 2. Future Maintainable Profits

### Statement of Average Profit

| Particulars                                                                                   | 2004<br>Rs.     | 2005<br>Rs.     | 2006<br>Rs.      |
|-----------------------------------------------------------------------------------------------|-----------------|-----------------|------------------|
| Profit after Tax                                                                              | <u>2,10,000</u> | <u>1,90,000</u> | <u>2,00,000</u>  |
| Profit before Tax ( $PAT \times \frac{1}{0.50}$ )                                             | 4,20,000        | 3,80,000        | 4,00,000         |
| Add: Capital expenditure charged to revenue                                                   | 50,000          | -               | -                |
| Less: Depreciation of the Machinery                                                           | (5,000)         | (4,500)         | (4,050)          |
| Dividend on Non-Trade Investments                                                             | (12,000)        | (24,000)        | (24,000)         |
| Over-valuation of closing stock                                                               | -               | (10,000)        | -                |
| Add: Overvaluation of opening stock                                                           | -               | -               | 10,000           |
| Add: Loss on sale of furniture                                                                | -               | -               | -                |
| (Presumed to be extra ordinary items)                                                         | -               | -               | 4,000            |
| Less: Provision for debtors                                                                   |                 |                 | <u>(5,000)</u>   |
|                                                                                               | <u>4,53,000</u> | <u>3,41,500</u> | <u>3,80,950</u>  |
| Total profit for the three years                                                              |                 |                 | <u>11,75,450</u> |
| Average Profit = $\frac{Rs.11,75,450}{3}$                                                     |                 |                 | 3,91,817         |
| Less: Depreciation @ 10% on increase in the value of machinery                                |                 |                 |                  |
| $8,36,450 \times \frac{5}{100} \times \frac{10}{100} = Rs.41,823 \times \frac{10}{100}$ i.e., |                 | 4,182           |                  |
| Expected increase in expenditure                                                              |                 | 20,000          |                  |
| Annual R & D Expenses anticipated in future                                                   |                 | <u>30,000</u>   | <u>54,182</u>    |
| Future Maintainable profit before tax                                                         |                 |                 | 3,37,635         |
| Less: Tax @ 40% of Rs.3,37,635                                                                |                 |                 | <u>1,35,054</u>  |
| Future Maintainable Profit After Tax                                                          |                 |                 | <u>2,02,581</u>  |

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\* Future tax rate has been considered.

### Advanced Accounting

|                                                           |                 |
|-----------------------------------------------------------|-----------------|
| 3. Computation of Goodwill                                | Rs.             |
| Future Maintainable Profit After Tax                      | 2,02,581        |
| Less: Normal Profit (10% of Rs.19,87,788)                 | <u>1,98,779</u> |
| Super Profit                                              | <u>3,802</u>    |
| Value of Goodwill = Super Profit x No. of years' purchase |                 |
| = Rs.3,802 x 3                                            | <u>11,406</u>   |

#### Question 20

From the following data, compute the 'Net Assets' value of each category of equity shares of Smith Ltd.:

Shareholders funds

- 10,000 'A' Equity shares of Rs.100 each, fully paid
- 10,000 'B' Equity shares of Rs.100 each, Rs.80 paid
- 10,000 'C' Equity shares of Rs.100 each, Rs.50 paid
- Retained Earnings Rs.9,00,000

(6 Marks)(May, 2008)

#### Answer

##### (i) Computation of Net assets

Worth of net assets is equal to shareholders' fund, i.e.

|                                                    |                  |
|----------------------------------------------------|------------------|
|                                                    | Rs.              |
| Paid up value of 'A' equity shares 10,000 x Rs.100 | 10,00,000        |
| Paid up value of 'B' equity shares 10,000 x Rs. 80 | 8,00,000         |
| Paid up value of 'C' equity shares 10,000 x Rs. 50 | 5,00,000         |
| Retained earnings                                  | <u>9,00,000</u>  |
| Net assets                                         | <u>32,00,000</u> |

##### (ii) Net asset value of equity share of Rs.100 paid up

Notional calls of Rs. 20 and Rs.50 per share on 'B' and 'C' equity shares respectively will make all the 30,000 equity shares fully paid up at Rs. 100 each. In that case,

|                                                       |                  |
|-------------------------------------------------------|------------------|
|                                                       | Rs.              |
| Net assets                                            | 32,00,000        |
| Add: Notional calls (10,000 x Rs.20 + 10,000 x Rs.50) | <u>7,00,000</u>  |
|                                                       | <u>39,00,000</u> |

Value of each equity share of Rs.100 fully paid up = Rs. 39,00,000 / 30,000=Rs.130

## Valuation

|                                                                                  |     |
|----------------------------------------------------------------------------------|-----|
| (iii) Net asset values of each category of equity shares                         | Rs. |
| Value of 'A' equity shares of Rs. 100 fully paid up                              | 130 |
| Value of 'B' equity shares of Rs. 100 each, out of which Rs. 80 paid up (130-20) | 110 |
| Value of 'C' Equity shares of Rs.100 each, out of which Rs. 50 paid up (130-50)  | 80  |

Alternatively value of an equity share may also be calculated as follows:

|                                   |                  |
|-----------------------------------|------------------|
| Total paid-up capital             | Rs.              |
| 'A' equity shares (10,000XRs.100) | 10,00,000        |
| 'B' equity shares (10,000XRs. 80) | 8,00,000         |
| 'C' equity shares (10,000XRs. 50) | <u>5,00,000</u>  |
|                                   | 23,00,000        |
| Retained earnings                 | <u>9,00,000</u>  |
| Net assets value of all shares    | <u>32,00,000</u> |

$$\text{Value per rupee of paid up capital} = \frac{\text{Net assets value of all shares}}{\text{Paid up capital}} = \frac{32,00,000}{23,00,000} = \text{Rs.1.391}$$

Therefore,

|                                           |                |           |
|-------------------------------------------|----------------|-----------|
| Net assets value of Rs. 100 paid up share | Rs.1.391 x 100 | Rs.139.10 |
| Net assets value of Rs. 80 paid up share  | Rs.1.391 x 80  | Rs.111.28 |
| Net assets value of Rs. 50 paid up share  | Rs.1.391 x 50  | Rs.69.55  |

## Advanced Accounting

NOTE

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

## HOLDING COMPANY ACCOUNTS

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Topics covered:

- Problems on consolidation of final accounts of a holding company having one subsidiary
- Chain Holding

## Advanced Accounting

### Question 1

Following are the draft Balance Sheets of two companies A Ltd. and B Ltd. as at 31.03.1996:

|                                 |              |             |                        | (Rs. in lakhs) |             |
|---------------------------------|--------------|-------------|------------------------|----------------|-------------|
| Liabilities                     | A Ltd.       | B Ltd.      | Assets                 | A Ltd.         | B Ltd.      |
| Share Capital<br>(Rs. 100 each) | 6.00         | 3.00        | Fixed Assets           | 5.00           | 1.50        |
| Profits:                        |              |             | Investment:            |                |             |
| Capital Profit                  | 0.80         | 0.85        | 2,400 Shares in B Ltd. | 3.00           | —           |
| Reserve Profit                  | 3.20         | 0.29        | 1,200 Shares in A Ltd. | —              | 2.00        |
| Creditors                       | 1.50         | 0.81        | Current Assets:        |                |             |
|                                 |              |             | Debtors                | 2.00           | 0.80        |
|                                 |              |             | Stock                  | 0.40           | 0.30        |
|                                 |              |             | Cash and Bank          | <u>1.10</u>    | <u>0.35</u> |
|                                 | <u>11.50</u> | <u>4.95</u> |                        | <u>11.50</u>   | <u>4.95</u> |

The following adjustments were not yet made:

1. Stock worth Rs. 5,000 in B Ltd. was found to be obsolete with no value.
2. A Ltd. acquires an asset costing Rs. 50,000 on 31.3.1996. No effect has been given for both the purchase and payment.
3. During the year A Ltd. sold an asset for Rs. 60,000 (original cost Rs. 40,000). The profit was included in the revenue profit.
4. Debtors of A Ltd. included a sum of Rs. 50,000 owed by B Ltd.

You are required to prepare the consolidated Balance Sheet of both the companies as on 31.3.1996 after giving effect to the above adjustments. (15 marks)(November, 1996)

Answer

### Consolidated Balance Sheet of A Ltd. and its subsidiary B Ltd. as at 31st March, 1996

|                                     |        |                 |            | (Rs. in thousands) |     |
|-------------------------------------|--------|-----------------|------------|--------------------|-----|
| Liabilities                         | Amount | Assets          |            | Amount             |     |
| Share Capital                       |        | Fixed Assets    |            |                    |     |
| (less: 1,200 shares held by B Ltd.) | 480    | A Ltd.          | 550        |                    |     |
| Minority Interest                   | 105    | B Ltd.          | <u>150</u> |                    |     |
| Capital profit                      | 60     |                 |            |                    | 700 |
| Revenue Profit                      | 304    | Cost of Control |            |                    | 40  |
| Creditors                           |        | Current Assets: |            |                    |     |



### Holding Company Accounts

|                           |           |              |                           |           |              |
|---------------------------|-----------|--------------|---------------------------|-----------|--------------|
| A Ltd.                    | 150       |              | Stock                     |           |              |
| B Ltd.                    | <u>81</u> |              | A Ltd.                    | 40        |              |
|                           | 231       |              | B Ltd.                    | <u>25</u> |              |
| Less: Mutual indebtedness | <u>50</u> | 181          |                           |           | 65           |
|                           |           |              | Debtors                   |           |              |
|                           |           |              | A Ltd.                    | 200       |              |
|                           |           |              | B Ltd.                    | <u>80</u> |              |
|                           |           |              |                           | 280       |              |
|                           |           |              | Less: Mutual indebtedness | <u>50</u> |              |
|                           |           |              |                           |           | 230          |
|                           |           |              | Cash and Bank             |           |              |
|                           |           |              | A Ltd.                    | 110       |              |
|                           |           |              | Less: Payment for asset   | <u>50</u> |              |
|                           |           |              |                           | 60        |              |
|                           |           |              | B Ltd.                    | <u>35</u> |              |
|                           |           |              |                           |           | <u>95</u>    |
|                           |           | <u>1,130</u> |                           |           | <u>1,130</u> |

#### Working Notes:

##### (1) Adjustment of Revenue and Capital Profits:

|                                                               |                |             |
|---------------------------------------------------------------|----------------|-------------|
|                                                               | (Rs. in lakhs) |             |
|                                                               | A Ltd.         | B Ltd.      |
| Revenue profits                                               | 3.20           | 0.29        |
| Less: Stock written off                                       | —              | 0.05        |
| Less: Transfer to capital profit<br>(Profit on sale of asset) | 0.20           | —           |
|                                                               | <u>3.00</u>    | <u>0.24</u> |
| Capital profits                                               | 0.80           | 0.85        |
| Add: Transfer from revenue profit                             | <u>0.20</u>    | <u>—</u>    |
|                                                               | <u>1.00</u>    | <u>0.85</u> |

##### (2) Calculation of Minority Interest in Revenue Profits

$$\begin{aligned}
 \text{Let } A &= \text{Revenue profits of A Ltd., and} \\
 B &= \text{Revenue profit of B Ltd.} \\
 A &= 3,00,000 + (4/5) \times B
 \end{aligned}$$

### Advanced Accounting

$$\begin{aligned}B &= 24,000 + (1/5) \times A \\B &= 24,000 + (1/5) \times [3,00,000 + (4/5) \times B] \\B &= 24,000 + 60,000 + (4/25) \times B \\B &= 84,000 + (4/25) \times B \\(21/25) \times B &= 84,000 \\B &= \text{Rs. } 1,00,000\end{aligned}$$

Minority interest in revenue profits is  $1/5$  of Rs. 1,00,000 or Rs. 20,000. Total revenue profits being Rs. 3,24,000 for A Ltd. and B Ltd. together, Rs. 3,04,000 remains for the group.

#### (3) Calculation of Minority Interest in Capital Profits

$$\begin{aligned}\text{Let A} &= \text{Capital profits of A Ltd., and} \\B &= \text{Capital profits of B Ltd.} \\A &= 1,00,000 + (4/5) B \\B &= 85,000 + (1/5) \times A \\B &= 85,000 + (1/5) \times [1,00,000 + (4/5) \times B] \\B &= 85,000 + 20,000 + (4/25) \times B \\B &= 1,05,000 + (4/25) \times B \\(21/25) \times B &= 1,05,000 \\B &= \text{Rs. } 1,25,000\end{aligned}$$

Minority interest ( $1/5$ ) would be Rs. 25,000. Shares of A Ltd. will be Rs. 1,00,000. Capital profits of A Ltd. =  $1,85,000 - 1,25,000 = \text{Rs. } 60,000$ .

#### (4) Total Minority Interest

|                          |                 |
|--------------------------|-----------------|
|                          | Rs.             |
| Shares held by outsiders | 60,000          |
| Revenue profit           | 20,000          |
| Capital profit           | <u>25,000</u>   |
| Minority Interest        | <u>1,05,000</u> |

#### (5) Cost of control

|                                      |                 |                 |
|--------------------------------------|-----------------|-----------------|
|                                      |                 | Rs.             |
| Amount paid by both companies        |                 | 5,00,000        |
| Less: Face value of shares in B Ltd. | 2,40,000        |                 |
| Face value of shares in A Ltd.       | 1,20,000        |                 |
| Capital profits                      | <u>1,00,000</u> |                 |
|                                      |                 | <u>4,60,000</u> |
| Cost of control                      |                 | <u>40,000</u>   |

## Holding Company Accounts

Note:

In adjustment no. 3 given in the question, the period (whether pre-acquisition or post-acquisition) in which the sale of asset took place, is not specified. The answer has been given on the basis of assumption that the asset was sold in the pre-acquisition period and accordingly the profit on sale has been treated as capital profit.

### Question 2

War Ltd. purchased on 31st March, 1997, 48,000 shares in Peace Ltd. at 50% premium over face value by issue of 8% debentures at 20% premium. The balance sheets of War and Peace Ltd. as on 31.3.1997, the date of purchase were as under:

| Liabilities             | War Ltd.         | Peace Ltd.      | Assets                  | War Ltd.         | Peace Ltd.      |
|-------------------------|------------------|-----------------|-------------------------|------------------|-----------------|
|                         | Rs.              | Rs.             |                         | Rs.              | Rs.             |
| Share Capital (Rs. 10)  | 10,50,000        | 6,00,000        | Fixed assets            | 6,50,000         | 2,00,000        |
| General reserve         | 1,20,000         | 40,000          | Stock in trade          | 3,00,000         | 1,80,000        |
| Profit and loss account | 80,000           | —               | Sundry debtors          | 3,20,000         | 2,00,000        |
| Sundry Creditors        | 1,00,000         | 60,000          | Cash in hand            | 60,000           | 30,000          |
|                         |                  |                 | Preliminary expenses    | 20,000           | 10,000          |
|                         |                  |                 | Profit and loss account | —                | 80,000          |
|                         | <u>13,50,000</u> | <u>7,00,000</u> |                         | <u>13,50,000</u> | <u>7,00,000</u> |

Particulars of War Ltd:

- (i) Profit made: Rs.
- |           |          |
|-----------|----------|
| 1997-1998 | 1,60,000 |
| 1998-1999 | 2,00,000 |
- (ii) The above profit was made after charging depreciation of Rs. 60,000 and Rs. 40,000 respectively.
- (iii) Out of profit shown above every year Rs. 20,000 had been transferred to general reserve.
- (iv) 10% dividend had been paid in both the years.
- (v) It has been decided to write down investment to face value of shares in 10 years and to provide for share of loss to subsidiary.

Particulars of Peace Ltd.:

The company incurred losses of Rs. 40,000 and Rs. 60,000 in 1997-1998 and 1998-1999 after charging depreciation of 10% p.a. of the book value as on 1.4.1997.

### Advanced Accounting

Prepare consolidated balance sheet as at 31.3.1999 of War Ltd., and its subsidiary.

(16 marks)(November, 1999)

Answer

#### Consolidated Balance Sheet of War Ltd. and its subsidiary Peace Ltd.

as at 31st March, 1999

| Liabilities                    | Rs.              | Assets               | Rs.              |
|--------------------------------|------------------|----------------------|------------------|
| Share Capital:                 |                  | Goodwill             | 2,32,000         |
| Issued and Subscribed:         |                  | Fixed Assets:        |                  |
| 1,05,000 shares of Rs. 10 each |                  | War Ltd.             | 5,50,000         |
| Fully paid up                  | 10,50,000        | Peace Ltd.           | <u>1,60,000</u>  |
| Minority Interest              | 90,000           | Net Current Assets:  | 7,10,000         |
| Capital Reserve                | 1,20,000         | War Ltd.             | 8,30,000         |
| General Reserve                | 1,60,000         | Peace Ltd.           | <u>2,90,000</u>  |
| Profit and Loss Account        | 62,000           | Preliminary Expenses | 20,000           |
| 8% Debentures                  | <u>6,00,000</u>  |                      |                  |
|                                | <u>20,82,000</u> |                      | <u>20,82,000</u> |

Working Notes:

(1) Investment in Peace Ltd. (48,000 shares)

|                               | Rs.             |
|-------------------------------|-----------------|
| Face value of shares          | 4,80,000        |
| Premium (50%) over face value | <u>2,40,000</u> |
| Cost of investment            | <u>7,20,000</u> |

Acquired by issue of debentures at 20% premium:

|                                              | Rs.             |
|----------------------------------------------|-----------------|
| 8% Debentures                                | 6,00,000        |
| (Nominal value = $7,20,000/120 \times 100$ ) |                 |
| Debenture premium                            | <u>1,20,000</u> |
|                                              | 7,20,000        |
| Writing down of investment                   |                 |
| 1997-1998 : $1/10 \times 2,40,000$           | (24,000)        |
| 1998-1999 : $1/10 \times 2,40,000$           | <u>(24,000)</u> |
| Investment as on 31.3.1999                   | <u>6,72,000</u> |

## Holding Company Accounts

### (2) Balance of Profit and Loss Account on 31st March, 1999

|                                           | War Ltd.<br>Rs.   | Peace Ltd.<br>Rs. |
|-------------------------------------------|-------------------|-------------------|
| Balance as on 31.3.1997                   | 80,000            | (80,000)          |
| Profit/(Loss)                             |                   |                   |
| For 1997-1998                             | 1,60,000          | (40,000)          |
| For 1998-1999                             | 2,00,000          | (60,000)          |
| Investment written off                    |                   |                   |
| 1997-1998                                 | (24,000)          |                   |
| 1998-1999                                 | (24,000)          |                   |
| Provision for share of loss in subsidiary |                   |                   |
| 1997-1998: $\frac{4}{5} \times 40,000$    | (32,000)          |                   |
| 1998-1999: $\frac{4}{5} \times 60,000$    | (48,000)          |                   |
| Transfer to General Reserve               |                   |                   |
| 1997-1998                                 | (20,000)          |                   |
| 1998-1999                                 | (20,000)          |                   |
| Dividend                                  |                   |                   |
| 1997-1998                                 | (1,05,000)        |                   |
| 1998-1999                                 | <u>(1,05,000)</u> |                   |
|                                           | <u>62,000</u>     | <u>(1,80,000)</u> |

(In the absence of information, taxation has not been considered).

### (3) Balance Sheets as at 31st March, 1999

| Liabilities                            | War Ltd.<br>Rs.  | Peace Ltd.<br>Rs. | Assets                                          | War Ltd.<br>Rs.  | Peace Ltd.<br>Rs. |
|----------------------------------------|------------------|-------------------|-------------------------------------------------|------------------|-------------------|
| Share Capital                          | 10,50,000        | 6,00,000          | Fixed assets*                                   | 5,50,000         | 1,60,000          |
| Capital reserve<br>(Debenture premium) | 1,20,000         | —                 | Investment                                      | 6,72,000         |                   |
| General reserve                        | 1,60,000         | 40,000            | Less:<br>Provision for<br>loss in<br>subsidiary | <u>80,000</u>    | —                 |
| Profit and loss<br>account             | 62,000           | —                 | Net current<br>assets                           | 8,30,000         | 2,90,000          |
| 8% Debentures                          | 6,00,000         | —                 | (Balancing<br>figure)                           |                  |                   |
|                                        |                  |                   | Preliminary<br>expenses                         | 20,000           | 10,000            |
|                                        |                  |                   | Profit and loss<br>account                      | <u>—</u>         | <u>1,80,000</u>   |
|                                        | <u>19,92,000</u> | <u>6,40,000</u>   |                                                 | <u>19,92,000</u> | <u>6,40,000</u>   |

## Advanced Accounting

\*Fixed Assets on 31st March, 1999

|                           | War Ltd.<br>Rs. | Peace Ltd.<br>Rs. |
|---------------------------|-----------------|-------------------|
| Fixed assets on 31.3.1997 | 6,50,000        | 2,00,000          |
| Less: Depreciation        |                 |                   |
| 1997-1998                 | (60,000)        | (20,000)          |
| 1998-1999                 | <u>(40,000)</u> | <u>(20,000)</u>   |
|                           | <u>5,50,000</u> | <u>1,60,000</u>   |

Note: In the absence of information about the movement in individual current assets and current liabilities, balance sheets on 31.3.1999 have been prepared on the basis of net current assets.

### (4) Computations for Consolidation

#### (a) Analysis of Profits/(Losses) of Peace Ltd.

|                                                     | Capital<br>Profit<br>Rs. | Revenue<br>Profit<br>Rs. |
|-----------------------------------------------------|--------------------------|--------------------------|
| General Reserve on 31.3.1997                        | 40,000                   | —                        |
| Profit and Loss Account on 31.3.1997                | (80,000)                 |                          |
| Profit/(Loss) for the years 1997-1998 and 1998-1999 | <u>(40,000)</u>          | <u>(1,00,000)</u>        |
| Minority Interest (1/5)                             | (8,000)                  | (20,000)                 |
| Share of War Ltd. (4/5)                             | (32,000)                 | (80,000)                 |

#### (b) Minority Interest

|                                              | Rs.            |
|----------------------------------------------|----------------|
| Share Capital                                | 1,20,000       |
| Capital profits/(losses)                     | (8,000)        |
| Revenue profits/(losses)                     | (20,000)       |
| Preliminary expenses ( $1/5 \times 10,000$ ) | <u>(2,000)</u> |
|                                              | <u>90,000</u>  |

#### (c) Cost of Control

|                                              |                | Rs.             |
|----------------------------------------------|----------------|-----------------|
| Investment in Peace Ltd.                     |                | 6,72,000        |
| Less: Paid up value of investment            | 4,80,000       |                 |
| Capital profit/(losses)                      | (32,000)       |                 |
| Preliminary expenses ( $4/5 \times 10,000$ ) | <u>(8,000)</u> | <u>4,40,000</u> |
| Goodwill                                     |                | <u>2,32,000</u> |

## Holding Company Accounts

(d) Profit and Loss Account – War Ltd.

|                                       | Rs.           |
|---------------------------------------|---------------|
| Balance                               | 62,000        |
| Less: Share of loss in Peace Ltd.     | <u>80,000</u> |
|                                       | (18,000)      |
| Add: Provision for loss in subsidiary | <u>80,000</u> |
|                                       | <u>62,000</u> |

### Question 3

The Balance Sheets of Sun Ltd. and Moon Ltd. as on 31.3.2000 are given below:

|                                            | Sun Ltd.<br>(Rs.) | Moon Ltd.<br>(Rs.) | Assets                  | Sun Ltd.<br>(Rs.) | Moon Ltd.<br>(Rs.) |
|--------------------------------------------|-------------------|--------------------|-------------------------|-------------------|--------------------|
| Share Capital (Rs. 10)                     | 1,20,000          | 1,00,000           | Fixed Assets            | 44,000            | 84,000             |
| General Reserve                            | 20,000            | 36,000             | Investment in Moon Ltd. |                   |                    |
| Profit and Loss Account                    | 12,000            | 20,000             | 8,000 Shares @ Rs. 11   | 88,000            |                    |
| Bills Payable                              | 2,000             | 5,000              |                         |                   |                    |
| Sundry Creditors                           | 4,000             | 7,000              | Sundry Debtors          | 6,000             | 15,000             |
| Contingent Liability of<br>Sun Ltd.: Bills |                   |                    | Bills Receivable        | 4,000             | 16,000             |
| Discounted not yet<br>matured Rs.2,500     |                   |                    | Stock in Trade          | 10,000            | 40,000             |
|                                            |                   |                    | Cash at Bank            | 6,000             | 13,000             |
|                                            | <u>1,58,000</u>   | <u>1,68,000</u>    |                         | <u>1,58,000</u>   | <u>1,68,000</u>    |

Shares were purchased on 1.4.1997. When the shares were purchased General Reserve and Profit and Loss Account of Moon Ltd. stood at Rs. 30,000 and Rs. 16,000 respectively. Dividends have been paid @ 10% every year after acquisition of shares, first dividend being paid out of pre-acquisition profits. No dividend has been proposed for 1999-2000 as yet and no provision need be made in consolidated Balance Sheet. Sun Ltd. has credited all dividends received to Profit and Loss Account.

On 31.3.2000, Bonus shares has been declared by Moon Ltd. @ 1 fully paid share for 5 held, but no effect has been given to that in the above accounts. The Bonus was declared out of profits earned prior to 1.4.1997 from General Reserve.

When the shares were purchased, agreed valuations of Fixed Assets of Moon Ltd. was Rs. 1,08,000 although no effect has been given thereto in accounts.

Depreciation has been charged @ 10% p.a. on the book value as on 1.4.1997, (on straight line method), there being no addition or sale since then.

Out of Current Profits, Rs. 2,000 has been transferred to general reserve every year. Bills receivable of Sun Ltd. include Rs. 2,000 bills accepted by Moon Ltd. and bills discounted by Sun Ltd., but not yet matured include Rs. 1,500 accepted by Moon Ltd. Sundry

### Advanced Accounting

creditors of Sun Ltd. include Rs. 2,000 due to Moon Ltd. whereas Sundry Debtors of Moon Ltd. include Rs. 4,000 due from Sun Ltd. It is found that Sun Ltd. has remitted a cheque of Rs. 2,000, which has not yet been received by Moon Ltd.

Prepare consolidated Balance Sheet as at 31.3.2000 of Sun Ltd. and its Subsidiary.

(20 marks)(May, 2000)

Answer

#### Consolidated Balance Sheet of Sun Ltd.

and its Subsidiary Moon Ltd.

As at 31st March, 2000

| Liabilities               | Rs.<br>Amount   | Assets                              | Rs.<br>Amount   |
|---------------------------|-----------------|-------------------------------------|-----------------|
| Share Capital (Rs.10)     | 1,20,000        | Fixed Assets                        |                 |
| Minority Interest         | 29,520          | Sun Ltd.                            | 44,000          |
| Capital Reserve           | 19,200          | Moon Ltd.                           |                 |
| General Reserve           | 24,800          | (84,000-12,000+3,600)               | <u>75,600</u>   |
| Profit and Loss Account   | 18,080          | Stock in Trade                      |                 |
| Bills Payable             |                 | Sun Ltd.                            | 10,000          |
| Sun Ltd.                  | 2,000           | Moon Ltd.                           | <u>40,000</u>   |
| Moon Ltd.                 | <u>5,000</u>    | Sundry Debtors                      | 50,000          |
|                           | 7,000           | Sun Ltd.                            | 6,000           |
| Less: Mutual indebtedness | <u>2,000</u>    | Moon Ltd.                           |                 |
|                           | 5,000           | (15,000 – 2,000, Cheque in transit) | <u>13,000</u>   |
| Sundry Creditors          |                 |                                     | 19,000          |
| Sun Ltd.                  | 4,000           | Less: Mutual indebtedness           | <u>2,000</u>    |
| Moon Ltd.                 | <u>7,000</u>    | Cash at Bank                        | 17,000          |
|                           | 11,000          | Sun Ltd.                            | 6,000           |
| Less: Mutual indebtedness | <u>2,000</u>    | Moon Ltd.                           | <u>13,000</u>   |
|                           | 9,000           | Remittance in transit               | 2,000           |
|                           |                 | Bills Receivable                    |                 |
|                           |                 | Sun Ltd.                            | 4,000           |
|                           |                 | Moon Ltd.                           | <u>16,000</u>   |
|                           |                 |                                     | 20,000          |
|                           |                 | Less: Mutual indebtedness           | <u>2,000</u>    |
|                           |                 |                                     | <u>18,000</u>   |
|                           | <u>2,25,600</u> |                                     | <u>2,25,600</u> |



## Holding Company Accounts

### Contingent Liability

Bills discounted not yet matured Rs. 1,000

### Working Notes:

#### (1) Analysis of Profit of Moon Ltd.

|                                                                                    |               | Capital<br>Profits<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>Profits<br>Rs. |
|------------------------------------------------------------------------------------|---------------|---------------------------|---------------------------|---------------------------|
| General reserve on 1.4.97                                                          | 30,000        |                           |                           |                           |
| Less: Bonus issue                                                                  | <u>20,000</u> | 10,000                    |                           |                           |
| Increase in reserve (Annual transfer of Rs. 2,000 for 3 years) (36,000 – 30,000)   |               |                           | 6,000                     |                           |
| Profit and loss account on 1.4.97                                                  | 16,000        |                           |                           |                           |
| Less: Dividend for 1997-98                                                         | <u>10,000</u> | 6,000                     |                           |                           |
| Increase in profit<br>(20,000–6,000)                                               |               |                           |                           | 14,000                    |
| Loss on revaluation<br>[84,000 × 100/70 i.e. 1,20,000] – 1,08,000]                 |               | (12,000)                  |                           |                           |
| Additional depreciation written back<br>(12,000 × 10/100 × 3)                      |               |                           |                           | 3,600                     |
|                                                                                    |               | <u>4,000</u>              | <u>6,000</u>              | <u>17,600</u>             |
| Sun Ltd.'s share (80%)                                                             |               | <u>3,200</u>              | <u>4,800</u>              | <u>14,080</u>             |
| Minority's share (20%)                                                             |               | <u>800</u>                | <u>1,200</u>              | <u>3,520</u>              |
| (2) Minority Interest                                                              |               |                           | Rs.                       |                           |
| Share capital (including bonus shares)<br>(20,000+20,000×1/5)                      |               |                           | 24,000                    |                           |
| Capital profits                                                                    |               |                           | 800                       |                           |
| Revenue reserve                                                                    |               |                           | 1,200                     |                           |
| Revenue profits                                                                    |               |                           | <u>3,520</u>              |                           |
|                                                                                    |               |                           | <u>29,520</u>             |                           |
| (3) Cost of Control                                                                |               |                           |                           |                           |
| Investment in Moon Ltd.                                                            |               | 88,000                    |                           |                           |
| Less: Dividend of capital profits                                                  |               | <u>8,000</u>              | 80,000                    |                           |
| Less: Face value of investment (including<br>bonus shares) (80,000 + 80,000 × 1/5) | 96,000        |                           |                           |                           |
| Capital profits                                                                    | <u>3,200</u>  |                           | <u>99,200</u>             |                           |
| Capital Reserve                                                                    |               |                           | <u>19,200</u>             |                           |

### Advanced Accounting

|                                                |               |
|------------------------------------------------|---------------|
| (4) General Reserve – Sun Ltd. Balance         | 20,000        |
| Add: Share in Moon Ltd.                        | <u>4,800</u>  |
|                                                | <u>24,800</u> |
| (5) Profit and Loss Account – Sun Ltd. Balance | 12,000        |
| Less: Dividend Credited to investment          | <u>8,000</u>  |
|                                                | 4,000         |
| Add: Share in Moon Ltd.                        | <u>14,080</u> |
|                                                | <u>18,080</u> |

Note: As regards bills receivable of Sun Ltd., the students may, alternatively, assume that out of bills of Sun Ltd. accepted by Moon Ltd. Rs. 2,000, Rs. 1,500 have been discounted. In such case, only Rs. 500 will be deducted as mutual indebtedness from bills receivable and bills payable in the balance sheet instead of Rs. 2,000.

#### Question 4

The Balance Sheets of Bat Ltd. and Ball Ltd. as on 31.3.2000 are as follows:

|                         | Bat Ltd.<br>Rs. | Ball Ltd.<br>Rs. |                     | Bat Ltd.<br>Rs. | Ball Ltd.<br>Rs. |
|-------------------------|-----------------|------------------|---------------------|-----------------|------------------|
| Share Capital           |                 |                  | Investments         |                 |                  |
| (Shares of Rs. 10 each) | 1,60,000        | 2,00,000         | Shares in Ball Ltd. | 1,96,000        | –                |
| Profit and Loss account | 50,000          | 60,000           | Debtors             | –               | 1,20,000         |
| Creditors               | –               | 16,000           | Stock               | –               | 80,000           |
|                         |                 |                  | Cash at Bank        | –               | 70,000           |
|                         |                 |                  | Cash in hand        | <u>14,000</u>   | <u>6,000</u>     |
|                         | <u>2,10,000</u> | <u>2,76,000</u>  |                     | <u>2,10,000</u> | <u>2,76,000</u>  |

Particulars of Bat Ltd.:

- (1) This company was formed on 1.4.1999.
- (2) It acquired the shares of Ball Ltd. as under:

| Date of Acquisition | No. of Shares | Cost<br>Rs. |
|---------------------|---------------|-------------|
| 1.4.1999            | 8,000         | 1,10,000    |
| 31.7.1999           | 6,000         | 86,000      |

- (3) The shares purchased on 31.7.1999 are ex-dividend and ex-bonus from existing holders.
- (4) On 31.7.1999 dividend at 10% was received from Ball Ltd. and was credited to Profit and Loss Account.

### Holding Company Accounts

- (5) On 31.7.1999 it received bonus shares from Ball Ltd. in the ratio of one share on every four shares held.
- (6) Bat Ltd. incurred an expenditure of Rs. 500 per month on behalf of Ball Ltd. and this was debited to the Profit and Loss Account of Bat Ltd., but nothing has been done in the books of Ball Ltd.
- (7) The balance in the Profit and Loss Account as on 31.3.2000 included Rs. 36,000 being the net profit made during the year.
- (8) Dividend proposed for 1999-2000 at 10% was not provided for as yet.

Particulars of Ball Ltd.:

- (1) The balance in the Profit and Loss Account as on 31.3.2000 is after the issue of bonus shares made on 31.7.1999.
- (2) The net profit made during the year is Rs. 24,000 including Rs. 6,000 received from insurance company in settlement of the claim towards loss of stock by fire on 30.06.1999 (Cost Rs. 10,800 included in opening stock).
- (3) Dividend proposed for 1999-2000 at 10% was not provided for in the accounts.

Prepare the Consolidated Balance Sheet of Bat Ltd. as on 31.3.2000.

(16 marks)(November, 2000)

Answer

#### Consolidated Balance Sheet of Bat Ltd. and its subsidiary Ball Ltd.

as at 31st March, 2000

| Liabilities                              | Amount<br>Rs.   | Assets       | Amount<br>Rs.   |
|------------------------------------------|-----------------|--------------|-----------------|
| Share Capital<br>(Shares of Rs. 10 each) | 1,60,000        | Stock        | 80,000          |
| Minority Interest                        | 50,800          | Debtors      | 1,20,000        |
| Capital Reserve                          | 3,040           | Cash at Bank | 70,000          |
| Profit and Loss Account                  | 44,160          | Cash in hand | 20,000          |
| Creditors                                | 16,000          |              |                 |
| Proposed Dividend                        | <u>16,000</u>   |              |                 |
|                                          | <u>2,90,000</u> |              | <u>2,90,000</u> |

Working Notes:

|                                                          |                           |                           |
|----------------------------------------------------------|---------------------------|---------------------------|
| (1) Analysis of profits of Ball Ltd.                     | Capital<br>Profits<br>Rs. | Revenue<br>Profits<br>Rs. |
| Profit and Loss Account on 1.4.1999<br>(60,000 – 24,000) | 36,000                    |                           |
| Profit for the year                                      | 24,000                    |                           |

## Advanced Accounting

|                                                                                                                                                           |               |                   |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------|
| Add back: Loss by fire                                                                                                                                    | <u>4,800</u>  |                   |
|                                                                                                                                                           | 28,800        |                   |
| Less: Expenses not considered                                                                                                                             | <u>6,000</u>  |                   |
|                                                                                                                                                           | 22,800        |                   |
| Pre-acquisition profits = $\frac{4}{12} \times 22,800 =$                                                                                                  | 7,600         |                   |
| Less: Loss in pre-acquisition period =                                                                                                                    | <u>4,800</u>  | 2,800             |
| Post-acquisition profits                                                                                                                                  |               |                   |
| $\left( \frac{8}{12} \times 22,800 \right)$                                                                                                               |               | 15,200            |
|                                                                                                                                                           | <u>38,800</u> | <u>15,200</u>     |
| Bat Ltd.'s share (80%*)                                                                                                                                   | <u>31,040</u> | <u>12,160</u>     |
| Minority's share (20%)                                                                                                                                    | <u>7,760</u>  | <u>3,040</u>      |
| $8,000 + 6,000 + \text{Bonus shares } \frac{8,000}{4} \text{ i.e. 2,000}$ $* \frac{\quad}{20,000} \times 100$ $= \frac{16,000}{20,000} \times 100 = 80\%$ |               |                   |
| (2) Minority interest                                                                                                                                     |               | Rs.               |
| Share capital                                                                                                                                             |               | 40,000            |
| Capital profits                                                                                                                                           |               | 7,760             |
| Revenue profits                                                                                                                                           |               | <u>3,040</u>      |
|                                                                                                                                                           |               | <u>50,800</u>     |
| (3) Cost of control                                                                                                                                       |               | Rs.               |
| Face value of investments                                                                                                                                 | 1,60,000      |                   |
| Capital profits                                                                                                                                           | <u>31,040</u> | 1,91,040          |
| Investment in Ball Ltd.                                                                                                                                   | 1,96,000      |                   |
| Less: Pre-acquisition dividend                                                                                                                            | <u>8,000</u>  | <u>(1,88,000)</u> |
| Capital Reserve                                                                                                                                           |               | <u>3,040</u>      |
| (4) Profit and Loss Account – Bat Ltd.                                                                                                                    |               | Rs.               |
| Balance                                                                                                                                                   |               | 50,000            |
| Less: Pre-acquisition dividend wrongly credited                                                                                                           |               | <u>8,000</u>      |
|                                                                                                                                                           |               | 42,000            |
| Less: Proposed dividend                                                                                                                                   |               | <u>16,000</u>     |
|                                                                                                                                                           |               | 26,000            |
| Add: Expenses of Ball Ltd. written back                                                                                                                   |               | 6,000             |
| Add: Share in Ball Ltd.                                                                                                                                   |               | <u>12,160</u>     |
|                                                                                                                                                           |               | <u>44,160</u>     |

## Holding Company Accounts

### Question 5

The summarised Balance Sheets of A Ltd. and B Limited are as follows:

Balance Sheets as at 31st December, 2000

|                                                 | A Ltd.          | B Ltd.        |
|-------------------------------------------------|-----------------|---------------|
| Sources of Funds:                               | Rs.             | Rs.           |
| Share Capital in equity shares of Rs. 10 each   | 2,00,000        | 50,000        |
| Reserves                                        | 20,000          | 5,000         |
| Profit and Loss Account as on 1st January, 2000 | 30,000          | 10,000        |
| Profit for the year                             | 8,000           | 8,000         |
| Add: Dividends from B Ltd.                      | 4,000           | —             |
| Less: Dividends paid                            | —               | (5,000)       |
| Creditors                                       | <u>30,000</u>   | <u>20,000</u> |
| Total                                           | <u>2,92,000</u> | <u>88,000</u> |
| Application of Funds:                           |                 |               |
| Fixed Assets                                    | 2,00,000        | 80,000        |
| Current Assets                                  | 32,000          | 8,000         |
| Shares in B Ltd. at cost – 3,000 shares         | <u>60,000</u>   | <u>—</u>      |
| Total                                           | <u>2,92,000</u> | <u>88,000</u> |

A Limited had acquired 4,000 shares in B Ltd. at Rs. 20 each on 1st January, 2000 and sold 1,000 of them at the same price on 1st October, 2000. The sale is cum dividend. An interim dividend of 10% was paid by B Limited on 1st July, 2000.

Draft the consolidated Balance Sheet as at 31st December, 2000.

(16 marks)(November, 2001)

Answer

### Consolidated Balance Sheet of A Limited and its subsidiary B Limited as at 31st December, 2000

| Liabilities                                   | Rs.             | Assets         | Rs.             |
|-----------------------------------------------|-----------------|----------------|-----------------|
| Share Capital in equity shares of Rs. 10 each | 2,00,000        | Goodwill       | 21,000          |
| Minority Interest                             | 27,200          | Fixed Assets   | 2,80,000        |
| Reserves                                      | 20,000          | Current Assets | 40,000          |
| Profit and Loss Account                       | 43,800          |                |                 |
| Creditors                                     | <u>50,000</u>   |                |                 |
|                                               | <u>3,41,000</u> |                | <u>3,41,000</u> |

## Advanced Accounting

### Working Notes:

| (1) Analysis of Profits of B Ltd.      | Capital Profits   | Revenue Profits   |
|----------------------------------------|-------------------|-------------------|
|                                        | Rs.               | Rs.               |
| Reserves                               | 5,000             |                   |
| Profit and loss account on 1.1.2000    | 10,000            |                   |
| Profit for the year (8,000 – 5,000)    | <u>          </u> | <u>3,000</u>      |
|                                        | 15,000            | 3,000             |
| A Ltd.'s share (60%)                   | <u>9,000</u>      | <u>1,800</u>      |
| Minority's share (40%)                 | <u>6,000</u>      | <u>1,200</u>      |
| (2) Minority Interest:                 |                   |                   |
| Share capital                          |                   | 20,000            |
| Capital profit                         |                   | 6,000             |
| Revenue profits                        |                   | <u>1,200</u>      |
|                                        |                   | <u>27,200</u>     |
| (3) Cost of control:                   |                   |                   |
| Investment in B Ltd.                   |                   | 60,000            |
| Less: Face value of investment         | 30,000            |                   |
| Capital profits                        | <u>9,000</u>      | <u>39,000</u>     |
| Goodwill                               |                   | <u>21,000</u>     |
| (4) Profit and Loss Account – A Ltd.   |                   |                   |
| Balance as on 1st January, 2000        |                   | 30,000            |
| Profit for the year                    |                   | <u>8,000</u>      |
|                                        |                   | 38,000            |
| Add: Dividends from B Ltd.             |                   | <u>4,000</u>      |
|                                        |                   | 42,000            |
| Add: Profit / (loss) on sale of shares |                   | <u>          </u> |
|                                        |                   | 42,000            |
| Add: Share in B Ltd.                   |                   | <u>1,800</u>      |
|                                        |                   | <u>43,800</u>     |

## Holding Company Accounts

### Question 6

On 31st March, 2002, the Balance Sheets of H Ltd. and S Ltd. stood as follows:

|                                                                 | H Ltd.       | S Ltd.<br>(Rs. in 000's) |
|-----------------------------------------------------------------|--------------|--------------------------|
| <b>Liabilities</b>                                              |              |                          |
| Equity Share (Capital – Authorised)                             | <u>5,000</u> | <u>3,000</u>             |
| Issued and subscribed in Equity Shares of Rs. 10 each full paid | 4,000        | 2,400                    |
| General Reserve                                                 | 928          | 690                      |
| Profit and Loss Account                                         | 1,305        | 810                      |
| Bills Payable                                                   | 124          | 80                       |
| Sundry Creditors                                                | 487          | 427                      |
| Provision for Taxation                                          | 220          | 180                      |
| Other Provisions                                                | <u>65</u>    | <u>17</u>                |
|                                                                 | <u>7,129</u> | <u>4,604</u>             |
| <b>Assets:</b>                                                  |              |                          |
| Plant and Machinery                                             | 2,541        | 2,450                    |
| Furniture and Fittings                                          | 615          | 298                      |
| Investment in the Equity Shares of S Ltd.                       | 1,500        | –                        |
| Stock                                                           | 983          | 786                      |
| Debtors                                                         | 700          | 683                      |
| Bills Receivables                                               | 120          | 95                       |
| Cash and Bank Balances                                          | 410          | 102                      |
| Sundry Advances                                                 | <u>260</u>   | <u>190</u>               |
|                                                                 | <u>7,129</u> | <u>4,604</u>             |

Following Additional Information is available :

- (a) H Ltd. purchased 90 thousand Equity Shares in S Ltd. on 1st April, 2001 at which date the following balances stood in the books of S Ltd.

General Reserve Rs. 1,500 thousand; Profit and Loss Account Rs. 633 thousand.

- (b) On 14th July, 2001 S Ltd. declared a dividend of 20% out of pre-acquisition profits and paid corporate dividend tax (including surcharge) at 11%. H Ltd. credited the dividend received to its Profit and Loss Account.
- (c) On 1st November, 2001 S Ltd. issued a 3 fully paid Equity Shares of Rs. 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.
- (d) On 31st March, 2002, the Stock of S Ltd. included goods purchased for Rs. 50 thousand from H Ltd., which had made a profit of 25% on Cost.

Prepare a consolidated Balance Sheet as on 31st March, 2002.

(16 marks)(November, 2002)

## Advanced Accounting

Answer

### Consolidated Balance Sheet of H Ltd. with its subsidiary S Ltd. as on 31st March, 2002

| Liabilities                                     | Rs. in<br>000's | Assets                             | Rs. in<br>000's |
|-------------------------------------------------|-----------------|------------------------------------|-----------------|
| Share Capital                                   |                 | Fixed Assets                       |                 |
| Authorised                                      | <u>5,000</u>    | Plant and Machinery                |                 |
| Issued, Subscribed and Paid up                  |                 | H Ltd.                             | 2,541           |
| 4 lakh equity shares of Rs. 10 each, fully paid | 4,000           | S Ltd.                             | <u>2,450</u>    |
| Minority Interest (Note 6)                      | 1,560           | Furniture and fittings             | 4,991           |
| Reserves and Surplus                            |                 | H Ltd.                             | 615             |
| Capital Reserve (Note 5)                        | 660             | S Ltd.                             | <u>298</u>      |
| General Reserve (928 + 54)                      | 982             | Current assets, Loans and Advances | 913             |
| Profit and Loss Account:                        |                 | (A) Current Assets                 |                 |
| H Ltd.                                          | 1,305           | Stock H Ltd.                       | 983             |
| Add: Share in S Ltd.                            | <u>306</u>      | S Ltd.                             | <u>786</u>      |
|                                                 | 1,611           |                                    | 1,769           |
| Less: Dividend wrongly credited                 | <u>180</u>      | Less: Unrealised profit (50x1/5)   | <u>10</u>       |
|                                                 | 1,431           | Debtors H Ltd.                     | 700             |
|                                                 | <u>10</u>       | S Ltd.                             | <u>683</u>      |
|                                                 | 1,421           |                                    | 1,383           |
| Less: Unrealised profit                         |                 |                                    |                 |
| Current Liabilities and Provisions              |                 | Cash and Bank Balances             |                 |
| (a) Current Liabilities                         |                 | H Ltd.                             | 410             |
| Bills payable H Ltd.                            | 124             | S Ltd.                             | <u>102</u>      |
| S Ltd.                                          | <u>80</u>       | (B) Loans and Advances             | 512             |
|                                                 | 204             | Bills Receivables                  |                 |
| Sundry Creditors H Ltd.                         | 487             | H Ltd.                             | 120             |
| S Ltd.                                          | <u>427</u>      | S Ltd.                             | <u>95</u>       |
|                                                 | 914             |                                    | 215             |
| (b) Provisions                                  |                 | Sundry Advances                    |                 |
| Provision for Taxation                          |                 | H Ltd.                             | 260             |
| H Ltd.                                          | 220             | S Ltd.                             | <u>190</u>      |
| S Ltd.                                          | <u>180</u>      |                                    | 450             |
|                                                 | 400             |                                    |                 |
| Other Provisions H Ltd.                         | 65              |                                    |                 |
| S Ltd.                                          | <u>17</u>       |                                    |                 |
|                                                 | <u>82</u>       |                                    |                 |
|                                                 | <u>10,223</u>   |                                    | <u>10,223</u>   |



## Holding Company Accounts

### Working Notes:

|    |                                                                           |              |    |                     |
|----|---------------------------------------------------------------------------|--------------|----|---------------------|
| 1. | S Ltd. General Reserve                                                    |              |    |                     |
|    |                                                                           | (Rs. in 000) |    | (Rs. in 000)        |
| To | Bonus to equity shareholders<br>$\left( \frac{2,400 \times 3}{8} \right)$ | 900          | By | Balance b/d         |
|    |                                                                           |              | By | Profit and Loss A/c |
| To | Balance c/d                                                               | <u>690</u>   |    | (Balancing figure)  |
|    |                                                                           | <u>1,590</u> |    | <u>1,590</u>        |

|    |                                                                         |              |    |                                               |
|----|-------------------------------------------------------------------------|--------------|----|-----------------------------------------------|
| 2. | S Ltd. Profit and Loss Account                                          |              |    |                                               |
|    |                                                                         | (Rs. in 000) |    | (Rs. in 000)                                  |
| To | General Reserve                                                         | 90           | By | Balance b/d                                   |
| To | Dividend paid on 14.7.2001<br>$\frac{\text{Rs. } 1,500 \times 20}{100}$ | 300          | By | Net Profit for the year<br>(Balancing figure) |
| To | Corporate Dividend Tax<br>(11% of Rs. 300)                              | 33           |    |                                               |
| To | Balance c/d                                                             | <u>810</u>   |    |                                               |
|    |                                                                         | <u>1,233</u> |    | <u>1,233</u>                                  |

\* Out of Rs. 6,00,000 profit for the year, Rs. 90,000 has been transferred to reserves by S Ltd.

|    |                                                                   |             |
|----|-------------------------------------------------------------------|-------------|
| 3. | Distribution of Revenue Profits                                   | Rs. in '000 |
|    | Revenue Profit as above                                           | 600         |
|    | Share of H Ltd.                                                   | 360         |
|    | 60% of (General Reserve Rs. 54 + Profit and Loss Account Rs. 306) |             |
|    | Share of Minority shareholders (Rs. 600 – Rs. 360)                | <u>240</u>  |

|    |                                                            |             |             |
|----|------------------------------------------------------------|-------------|-------------|
| 4. | Computation of Capital Profits                             | Rs. in '000 | Rs. in '000 |
|    | General Reserve on the date of acquisition                 |             | 1,500       |
|    | Less: Bonus issue of shares                                |             | <u>900</u>  |
|    |                                                            |             | 600         |
|    | Profit and Loss Account balance on the date of acquisition | 633         |             |
|    | Less: Dividends paid                                       | 300         |             |

## Advanced Accounting

|                                                                                             |            |              |
|---------------------------------------------------------------------------------------------|------------|--------------|
| Corporate tax paid                                                                          | <u>33</u>  |              |
|                                                                                             | <u>333</u> | <u>300</u>   |
|                                                                                             |            | <u>900</u>   |
| Share of H Ltd.                                                                             |            | 540          |
| Share of Minority shareholders                                                              |            | <u>360</u>   |
| 5. Computation of capital Reserve                                                           |            |              |
| 60% of share capital of S Ltd.                                                              |            | 1,440        |
| Add: Share of H Ltd. in the capital profits<br>as in working note No. (4)                   |            | <u>540</u>   |
|                                                                                             |            | 1,980        |
| Less: Investments in S Ltd.                                                                 | 1,500      |              |
| Less: Dividends received out of pre-<br>acquisition profits Rs. $300 \times \frac{60}{100}$ | <u>180</u> | <u>1,320</u> |
|                                                                                             |            | <u>660</u>   |
| 6. Calculation of Minority Interest                                                         |            |              |
| 40% of share capital of S Ltd.                                                              |            | 960          |
| Add: Share of Revenue Profits (Note 3)                                                      |            | 240          |
| Share of Capital Profits (Note 4)                                                           |            | <u>360</u>   |
|                                                                                             |            | <u>1,560</u> |

### Question 7

On 31st March, 1996, P Ltd. acquired 1,05,000 shares of Q Ltd. for Rs. 12,00,000. The Balance Sheet of Q Ltd. on that date was as under:

| Liabilities                                         | Rs.              | Assets         | Rs.              |
|-----------------------------------------------------|------------------|----------------|------------------|
| 1,50,000 equity shares of Rs. 10<br>each fully paid | 15,00,000        | Fixed Assets   | 10,50,000        |
| Pre-incorporation profits                           | 30,000           | Current Assets | 6,45,000         |
| Profit and Loss Account                             | 60,000           |                |                  |
| Creditors                                           | <u>1,05,000</u>  |                |                  |
|                                                     | <u>16,95,000</u> |                | <u>16,95,000</u> |

On 31st March, 2002 the Balance Sheets of two companies were as follows:

| Liabilities                                                        | P Ltd.<br>Rs. | Q Ltd.<br>Rs. | Assets                                       | P Ltd.<br>Rs. | Q Ltd.<br>Rs. |
|--------------------------------------------------------------------|---------------|---------------|----------------------------------------------|---------------|---------------|
| Equity shares of Rs. 10<br>each fully paid (before<br>bonus issue) | 45,00,000     | 15,00,000     | Fixed Assets<br>1,05,000 equity<br>shares in | 79,20,000     | 23,10,000     |

### Holding Company Accounts

|                           |                    |                  |                |                    |                  |
|---------------------------|--------------------|------------------|----------------|--------------------|------------------|
| Securities Premium        | 9,00,000           | –                | Q Ltd. at cost | 12,00,000          | –                |
| Pre-incorporation profits | –                  | 30,000           | Current Assets | 44,10,000          | 17,55,000        |
| General Reserve           | 60,00,000          | 19,05,000        |                |                    |                  |
| Profit and Loss Account   | 15,75,000          | 4,20,000         |                |                    |                  |
| Creditors                 | <u>5,55,000</u>    | <u>2,10,000</u>  |                |                    |                  |
|                           | <u>1,35,30,000</u> | <u>40,65,000</u> |                | <u>1,35,30,000</u> | <u>40,65,000</u> |

Directors of Q Ltd. made bonus issue on 31.3.2002 in the ratio of one equity share of Rs. 10 each fully paid for every two equity shares held on that date.

Calculate as on 31st March, 2002 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

- (i) Before issue of bonus shares.
- (ii) Immediately after issue of bonus shares.

It may be assumed that bonus shares were issued out of post-acquisition profits by using General Reserve.

Prepare a Consolidated Balance Sheet after the bonus issue.

(10 marks)(May, 2003)

Answer

- (i) Before issue of bonus shares

|                                                     |               |                  |
|-----------------------------------------------------|---------------|------------------|
| (i) Cost of control/capital reserve                 | Rs.           | Rs.              |
| Investment in Q Ltd.                                |               | 12,00,000        |
| Less: Face value of investments                     | 10,50,000     |                  |
| Capital profits (W.N.)                              | <u>63,000</u> | <u>11,13,000</u> |
| Cost of control                                     |               | <u>87,000</u>    |
| (ii) Minority Interest                              |               | Rs.              |
| Share Capital                                       |               | 4,50,000         |
| Capital profits (W.N.)                              |               | 27,000           |
| Revenue profits (W.N.)                              |               | <u>6,79,500</u>  |
|                                                     |               | <u>11,56,500</u> |
| (iii) Consolidated profit and loss account – P Ltd. |               | Rs.              |
| Balance                                             |               | 15,75,000        |
| Add: Share in revenue profits of Q Ltd.(W.N.)       |               | <u>15,85,500</u> |
|                                                     |               | <u>31,60,500</u> |

- (ii) Immediately after issue of bonus shares

|                                     |           |     |
|-------------------------------------|-----------|-----|
| (i) Cost of control/capital reserve | Rs.       | Rs. |
| Face value of investments           | 15,75,000 |     |

## Advanced Accounting

|       |                                                |                  |
|-------|------------------------------------------------|------------------|
|       | (Rs. 10,50,000 + 5,25,000)                     |                  |
|       | Capital Profits (W.N.)                         | <u>63,000</u>    |
|       | Less: Investment in Q Ltd.                     | <u>12,00,000</u> |
|       | Capital reserve                                | <u>4,38,000</u>  |
| (ii)  | Minority Interest                              | Rs.              |
|       | Share Capital (Rs. 4,50,000 + 2,25,000)        | 6,75,000         |
|       | Capital Profits (W.N.)                         | 27,000           |
|       | Revenue Profits (W.N.)                         | <u>4,54,500</u>  |
|       |                                                | <u>11,56,500</u> |
| (iii) | Consolidated Profit and Loss Account – P td.   | Rs.              |
|       | Balance                                        | 15,75,000        |
|       | Add: Share in revenue profits of Q Ltd. (W.N.) | <u>10,60,500</u> |
|       |                                                | <u>26,35,500</u> |

Consolidated Balance Sheet of P Ltd. and its subsidiary Q Ltd.

as on 31st March, 2002

| Liabilities             | Rs.                | Assets         | Rs.                |
|-------------------------|--------------------|----------------|--------------------|
| Share Capital           |                    | Fixed Assets   | 1,02,30,000        |
| (Shares of Rs. 10 each) | 45,00,000          | Current Assets | 61,65,000          |
| Securities Premium      | 9,00,000           |                |                    |
| Capital Reserve         | 4,38,000           |                |                    |
| General Reserve         | 60,00,000          |                |                    |
| Profit and Loss Account | 26,35,500          |                |                    |
| Creditors               | 7,65,000           |                |                    |
| Minority Interest       | <u>11,56,500</u>   |                |                    |
|                         | <u>1,63,95,000</u> |                | <u>1,63,95,000</u> |

Working Note:

Analysis of Profits of Q Ltd.

|                                      | Capital Profits<br>(Before and<br>after issue of<br>bonus shares)<br>Rs. | Revenue Profits<br>Before<br>Bonus<br>Issue<br>Rs. | After<br>Bonus<br>Issue<br>Rs. |
|--------------------------------------|--------------------------------------------------------------------------|----------------------------------------------------|--------------------------------|
| Pre-incorporation profits            | 30,000                                                                   |                                                    |                                |
| Profit and loss account on 31.3.1996 | <u>60,000</u>                                                            |                                                    |                                |
|                                      | <u>90,000</u>                                                            |                                                    |                                |
| General reserve*                     |                                                                          | 19,05,000                                          | 19,05,000                      |

### Holding Company Accounts

|                                                                                      |        |                  |                  |
|--------------------------------------------------------------------------------------|--------|------------------|------------------|
| Less: Bonus shares                                                                   |        | <u>7,50,000</u>  |                  |
|                                                                                      |        |                  | 11,55,000        |
| Profit for period of 1st April, 1997 to 31st March, 2002 (Rs. 4,20,000 – Rs. 60,000) |        | <u>3,60,000</u>  | <u>3,60,000</u>  |
|                                                                                      |        | <u>22,65,000</u> | <u>15,15,000</u> |
| P Ltd.'s share (70%)                                                                 | 63,000 | 15,85,500        | 10,60,500        |
| Minority's share (30%)                                                               | 27,000 | 6,79,500         | 4,54,500         |

\*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

#### Question 8

On 31st March, 2004 the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

| Liabilities                                 | H Ltd.<br>Rs. in<br>lakhs | S Ltd.<br>Rs. in lakhs |
|---------------------------------------------|---------------------------|------------------------|
| Share Capital:                              |                           |                        |
| Authorised                                  | <u>15,000</u>             | <u>6,000</u>           |
| Issued and Subscribed:                      |                           |                        |
| Equity Shares of Rs. 10 each, fully paid up | 12,000                    | 4,800                  |
| General Reserve                             | 2,784                     | 1,380                  |
| Profit and Loss Account                     | 2,715                     | 1,620                  |
| Bills Payable                               | 372                       | 160                    |
| Sundry Creditors                            | 1,461                     | 854                    |
| Provision for Taxation                      | 855                       | 394                    |
| Proposed Dividend                           | <u>1,200</u>              | <u>—</u>               |
|                                             | <u>21,387</u>             | <u>9,208</u>           |
|                                             |                           |                        |
| Assets                                      | H Ltd.<br>Rs. in lakhs    | S Ltd.<br>Rs. in lakhs |
| Land and Buildings                          | 2,718                     | —                      |
| Plant and Machinery                         | 4,905                     | 4,900                  |
| Furniture and Fittings                      | 1,845                     | 586                    |
| Investments in shares in S Ltd.             | 3,000                     | —                      |
| Stock                                       | 3,949                     | 1,956                  |
| Debtors                                     | 2,600                     | 1,363                  |
| Cash and Bank Balances                      | 1,490                     | 204                    |

### Advanced Accounting

|                  |               |              |
|------------------|---------------|--------------|
| Bills Receivable | 360           | 199          |
| Sundry Advances  | <u>520</u>    | <u>—</u>     |
|                  | <u>21,387</u> | <u>9,208</u> |

The following information is also provided to you:

- H Ltd. purchased 180 lakh shares in S Ltd. on 1st April, 2003 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at Rs. 3,000 lakh and 1,200 lakh respectively.
- On 4th July, 2003 S Ltd. declared a dividend @ 20% for the year ended 31st March, 2003. H Ltd. credited the dividend received by it to its Profit and Loss Account.
- On 1st January, 2004 S Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2003.
- On 31st March, 2004 all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only Rs. 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its creditors.
- On 31st March, 2004 S Ltd.'s stock included goods which it had purchased for Rs. 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2004 bearing in mind the requirements of AS 21. (16 marks)(May, 2004)

Answer

#### Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31st March, 2004

| Liabilities                                    | Rs.<br>in<br>lakhs | Rs. in<br>lakhs | Assets                 | Rs. in<br>lakhs | Rs. in<br>lakhs |
|------------------------------------------------|--------------------|-----------------|------------------------|-----------------|-----------------|
| Share Capital                                  |                    |                 | Fixed Assets           |                 |                 |
| Authorised                                     |                    | 15,000          | Land and Buildings     |                 |                 |
| Issued and Subscribed:                         |                    |                 | H Ltd.                 |                 | 2,718           |
| Equity shares of Rs. 10 each, fully<br>paid up |                    | 12,000          | Plant and<br>Machinery |                 |                 |
| Minority Interest (Note 6)                     |                    | 3,120           | H Ltd.                 | 4,905           |                 |
|                                                |                    |                 | S Ltd.                 | <u>4,900</u>    | 9,805           |
| Reserves and Surplus                           |                    |                 | Furniture and Fittings |                 |                 |
| Capital Reserve (Note 5)                       |                    | 1,320           | H Ltd.                 | 1,845           |                 |
| General Reserve (2,784 + 108)                  |                    | 2,892           | S Ltd.                 | <u>586</u>      | 2,431           |
| Profit and Loss Account:                       |                    |                 |                        |                 |                 |
| H Ltd.                                         | 2,715              |                 | Current Assets, Loans  |                 |                 |

## Holding Company Accounts

|                                     |           |               |       |                        |              |               |  |
|-------------------------------------|-----------|---------------|-------|------------------------|--------------|---------------|--|
| Less: Dividend wrongly credited 360 |           |               |       | and Advances           |              |               |  |
| Unrealised Profit                   | <u>20</u> | <u>380</u>    |       | Current Assets         |              |               |  |
|                                     |           | 2,335         |       | Stock                  |              |               |  |
| Add: Share in S Ltd.'s              |           |               |       | H Ltd.                 | 3,949        |               |  |
| Revenue profits                     |           | <u>612</u>    | 2,947 | S Ltd.                 | <u>1,956</u> |               |  |
|                                     |           |               |       |                        | 5,905        |               |  |
| Current Liabilities                 |           |               |       | Less: Unrealised       |              |               |  |
| and Provisions                      |           |               |       | profit                 | <u>20</u>    | 5,885         |  |
| Current Liabilities                 |           |               |       | Debtors                |              |               |  |
| Bills Payable                       |           |               |       | H Ltd.                 | 2,600        |               |  |
| H Ltd.                              |           | 372           |       | S Ltd.                 | <u>1,363</u> | 3,963         |  |
| S Ltd.                              |           | <u>160</u>    |       | Cash and Bank Balances |              |               |  |
|                                     |           | 532           |       | H Ltd.                 | 1,490        |               |  |
| Less: Mutual owing                  |           | <u>45</u>     | 487   | S Ltd.                 | <u>204</u>   | 1,694         |  |
|                                     |           |               |       | Loans and              |              |               |  |
|                                     |           |               |       | Advances               |              |               |  |
| Sundry Creditors                    |           |               |       | Bills Receivable       |              |               |  |
| H Ltd.                              |           | 1,461         |       | H Ltd.                 | 360          |               |  |
| S Ltd.                              |           | <u>854</u>    | 2,315 | S Ltd.                 | <u>199</u>   |               |  |
|                                     |           |               |       |                        | 559          |               |  |
| Provisions                          |           |               |       | Less: Mutual Owing     | <u>45</u>    | 514           |  |
| Provision for Taxation              |           |               |       | Sundry Advances        |              |               |  |
| H Ltd.                              |           | 855           |       | H Ltd.                 |              | 520           |  |
| S Ltd.                              |           | <u>394</u>    | 1,249 |                        |              |               |  |
| Proposed Dividend                   |           |               |       |                        |              |               |  |
| H Ltd.                              |           | <u>1,200</u>  |       |                        |              |               |  |
|                                     |           | <u>27,530</u> |       |                        |              | <u>27,530</u> |  |

### Working Notes:

|    |                              |              |    |                     |              |
|----|------------------------------|--------------|----|---------------------|--------------|
| 1. | S Ltd.'s General Reserve     |              |    |                     |              |
|    |                              | Rs. in lakhs |    |                     | Rs. in lakhs |
| To | Bonus to Equity Shareholders | 1,800        | By | Balance b/d         | 3,000        |
| To | Balance c/d                  | 1,380        | By | Profit and Loss A/c | 180          |
|    |                              | _____        |    | (Balancing figure)  | _____        |
|    |                              | 3,180        |    |                     | 3,180        |

|    |                                  |              |    |             |              |
|----|----------------------------------|--------------|----|-------------|--------------|
| 2. | S Ltd.'s Profit and Loss Account |              |    |             |              |
|    |                                  | Rs. in lakhs |    |             | Rs. in lakhs |
| To | General Reserve                  | 180          | By | Balance b/d | 1,200        |

### Advanced Accounting

|    |                                       |              |    |                          |               |
|----|---------------------------------------|--------------|----|--------------------------|---------------|
| To | Dividend paid (20% on Rs.3,000 lakhs) | 600          | By | Net Profit for the year* | 1,200         |
| To | Balance c/d                           | <u>1,620</u> |    | (Balancing figure)       | <u>      </u> |
|    |                                       | <u>2,400</u> |    |                          | <u>2,400</u>  |

\*Out of Rs. 1,200 lakhs profit for the year, Rs. 180 lakhs has been transferred to reserves.

#### 3. Distribution of Revenue profits

|                                                             | Rs. in lakhs  |
|-------------------------------------------------------------|---------------|
| Revenue profits (W. N. 2)                                   | 1,200         |
| Less: Share of H Ltd. 60%                                   | 720           |
| (General Reserve Rs. 108 + Profit and Loss Account Rs. 612) | <u>      </u> |
| Share of Minority Shareholders (40%)                        | <u>480</u>    |

#### 4. Calculation of Capital Profits

|                                                                                                | Rs. in lakhs |
|------------------------------------------------------------------------------------------------|--------------|
| General Reserve on the date of acquisition less bonus shares<br>(Rs. 3,000 – Rs. 1,800)        | 1,200        |
| Profit and loss account on the date of acquisition less dividend paid<br>(Rs. 1,200 – Rs. 600) | 600          |
|                                                                                                | <u>1,800</u> |

H Ltd.'s share = 60% of Rs. 1,800 lakhs = Rs. 1,080 lakhs

Minority interest = Rs. 1,800 – Rs. 1,080 = Rs. 720 lakhs

#### 5. Calculation of capital reserve

|                                                                   | Rs. in lakhs |
|-------------------------------------------------------------------|--------------|
| Paid up value of shares held (60% of Rs.4,800)                    | 2,880        |
| Add: Share in capital profits                                     | <u>1,080</u> |
|                                                                   | 3,960        |
| Less: Cost of shares less dividend received (Rs. 3,000 – Rs. 360) | <u>2,640</u> |
| Capital reserve                                                   | <u>1,320</u> |

#### 6. Calculation of Minority Interest

|                                         | Rs. in lakhs |
|-----------------------------------------|--------------|
| 40% of share capital (40% of Rs. 4,800) | 1,920        |
| Add: Share in revenue profits           | 480          |
| Share in capital profits                | <u>720</u>   |
|                                         | <u>3,120</u> |



## Holding Company Accounts

### 7. Unrealised profit in respect of stock

$$\text{Rs. 100 lakhs} \times \frac{25}{125} = \text{Rs. 20 lakhs}$$

### Question 9

The following are the summarised Balance Sheets of PD Co. Ltd. and SD Co. Ltd. as on 31.3.2004.

| Liabilities                             | PD Co. Ltd.<br>Rs. | SD Co. Ltd.<br>Rs. |
|-----------------------------------------|--------------------|--------------------|
| Share Capital:                          |                    |                    |
| Authorised                              | <u>70,00,000</u>   | <u>30,00,000</u>   |
| Issued and Subscribed Capital           |                    |                    |
| Equity shares of Rs. 10 each fully paid | 50,00,000          | 20,00,000          |
| Capital Reserve                         | 5,00,000           | 3,10,000           |
| Revenue Reserve                         | 8,50,000           | 75,000             |
| Profit and Loss Account                 | 4,00,000           | 2,80,000           |
| Sundry Creditors                        | 2,50,000           | 2,25,000           |
| Bills Payable                           | <u>1,00,000</u>    | <u>10,000</u>      |
|                                         | <u>71,00,000</u>   | <u>29,00,000</u>   |
| Assets                                  | PD Co. Ltd.<br>Rs. | SD Co. Ltd.<br>Rs. |
| Land and Buildings                      | 20,00,000          | 15,20,000          |
| Plant and Machinery                     | 20,00,000          | 8,00,000           |
| Furniture                               | 5,00,000           | 1,60,000           |
| Investments                             | 16,10,000          | —                  |
| Stock                                   | 3,40,000           | 1,00,000           |
| Sundry Debtors                          | 3,60,000           | 2,00,000           |
| Bills Receivable                        | 50,000             | 40,000             |
| Bank                                    | <u>2,40,000</u>    | <u>80,000</u>      |
|                                         | <u>71,00,000</u>   | <u>29,00,000</u>   |

PD Ltd. acquired 80% shares of SD Ltd. on 30.09.2003 at a cost of Rs. 18,10,000. On 1.10.2003 SD Ltd. declared and paid dividend on Equity Shares. PD Ltd. appropriately adjusted its share of dividend in Investment Account.

On 1.4.2003, the Capital Reserve and Profit and Loss Account stood in the books of SD Ltd. at Rs. 50,000 and Rs. 2,75,000 respectively.

## Advanced Accounting

Land and Buildings standing in the books of SD Ltd. at Rs. 16,00,000 on 1.4.2003, revalued at Rs.20,00,000 on 1.10.1993. Furniture, which stood in the books at Rs. 2,00,000 on 1.4.2003 revalued at Rs.1,50,000 on 1.10.2003. In both the cases the effects have not yet been given in the books.

SD Ltd. bought an item of machinery from PD Ltd. on hire-purchase basis. The following are the balances in respect of this machinery in the books on 31.03.2004:

|                             | Rs.    |
|-----------------------------|--------|
| Instalment due              | 20,000 |
| Instalment not due          | 8,000  |
| Hire-purchase stock reserve | 1,600  |

The above items stood included under appropriate heads in Balance Sheet.

Prepare a Consolidated Balance Sheet of PD Ltd. and its subsidiary SD Ltd. as at 31.03.2004, complying with the requirements of AS 21. (16 marks) (November, 2004)

Answer

### Consolidated Balance Sheet of PD Co. Ltd. with its subsidiary

SD Co. Ltd. as on 31st March, 2004

| Liabilities                | Rs.             | Rs.              | Assets                    | Rs.              | Rs.       |
|----------------------------|-----------------|------------------|---------------------------|------------------|-----------|
| Share Capital              |                 |                  | Fixed Assets              |                  |           |
| Authorised                 |                 | <u>70,00,000</u> | Land and buildings        |                  |           |
| Issued and subscribed      |                 |                  | PD Ltd.                   | 20,00,000        |           |
| Equity shares of Rs. 10    |                 |                  | SD Ltd. (W.N. 2)          | <u>19,50,000</u> | 39,50,000 |
| each, fully paid up        | 50,00,000       |                  | Plant and machinery       |                  |           |
| Minority interest (W.N. 5) | 6,14,000        |                  | PD Ltd.                   | 20,00,000        |           |
| Reserves and surplus:      |                 |                  | SD Ltd.                   | <u>8,00,000</u>  |           |
| Capital reserve (W.N. 8)   | 12,18,000       |                  |                           | 28,00,000        |           |
| Revenue reserve (W.N. 9)   | 8,80,000        |                  | Less: Unrealised profit   |                  |           |
| Profit and loss account    | 4,92,400        |                  | on hire purchase          |                  |           |
| (W.N. 10)                  |                 |                  | transaction               | <u>5,600</u>     | 27,94,400 |
| Current liabilities and    |                 |                  | Furniture                 |                  |           |
| provisions                 |                 |                  | PD Ltd.                   | 5,00,000         |           |
| Current liabilities        |                 |                  | SD Ltd. (W.N. 2)          | <u>1,35,000</u>  | 6,35,000  |
| Sundry creditors           |                 |                  | Current assets, loans and |                  |           |
| PD Ltd.                    | 2,50,000        |                  | advances                  |                  |           |
| SD Ltd.                    | <u>2,25,000</u> |                  | Current assets            |                  |           |
|                            | 4,75,000        |                  | Stock                     |                  |           |

### Holding Company Accounts

|                                         |               |                  |                                        |                 |                  |
|-----------------------------------------|---------------|------------------|----------------------------------------|-----------------|------------------|
| Less: Mutual hire purchase indebtedness | <u>28,000</u> | 4,47,000         | PD Ltd.                                | 3,40,000        |                  |
| Bills payable                           |               |                  | SD Ltd.                                | <u>1,00,000</u> |                  |
| PD Ltd.                                 | 1,00,000      |                  |                                        | 4,40,000        |                  |
| SD Ltd.                                 | <u>10,000</u> | 1,10,000         | Less: Hire purchase instalment not due | <u>8,000</u>    | 4,32,000         |
|                                         |               |                  | Sundry debtors                         |                 |                  |
|                                         |               |                  | PD Ltd.                                | 3,60,000        |                  |
|                                         |               |                  | SD Ltd.                                | <u>2,00,000</u> |                  |
|                                         |               |                  |                                        | 5,60,000        |                  |
|                                         |               |                  | Less: Hire purchase Instalment due     | <u>20,000</u>   | 5,40,000         |
|                                         |               |                  | Loans and advances                     |                 |                  |
|                                         |               |                  | Bills receivable                       |                 |                  |
|                                         |               |                  | PD Ltd.                                | 50,000          |                  |
|                                         |               |                  | SD Ltd.                                | <u>40,000</u>   | 90,000           |
|                                         |               |                  | Cash and Bank Balances:                |                 |                  |
|                                         |               |                  | Bank                                   |                 |                  |
|                                         |               |                  | PD Ltd.                                | 2,40,000        |                  |
|                                         |               |                  | SD Ltd.                                | <u>80,000</u>   | <u>3,20,000</u>  |
|                                         |               | <u>87,61,400</u> |                                        |                 | <u>87,61,400</u> |

#### Working Notes:

##### 1. Analysis of reserves and profits of SD Co. Ltd. as on 31.03.2004.

|                                         |                 | Pre-acquisition profit<br>upto 30.09.2003<br>(Capital profits) | Capital<br>reserve | Post-acquisition profits<br>(1.10.2003 – 31.3.2004)<br>Revenue<br>reserve | Profit and loss<br>account |
|-----------------------------------------|-----------------|----------------------------------------------------------------|--------------------|---------------------------------------------------------------------------|----------------------------|
| Capital reserve as on 31.3.2004         | 3,10,000        |                                                                |                    |                                                                           |                            |
| Less: Balance as on 1.4.2003            | <u>50,000</u>   | 50,000                                                         |                    |                                                                           |                            |
| Created during the year                 | <u>2,60,000</u> | 1,30,000                                                       | 1,30,000           |                                                                           |                            |
| Revenue reserve as on 31.3.2004         | 75,000          |                                                                |                    |                                                                           |                            |
| Less: balance as on 1.4.2003            | <u>—</u>        |                                                                |                    |                                                                           |                            |
| Created during the year                 | <u>75,000</u>   | 37,500                                                         |                    | 37,500                                                                    |                            |
| Profit and loss account as on 31.3.2004 | 2,80,000        |                                                                |                    |                                                                           |                            |
| Add: Dividend paid on 1.10.2003         | 2,50,000        |                                                                |                    |                                                                           |                            |
| (out of pre-acquisition profits)        | <u>5,30,000</u> |                                                                |                    |                                                                           |                            |

## Advanced Accounting

|                                                                  |                 |                 |               |                 |
|------------------------------------------------------------------|-----------------|-----------------|---------------|-----------------|
| Less: balance as on 1.4.2003                                     | <u>2,75,000</u> |                 |               |                 |
| Earned during the year                                           | <u>2,55,000</u> | 1,27,500        |               | 1,27,500        |
| Profit as on 1.4.2003                                            | 2,75,000        |                 |               |                 |
| Less: Dividend paid                                              |                 |                 |               |                 |
| [(Rs.18,10,000 –<br>Rs.16,10,000) × 5/4]                         | 2,50,000        |                 |               |                 |
| Balance of pre-acquisition profit<br>as on 31.3.2004             | <u>25,000</u>   | 25,000          |               |                 |
| Revaluation reserves as on<br>1.10.2003:                         |                 |                 |               |                 |
| Profit on land and buildings<br>(W.N. 2)                         |                 | 4,40,000        |               |                 |
| Loss on furniture (W.N. 2)                                       |                 | (30,000)        |               |                 |
| Difference in depreciation (for 6<br>months) due to revaluation: |                 |                 |               |                 |
| Short depreciation on land and<br>building (W.N. 3)              |                 |                 |               | (10,000)        |
| Excess depreciation on furniture<br>(W.N. 3)                     |                 |                 |               | <u>5,000</u>    |
| Total                                                            | <u>7,80,000</u> | <u>1,30,000</u> | <u>37,500</u> | <u>1,22,500</u> |
| Minority Interest (20%)                                          | 1,56,000        | 26,000          | 7,500         | 24,500          |
| Share of PD Co. Ltd. (80%)                                       | <u>6,24,000</u> | <u>1,04,000</u> | <u>30,000</u> | <u>98,000</u>   |

## 2. Profit or loss on revaluation of assets in the books of SD Ltd. and their book values as on 31.3.2004

|                                                                 |                  |
|-----------------------------------------------------------------|------------------|
|                                                                 | Rs.              |
| Land and buildings                                              |                  |
| Book value as on 1.4.2003                                       | 16,00,000        |
| Depreciation at 5% p.a. [(80,000 × 100)/16,00,000] for 6 months | <u>40,000</u>    |
|                                                                 | 15,60,000        |
| Revalued on 1.10.2003                                           | <u>20,00,000</u> |
| Profit on revaluation                                           | <u>4,40,000</u>  |
| Value as per balance sheet on 31.3.2004                         | 15,20,000        |
| Add: Profit on revaluation                                      | <u>4,40,000</u>  |
|                                                                 | 19,60,000        |
| Less: Short Depreciation (W.N. 3)                               | <u>10,000</u>    |
| Value as on 31.3.2004                                           | <u>19,50,000</u> |
| Furniture                                                       |                  |
| Book value as on 1.4.2003                                       | 2,00,000         |

## Holding Company Accounts

|                                                                             |                 |
|-----------------------------------------------------------------------------|-----------------|
| Less: Depreciation @ 20% p.a. $[(40,000 \times 100)/2,00,000]$ for 6 months | <u>20,000</u>   |
|                                                                             | 1,80,000        |
| Revalued on 1.10.2003                                                       | <u>1,50,000</u> |
| Loss on revaluation                                                         | <u>30,000</u>   |
| Value as per balance sheet on 31.3.2004                                     | 1,60,000        |
| Less: Loss on revaluation                                                   | <u>30,000</u>   |
|                                                                             | 1,30,000        |
| Add: Excess depreciation written back (W.N. 3)                              | <u>5,000</u>    |
| Value as on 31.3.2004                                                       | <u>1,35,000</u> |

### 3. Calculation of short/excess depreciation

|                                                                          | Building        | Furniture     |
|--------------------------------------------------------------------------|-----------------|---------------|
| Revalued figure as on 1.10.2003                                          | 20,00,000       | 1,50,000      |
| Rate of depreciation                                                     | 5% p.a.         | 20% p.a.      |
| Depreciation for 6 months on revalued figure<br>(1.10.2003 to 31.3.2004) | 50,000          | 15,000        |
| Depreciation already provided                                            | <u>40,000</u>   | <u>20,000</u> |
| Difference [(short)/excess]                                              | <u>(10,000)</u> | <u>5,000</u>  |

### 4. Calculation of cost of control

|                           | Rs.              |
|---------------------------|------------------|
| Share capital in SD Ltd.  | 16,00,000        |
| Add: Capital profit       | <u>6,24,000</u>  |
|                           | 22,24,000        |
| Less: Cost of Investments | <u>16,10,000</u> |
| Capital Reserve           | <u>6,14,000</u>  |

### 5. Calculation of minority interest

|                                     | Rs.           | Rs.             |
|-------------------------------------|---------------|-----------------|
| Share capital                       |               | 4,00,000        |
| Capital (pre-acquisition) profits   |               | 1,56,000        |
| Revenue (post-acquisition) profits: |               |                 |
| Capital Reserve                     | 26,000        |                 |
| Revenue reserve                     | 7,500         |                 |
| Profit and loss                     | <u>24,500</u> | <u>58,000</u>   |
|                                     |               | <u>6,14,000</u> |

## Advanced Accounting

### 6. Stock reserve (plant and machinery)

Percentage of profit on hire purchase transaction

$$\frac{1,600 \times 100}{8,000} = 20\%$$

20% on Rs. 20,000 = Rs. 4,000

Total unrealised profit = Rs. 4,000 + Rs. 1,600 = Rs. 5,600

### 7. Elimination of mutual indebtedness

Elimination of mutual indebtedness in respect of sale of machinery on hire purchase basis will be made as under in the Consolidated Balance Sheet.

|                                                                          | Creditors        | Debtors         | Stock           | Plant and machinery |
|--------------------------------------------------------------------------|------------------|-----------------|-----------------|---------------------|
|                                                                          | Rs.              | Rs.             | Rs.             | Rs.                 |
| Total (PD Ltd. and SD Ltd.)                                              | 4,75,000         | 5,60,000        | 4,40,000        | 28,00,000           |
| Less: Instalment due                                                     | 20,000           | 20,000          | —               | —                   |
| Less: Instalment not due                                                 | 8,000            | —               | 8,000           | —                   |
| Less: Profit on plant purchased by SD Ltd. from PD Ltd. on hire purchase | —                | —               | —               | 5,600               |
|                                                                          | <u>4, 47,000</u> | <u>5,40,000</u> | <u>4,32,000</u> | <u>27,94,400</u>    |

For consolidated balance sheet purpose, the unrealised profits will be eliminated by deducting Rs. 5,600 from Plant & Machinery and from profit and loss account.

### 8. Consolidated capital reserve as on 31.3.2004

|                                                                    | Rs.              |
|--------------------------------------------------------------------|------------------|
| Capital reserve of PD Ltd. as on 31.3.2004                         | 5,00,000         |
| Add: Share in post acquisition capital reserve of SD Ltd. (W.N. 1) | 1,04,000         |
| Add: Cost of control (W.N. 4)                                      | <u>6,14,000</u>  |
|                                                                    | <u>12,18,000</u> |

### 9. Consolidated revenue reserve as on 31.3.2004

|                                                                    | Rs.             |
|--------------------------------------------------------------------|-----------------|
| Revenue reserve of PD Ltd. as on 31.3.2004                         | 8,50,000        |
| Add: Share in post acquisition revenue reserve of SD Ltd. (W.N. 1) | <u>30,000</u>   |
|                                                                    | <u>8,80,000</u> |

### 10. Consolidated profit and loss account as on 31.3.2004

|                                                                            | Rs.      |
|----------------------------------------------------------------------------|----------|
| Profit and loss account balance of PD Ltd. as on 31.3.2004                 | 4,00,000 |
| Add: Share in post acquisition profit and loss account of SD Ltd. (W.N. 1) | 98,000   |

### Holding Company Accounts

|                                          |                 |
|------------------------------------------|-----------------|
| Less: Unrealised profit on hire purchase | <u>(5,600)</u>  |
|                                          | <u>4,92,400</u> |

Note: In the question, the balance of capital reserve and profit and loss account of SD Ltd., as on 1.4.2003 only has been given and not of revenue reserve. Hence, it has been assumed in the above solution that the revenue reserve is created during the year from current year's profits.

#### Question 10

The Balance Sheets of Football Ltd. and its subsidiary Hockey Ltd. as on 31st March, 2005 are as under:

| Liabilities                          | Football<br>Ltd.<br>Rs. | Hockey<br>Ltd.<br>Rs. | Assets                 | Football<br>Ltd.<br>Rs. | Hockey<br>Ltd.<br>Rs. |
|--------------------------------------|-------------------------|-----------------------|------------------------|-------------------------|-----------------------|
| Equity shares of Rs. 10 each         | 48,00,000               | 20,00,000             | Goodwill               | 4,50,000                | 3,00,000              |
| 10% Preference shares of Rs. 10 each | 7,00,000                | 3,80,000              | Plant and machinery    | 12,00,000               | 5,00,000              |
| General reserve                      | 5,50,000                | 4,20,000              | Motor vehicles         | 9,50,000                | 7,50,000              |
| Profit and loss account              | 10,00,000               | 6,00,000              | Furniture and fittings | 6,50,000                | 4,00,000              |
| Bank overdraft                       | 1,20,000                | 70,000                | Investments            | 26,00,000               | 4,50,000              |
| Sundry creditors                     | 4,30,000                | 4,80,000              | Stock                  | 4,50,000                | 7,20,000              |
| Bills payable                        | —                       | 1,60,000              | Cash at bank           | 2,25,000                | 2,10,000              |
|                                      |                         |                       | Debtors                | 9,30,000                | 7,80,000              |
|                                      |                         |                       | Bills receivable       | <u>1,45,000</u>         | <u>—</u>              |
|                                      | <u>76,00,000</u>        | <u>41,10,000</u>      |                        | <u>76,00,000</u>        | <u>41,10,000</u>      |

Details of acquisition of shares by Football Ltd. are as under:

| Nature of shares  | No. of shares<br>acquired | Date of<br>acquisition | Cost of<br>acquisition<br>Rs. |
|-------------------|---------------------------|------------------------|-------------------------------|
| Preference shares | 14,250                    | 1.4.2002               | 3,10,000                      |
| Equity shares     | 80,000                    | 1.4.2003               | 9,50,000                      |
| Equity shares     | 70,000                    | 1.4.2004               | 8,00,000                      |

Other information:

- (i) On 1.4.2004 profit and loss account and general reserve of Hockey Ltd. had credit balances of Rs. 3,00,000 and Rs. 2,00,000 respectively.

### Advanced Accounting

- (ii) Dividend @ 10% was paid by Hockey Ltd. for the year 2003-2004 out of its profit and loss account balance as on 1.4.2004. Football Ltd. credited its share of dividend to its profit and loss account.
- (iii) Hockey Ltd. allotted bonus shares out of general reserve at the rate of 1 share for every 10 shares held. Accounting thereof has not yet been made.
- (iv) Bills receivable of Football Ltd. were drawn upon Hockey Ltd.
- (v) During the year 2004-2005 Football Ltd. purchased goods from Hockey Ltd. for Rs. 1,00,000 at a sale price of Rs. 1,20,000. 40% of these goods remained unsold at close of the year.
- (vi) On 1.4.2004 motor vehicles of Hockey Ltd. were overvalued by Rs. 1,00,000. Applicable depreciation rate is 20%.
- (vii) Dividends recommended for the year 2004-2005 in the holding and the subsidiary companies are 15% and 10% respectively.

Prepare consolidated Balance Sheet as on 31st March, 2005. (16 marks)(May,2005)

Answer

| Consolidated Balance Sheet of Football Ltd.<br>and its subsidiary Hockey Ltd.<br>as on 31st March, 2005 |                 |           |                                         |                 |           |
|---------------------------------------------------------------------------------------------------------|-----------------|-----------|-----------------------------------------|-----------------|-----------|
|                                                                                                         | Amount          |           |                                         | Amount          |           |
| Liabilities                                                                                             | Rs.             | Rs.       | Assets                                  | Rs.             | Rs.       |
| Share Capital                                                                                           |                 |           | Fixed Assets                            |                 |           |
| Authorised, Issued and paid up capital                                                                  |                 | —         | Goodwill                                |                 |           |
| 4,80,000 equity shares of Rs. 10 each                                                                   |                 | 48,00,000 | Football Ltd.                           | 4,50,000        |           |
| 70,000 10% preference shares of Rs. 10 each                                                             |                 | 7,00,000  | Hockey Ltd.                             | <u>3,00,000</u> |           |
| Minority Interest (W.N. 3)                                                                              |                 | 9,86,750  |                                         | 7,50,000        |           |
| Reserves and Surplus                                                                                    |                 |           | Add: Goodwill on consolidation (W.N. 2) | <u>1,97,500</u> | 9,47,500  |
| General reserve (W.N. 5)                                                                                |                 | 7,15,000  | Plant and Machinery                     |                 |           |
| Profit and loss account (W.N. 4)                                                                        |                 | 5,07,750  | Football Ltd.                           | 12,00,000       |           |
| Current Liabilities and Provisions                                                                      |                 |           | Hockey Ltd.                             | <u>5,00,000</u> | 17,00,000 |
| Bank Overdraft                                                                                          |                 |           | Motor Vehicles                          |                 |           |
| Football Ltd.                                                                                           |                 |           | Football Ltd.                           | 9,50,000        |           |
|                                                                                                         | 1,20,000        |           | Hockey Ltd.                             |                 |           |
| Hockey Ltd.                                                                                             | <u>70,000</u>   | 1,90,000  | (7,50,000 – 1,00,000 + 20,000)          | <u>6,70,000</u> | 16,20,000 |
| Sundry Creditors                                                                                        |                 |           | Furniture & Fittings                    |                 |           |
| Football Ltd.                                                                                           | 4,30,000        |           | Football Ltd.                           | 6,50,000        |           |
| Hockey Ltd.                                                                                             | <u>4,80,000</u> | 9,10,000  | Hockey Ltd.                             | <u>4,00,000</u> | 10,50,000 |
| Bills payable                                                                                           |                 |           | Investments                             |                 |           |



## Holding Company Accounts

|                   |                 |                  |                                    |                 |                  |
|-------------------|-----------------|------------------|------------------------------------|-----------------|------------------|
| Hockey Ltd.       | 1,60,000        |                  | Football Ltd.                      |                 |                  |
| Less: Mutual debt | <u>1,45,000</u> | 15,000           | (26,00,000 – 20,60,000)            | 5,40,000        |                  |
| Proposed Dividend |                 |                  | Hockey Ltd.                        | <u>4,50,000</u> | 9,90,000         |
| Equity            | 7,20,000        |                  | Current assets, loans and advances |                 |                  |
| Preference        | <u>70,000</u>   | 7,90,000         | Current assets                     |                 |                  |
|                   |                 |                  | Stock                              |                 |                  |
|                   |                 |                  | Football Ltd.                      | 4,50,000        |                  |
|                   |                 |                  | Hockey Ltd.                        | <u>7,20,000</u> |                  |
|                   |                 |                  |                                    | 11,70,000       |                  |
|                   |                 |                  | Less: Unrealised profit            | <u>8,000</u>    | 11,62,000        |
|                   |                 |                  | Debtors                            |                 |                  |
|                   |                 |                  | Football Ltd.                      | 9,30,000        |                  |
|                   |                 |                  | Hockey Ltd.                        | <u>7,80,000</u> | 17,10,000        |
|                   |                 |                  | Cash at Bank                       |                 |                  |
|                   |                 |                  | Football Ltd.                      | 2,25,000        |                  |
|                   |                 |                  | Hockey Ltd.                        | <u>2,10,000</u> | 4,35,000         |
|                   |                 |                  | Loans and advances                 |                 |                  |
|                   |                 |                  | Bills receivable                   |                 |                  |
|                   |                 |                  | Football Ltd.                      | 1,45,000        |                  |
|                   |                 |                  | Less: Mutual Debt                  | <u>1,45,000</u> | <u>Nil</u>       |
|                   |                 | <u>96,14,500</u> |                                    |                 | <u>96,14,500</u> |

### Working Notes:

| (1) Analysis of Profits of Hockey Ltd.                                                 |                 | Capital Profits | Revenue Reserve | Revenue Profit |
|----------------------------------------------------------------------------------------|-----------------|-----------------|-----------------|----------------|
|                                                                                        | Rs.             | Rs.             | Rs.             | Rs.            |
| (a) General Reserve as on 1.4.2004                                                     | 2,00,000        |                 |                 |                |
| Less: Bonus issue (1/10 of Rs. 20,00,000)                                              | <u>2,00,000</u> | –               | –               |                |
| (b) Addition to General Reserve during 2004-2005 (Rs. 4,20,000 – Rs. 2,00,000)         |                 |                 | 2,20,000        |                |
| (c) Profit and Loss Account balance as on 1.4.2004                                     | 3,00,000        |                 |                 |                |
| Less: Dividend paid for the year 2003-2004                                             | <u>2,00,000</u> | 1,00,000        |                 |                |
| (d) Profit for the year 2004-2005 (Rs. 6,00,000 – Rs. 1,00,000)                        |                 |                 |                 | 5,00,000       |
| (e) Adjustment for over valuation of motor vehicles                                    |                 | (1,00,000)      |                 |                |
| (f) Adjustment of revenue profit due to overcharged depreciation (20% on Rs. 1,00,000) |                 |                 |                 | 20,000         |

## Advanced Accounting

|                                                      |                                                                    |               |   |                  |                 |
|------------------------------------------------------|--------------------------------------------------------------------|---------------|---|------------------|-----------------|
| (g) Preference dividend for the year 2004-2005 @ 10% |                                                                    |               |   |                  | (38,000)        |
|                                                      |                                                                    |               | — | <u>2,20,000</u>  | <u>4,82,000</u> |
|                                                      | Football Ltd.'s share (3/4)                                        |               |   | 1,65,000         | 3,61,500        |
|                                                      | Minority Interest (1/4)                                            |               |   | <u>55,000</u>    | <u>1,20,500</u> |
|                                                      |                                                                    |               |   | <u>2,20,000</u>  | <u>4,82,000</u> |
| (2)                                                  | Cost of Control                                                    | Rs.           |   | Rs.              |                 |
|                                                      | Cost of investments in Hockey Ltd.                                 |               |   | 20,60,000        |                 |
|                                                      | Less: Paid up value of equity shares (including bonus shares)      | 16,50,000     |   |                  |                 |
|                                                      | [80,000 + 70,000 + (10% of 1,50,000)] × Rs. 10                     |               |   |                  |                 |
|                                                      | Paid-up value of preference shares                                 | 1,42,500      |   |                  |                 |
|                                                      | Pre-acquisition dividend*                                          | <u>70,000</u> |   | <u>18,62,500</u> |                 |
|                                                      | Cost of control/Goodwill                                           |               |   | <u>1,97,500</u>  |                 |
| (3)                                                  | Minority Interest                                                  |               |   |                  |                 |
|                                                      | Equity share capital                                               |               |   |                  |                 |
|                                                      | [Rs. 5,00,000 + Rs. 50,000 (Bonus)]                                |               |   | 5,50,000         |                 |
|                                                      | Preference share capital                                           |               |   |                  |                 |
|                                                      | (Rs. 3,80,000 – Rs. 1,42,500)                                      |               |   | 2,37,500         |                 |
|                                                      | Share of revenue reserve                                           |               |   | 55,000           |                 |
|                                                      | Share of revenue profit                                            |               |   | 1,20,500         |                 |
|                                                      | Proposed preference dividend                                       |               |   | <u>23,750</u>    |                 |
|                                                      |                                                                    |               |   | <u>9,86,750</u>  |                 |
| (4)                                                  | Profit and Loss Account – Football Ltd.                            |               |   |                  |                 |
|                                                      | Balance                                                            |               |   | 10,00,000        |                 |
|                                                      | Share in profit of Hockey Ltd.                                     |               |   | 3,61,500         |                 |
|                                                      | Share in proposed preference dividend of Hockey Ltd.               |               |   | <u>14,250</u>    |                 |
|                                                      |                                                                    |               |   | 13,75,750        |                 |
|                                                      | Less: Pre-acquisition dividend credited to profit and loss account | 70,000        |   |                  |                 |
|                                                      | Unrealised profit on stock (40% of Rs.20,000)                      | 8,000         |   |                  |                 |
|                                                      | Proposed equity dividend                                           | 7,20,000      |   |                  |                 |
|                                                      | Proposed preference dividend                                       | <u>70,000</u> |   | <u>8,68,000</u>  |                 |
|                                                      |                                                                    |               |   | <u>5,07,750</u>  |                 |
| (5)                                                  | General reserve – Football Ltd.                                    |               |   |                  |                 |
|                                                      | Balance                                                            |               |   | 5,50,000         |                 |
|                                                      | Add: Share in Hockey Ltd.                                          |               |   | <u>1,65,000</u>  |                 |
|                                                      |                                                                    |               |   | <u>7,15,000</u>  |                 |

\* The dividend on 70,000 shares only (acquired on 1.4.2004) is a pre-acquisition dividend.

## Holding Company Accounts

Note: No information has been given in the question regarding date of bonus issue by Hockey. It is also not mentioned whether the bonus shares are issued from pre-acquisition general reserve or post-acquisition general reserve. The above solution is given on the basis that Hockey Ltd. allotted bonus shares out of pre-acquisition general reserve.

### Question 11

The Balance Sheet of Golden and Silver Limited as on 31.3.2006 are given below:

| Liabilities             | Golden Ltd. (Rs.) | Silver Ltd. (Rs.) | Assets           | Golden Ltd. (Rs.) | Silver Ltd. (Rs.) |
|-------------------------|-------------------|-------------------|------------------|-------------------|-------------------|
| Equity share capital    | 2,40,000          | 2,40,000          | Fixed assets     | 88,000            | 1,68,000          |
| General reserve         | 40,000            | 32,000            | Investment       | 1,80,000          | 10,000            |
| Profit and Loss account | 24,000            | 39,000            | Sundry debtors   | 12,000            | 30,000            |
| Bills payable           | 4,000             | 10,000            | Bills receivable | 8,000             | 32,000            |
| Sundry creditors        | 8,000             | 15,000            | Stock in trade   | 20,000            | 80,000            |
|                         |                   |                   | Cash at bank     | <u>8,000</u>      | <u>16,000</u>     |
|                         | <u>3,16,000</u>   | <u>3,36,000</u>   |                  | <u>3,16,000</u>   | <u>3,36,000</u>   |

Note: Contingent liability of Golden Ltd.: Bills discounted not yet matured at Rs.5,000.

Additional information:

- (i) On 1.10.2003, Golden Ltd. acquired 16,000 shares of Rs.10 each at the rate of Rs.11 per share.
- (ii) Balances to General reserve and Profit and Loss account of Silver Ltd. stood on 1.4.2003 at Rs.60,000 and Rs.32,000 respectively.
- (iii) Dividends have been paid @ 10% for each of the years 2003-04 and 2004-05. Dividend for the year 2003-04 was paid out of the pre-acquisition profits. No dividend has been proposed for the year 2005-06 as yet and no provision need to be made in consolidated Balance Sheet. Golden Ltd. has credited all dividends received to profit and Loss account.
- (iv) On 1.3.2006, bonus shares were issued by Silver Ltd. at the rate of one fully paid share for every five held and effect has been given to that in the above accounts. The bonus was declared from general reserves from out of profits earned prior to 1.4.2003.
- (v) On 1.10.2003, Fixed assets was revalued at Rs.2,16,000, but no adjustment had been made in the books.
- (vi) Depreciation had been charged @ 10% p.a. on the book value as on 1.4.2003 (on straight line method), there being no addition or sale since then.
- (vii) Out of Current profits Rs.4,000 have been transferred to General reserve every year.
- (viii) Bills receivable of Golden Ltd. include Rs.4,000 bills accepted by Silver Ltd. Bills discounted by Golden Ltd., but not yet matured include Rs.3,000 accepted by Silver Ltd.

### Advanced Accounting

- (ix) Sundry creditors of Golden Ltd. include Rs.4,000 due to Silver Ltd. Sundry debtors of Silver Ltd. include Rs.8,000 due from Golden Ltd.
- (x) It is found that Golden Ltd. has remitted a cheque of Rs.4,000, which has not yet been received by Silver Ltd.

Prepare consolidated Balance Sheet as at 31.3.2006 of Golden Ltd. and its Subsidiary.

(16 Marks) (Nov. 2006)

Answer

| Golden Ltd and its Subsidiary Silver Ltd.         |                 |                             |                 |                 |  |
|---------------------------------------------------|-----------------|-----------------------------|-----------------|-----------------|--|
| Consolidated Balance Sheet                        |                 |                             |                 |                 |  |
| as on 31 <sup>st</sup> March, 2006                |                 |                             |                 |                 |  |
| Liabilities                                       | Amount          | Assets                      | Amount          |                 |  |
|                                                   | Rs.             |                             | Rs.             |                 |  |
| Share capital<br>(24,000 shares of<br>Rs.10 each) | 2,40,000        | Fixed Assets                | 88,000          |                 |  |
| Minority Interests                                | 60,400          | (1,68,000-<br>12,000+3,000) | <u>1,59,000</u> | 2,47,000        |  |
| Capital Reserve                                   | 53,200          | Investment                  |                 | 14,000          |  |
| General Reserve                                   | 48,000          | (4,000*+10,000)             |                 |                 |  |
| Consolidated P&L<br>Account                       | 28,400          | Debtors                     |                 |                 |  |
| Bills Payable                                     | 14,000          | (12,000+30,000-4,000)       | 38,000          |                 |  |
| Less: Mutual<br>indebtedness                      | <u>4,000</u>    | Less: Mutual Debts          | <u>4,000</u>    | 34,000          |  |
| Sundry creditors                                  | 23,000          | Bills Receivable            | 40,000          |                 |  |
| Less: Mutual<br>indebtedness                      | <u>4,000</u>    | Less: Mutual Debts          | <u>4,000</u>    | 36,000          |  |
|                                                   | 19,000          | Stock (20,000+80,000)       |                 | 1,00,000        |  |
|                                                   |                 | Remittance in Transit       |                 | 4,000           |  |
|                                                   |                 | Cash at Bank                |                 |                 |  |
|                                                   |                 | (8,000+16,000)              |                 | <u>24,000</u>   |  |
|                                                   | <u>4,59,000</u> |                             |                 | <u>4,59,000</u> |  |

Note: Contingent Liability of Bills discounted not yet matured for payment Rs.2,000.

Working Notes:-

|                                                                                |                 |
|--------------------------------------------------------------------------------|-----------------|
| (i) Interest of Golden Ltd in Silver Ltd.                                      | Rs.             |
| Share capital of Silver Ltd. on 31.3.2006                                      | 2,40,000        |
| Less: Issue of Bonus Shares $\left(\frac{1}{6} \text{ of Rs. 2,40,000}\right)$ | <u>40,000</u>   |
| Share capital before Bonus issue                                               | <u>2,00,000</u> |

\* Rs. 1,80,000 – (16,000 shares x Rs. 11)

## Holding Company Accounts

|                                         |                                    |        |
|-----------------------------------------|------------------------------------|--------|
| No. of Equity Shares before Bonus issue | $\frac{2,00,000}{10}$              | 20,000 |
| No. of shares held by Golden Ltd.       |                                    | 16,000 |
| Interest of Golden Ltd. in Silver Ltd   | $\frac{16,000}{20,000} \times 100$ | 80%    |
| Minority shareholders' Interest         |                                    | 20%    |

### (ii) Analysis of Profit of Silver Ltd.

|                                                                                                                                   | Rs.            | Capital Profit<br>Rs. | Revenue Reserve<br>Rs. | Revenue Profit<br>Rs. |
|-----------------------------------------------------------------------------------------------------------------------------------|----------------|-----------------------|------------------------|-----------------------|
| General Reserve on 31.3.2006 (After Bonus issue)                                                                                  | 32,000         |                       |                        |                       |
| Add: Bonus issue                                                                                                                  | <u>40,000</u>  |                       |                        |                       |
| Balance (before bonus issue)                                                                                                      | <u>72,000</u>  |                       |                        |                       |
| General Reserve on 1.4.2003                                                                                                       | 60,000         |                       |                        |                       |
| Less: Bonus issue                                                                                                                 | <u>40,000</u>  | 20,000                |                        |                       |
| Increase in General Reserve (Transfer of Rs.4000 p.a. for 3 years)<br>(72,000 – 60,000)                                           | <u>12,000</u>  | 2,000                 | 10,000                 |                       |
| Profit and Loss Account                                                                                                           |                |                       |                        |                       |
| Increase in Profit after Dividend<br>39,000 – 12,000 =                                                                            | <u>27,000*</u> | 4,500                 |                        | 22,500                |
| Additional depreciation written back due to revaluation of fixed assets<br>$\left(12,000 \times \frac{10}{100} \times 2.5\right)$ |                |                       |                        | 3,000                 |
|                                                                                                                                   |                | <u>26,500</u>         | <u>10,000</u>          | <u>25,500</u>         |
| Share of Golden Ltd. (80%)                                                                                                        |                | 21,200                | 8,000                  | 20,400                |
| Share of Minority Shareholders (20%)                                                                                              |                | <u>5,300</u>          | <u>2,000</u>           | <u>5,100</u>          |
|                                                                                                                                   |                | <u>26,500</u>         | <u>10,000</u>          | <u>25,500</u>         |

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\* It has been assumed that Profit of Rs.27,000 after payment of dividend for the year 2004-2005, has been earned evenly in 3 years, (year 2003-04, 2004-05 and 2005-06) hence profit per year would be  $\frac{27,000}{3} = \text{Rs.9,000}$ . Half of the profit of Rs.9,000 for the year 2003-04 would be pre-acquisition (Capital Profit) and Remaining half i.e. Rs.4500 would be post-acquisition profit (Revenue profit).

## Advanced Accounting

(iii) Loss on Revaluation has been calculated as follows:

|                                                                                          |                 |
|------------------------------------------------------------------------------------------|-----------------|
|                                                                                          | Rs.             |
|                                                                                          | 2,40,000        |
| Value of Assets on 1.4.2003 ( $1,68,000 \times \frac{100}{70}$ )                         |                 |
|                                                                                          | <u>12,000</u>   |
| Less : Depreciation for 6 months ( $2,40,000 \times \frac{10}{100} \times \frac{1}{2}$ ) |                 |
| Valuation of Assets on 1.10.2003                                                         | 2,28,000        |
| Less: Re-valued value of Assets                                                          | <u>2,16,000</u> |
| Loss on Revaluation                                                                      | <u>12,000</u>   |

(iv) Cost of Control

|                                                            |               |
|------------------------------------------------------------|---------------|
|                                                            | Rs.           |
| Cost of Investment in Silver Ltd.                          | 1,76,000      |
| Less: Dividend out of capital profit                       | 16,000        |
| Less: Paid up value of investment (including Bonus Shares) |               |
|                                                            | 1,92,000      |
| ( $1,60,000 + 1,60,000 \times \frac{1}{5}$ )               |               |
| Less: Capital Profit                                       | <u>21,200</u> |
| Capital Reserve                                            | <u>53,200</u> |

(v) Minority Interest

|                                                        |               |
|--------------------------------------------------------|---------------|
| Paid-up share capital (Including Bonus Shares)         |               |
| $\left( 40,000 + 40,000 \times \frac{20}{100} \right)$ | 48,000        |
| Add: Share in Capital Profit                           | 5,300         |
| Share in Revenue Reserve                               | 2,000         |
| Share in Revenue Profit                                | <u>5,100</u>  |
|                                                        | <u>60,400</u> |

(vi) General Reserve

|                           |               |
|---------------------------|---------------|
| Balance in Golden Ltd.    | 40,000        |
| Add: Share in Silver Ltd. | <u>8,000</u>  |
|                           | <u>48,000</u> |

(vii) Consolidated Profit and Loss Account

|                                                       |        |
|-------------------------------------------------------|--------|
| Balance in Golden Ltd.                                | 24,000 |
| Less: Dividend credited out of Pre-acquisition Profit |        |

## Holding Company Accounts

|                                     |               |
|-------------------------------------|---------------|
| (Capital Profit)                    | <u>16,000</u> |
|                                     | 8,000         |
| Add: Share in Profit of Silver Ltd. | <u>20,400</u> |
|                                     | <u>28,400</u> |

### Question 12

X Ltd. purchases its raw materials from Y Ltd. and sells goods to Z Ltd. In order to ensure regular supply of raw materials and patronage for finished goods, X Ltd. through its wholly owned subsidiary, X Investments Ltd. acquires on 31st December, 1996, 51% of equity capital of Y Ltd. for Rs. 15 crores and 76% of equity capital of Z Ltd. for Rs.30 crores. X Investments Ltd. was floated by X Ltd. in 1990 from which date it was wholly owned by X Ltd.

The following are the Balance Sheets of the four companies as on 31st December, 1996:

|                                                     | X Ltd.    |            | X Investments Ltd. |           | Y Ltd.    |           | Z Ltd.     |           |
|-----------------------------------------------------|-----------|------------|--------------------|-----------|-----------|-----------|------------|-----------|
| (Rs. in crores)                                     | Rs.       |            | Rs.                |           | Rs.       |           | Rs.        |           |
| Share Capital:                                      |           |            |                    |           |           |           |            |           |
| Equity (Fully paid) Rs. 10 each                     | 25        |            | 5                  |           | 10        |           | 15         |           |
| Reserves and Surplus                                | <u>75</u> | 100        | <u>20</u>          | 25        | <u>15</u> | 25        | <u>20</u>  | 35        |
| Loan Funds:                                         |           |            |                    |           |           |           |            |           |
| Secured                                             | 15        |            | —                  |           | 5         |           | 20         |           |
| Unsecured                                           | <u>10</u> | <u>25</u>  | <u>50</u>          | <u>50</u> | <u>10</u> | <u>15</u> | <u>15</u>  | <u>35</u> |
| Total Sources                                       |           | <u>125</u> |                    | <u>75</u> |           | <u>40</u> |            | <u>70</u> |
| Fixed Assets:                                       |           |            |                    |           |           |           |            |           |
| Cost                                                | 60        |            | —                  |           | 15        |           | 30         |           |
| Less: Depreciation                                  | <u>35</u> | 25         | <u>—</u>           | —         | <u>7</u>  | 8         | <u>17</u>  | 13        |
| Investments at cost in fully paid Equity Shares of: |           |            |                    |           |           |           |            |           |
| X Investments Ltd.                                  |           | 5          |                    | —         |           | —         |            | —         |
| Y Ltd.                                              |           | —          |                    | 15        |           | —         |            | —         |
| Z Ltd.                                              |           | —          |                    | 30        |           | —         |            | —         |
| Other Companies                                     |           |            |                    |           |           |           |            |           |
| (Market Value Rs. 116 Cr.)                          |           | —          |                    | 29        |           | —         |            | —         |
| Net Current Assets:                                 |           |            |                    |           |           |           |            |           |
| Current Assets                                      | 105       |            | 1                  |           | 96        |           | 200        |           |
| Current Liabilities                                 | <u>10</u> | <u>95</u>  | <u>—</u>           | <u>1</u>  | <u>64</u> | <u>32</u> | <u>143</u> | <u>57</u> |
|                                                     |           | <u>125</u> |                    | <u>75</u> |           | <u>40</u> |            | <u>70</u> |

There are no intercompany transactions outstanding between the companies.

You are asked to prepare consolidated balance sheet as at 31st December, 1996 in vertical

### Advanced Accounting

form. Also comment on the group balance sheet with the help of various ratios\*. Show your workings. (15 marks)(May, 1997)

Answer

Consolidated Balance Sheet of X Ltd. and its subsidiaries  
X Investments Ltd., Y Ltd. and Z Ltd.  
as at 31st December, 1996

|     |                               |              | (Rs. in<br>crores) |
|-----|-------------------------------|--------------|--------------------|
| I   | SOURCES OF FUNDS              |              |                    |
| (1) | Shareholders' funds:          |              |                    |
| (a) | Capital                       | 25.00        |                    |
| (b) | Reserves and surplus          | <u>95.00</u> | 120.00             |
| (2) | Minority interest in:         |              |                    |
| (a) | Y Ltd.                        | 12.25        |                    |
| (b) | Z Ltd.                        | <u>8.40</u>  | 20.65              |
| (3) | Loan funds:                   |              |                    |
| (a) | Secured loans                 | 40.00        |                    |
| (b) | Unsecured loans               | <u>85.00</u> |                    |
|     |                               |              | <u>125.00</u>      |
|     | TOTAL                         |              | <u>265.65</u>      |
| II  | APPLICATION OF FUNDS          |              |                    |
| (1) | Fixed assets:                 |              |                    |
| (a) | Goodwill on consolidation of: |              |                    |
|     | Y Ltd.                        | 2.25         |                    |
|     | Z Ltd.                        | <u>3.40</u>  |                    |
|     |                               |              | 5.65               |
| (b) | Others:                       |              |                    |
|     | Gross block                   | 105.00       |                    |
|     | Less: Depreciation            | <u>59.00</u> |                    |
|     |                               | <u>46.00</u> |                    |
|     |                               |              | 51.65              |
| (2) | Investments at cost           |              | 29.00              |

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\* The part of the question requiring comment on the group balance sheet with the help of various ratios is no longer covered in the syllabus of Advanced Accounting at Final Level.



## Holding Company Accounts

|     |                                                                        |               |               |
|-----|------------------------------------------------------------------------|---------------|---------------|
|     | (in equity shares of other companies –<br>Market value Rs. 116 crores) |               |               |
| (3) | Current assets                                                         | 402.00        |               |
|     | Less: Current liabilities                                              | <u>217.00</u> |               |
|     | Net current assets                                                     |               | <u>185.00</u> |
|     | TOTAL                                                                  |               | <u>265.65</u> |

Ratios:

1. (a) Proprietary ratio =  $\frac{\text{Proprietors' funds}}{\text{Total group funds}}$

$$= \frac{120.00}{265.65} = 45.17\%$$

45.17% of total funds are financed out of proprietors' funds.

(b) Loan Funds : Total group funds =  $\frac{\text{Loan funds}}{\text{Total group funds}}$

$$= \frac{125.00}{265.65} = 47.05\%$$

47.05% of total funds are borrowed from lenders.

(c) Minority interest in subsidiaries =  $\frac{\text{Amount owing to minority}}{\text{Total group funds}}$

$$\text{Y Ltd.} = \frac{12.25}{265.65} = 4.61\%$$

$$\text{Z Ltd.} = \frac{8.40}{265.65} = 3.16\%$$

$$\text{Combined} = \frac{20.65}{265.65} = 7.78\%$$

Minority shareholders of subsidiaries have financed 7.78% of total funds.

Note: Current liabilities have been excluded from total group funds so as to compute ratios to judge long-term position of the group as a whole.

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2. Fixed assets: Total net assets =  $\frac{51.65}{265.65} = 19.44\%$

Fixed assets account for 19.44% of total funds deployed.

3. Investments : Total net assets =  $\frac{29.00}{265.65} = 10.92\%$

Investments account for 10.92% of total funds deployed.

4. Net current assets: Total net assets =  $\frac{185.00}{265.65} = 69.64\%$

Net current assets account for 69.64% of total funds deployed.

5. Current ratio =  $\frac{402.00}{217.00}$   
= 1.85 : 1

Current assets are 1.85 times the current liabilities.

Working Notes:

(A) X Investments Ltd.

(Rs. in crores)

| (1) Analysis of Profits and Share Capital: |                             | Capital Profit | Revenue Profit | Share Capital |
|--------------------------------------------|-----------------------------|----------------|----------------|---------------|
| (i)                                        | Y Ltd.                      | 15.00          | —              | 10.00         |
|                                            | Minority Interest (49%)     | <u>7.35</u>    | <u>—</u>       | <u>4.90</u>   |
|                                            | Share of X Investments Ltd. | <u>7.65</u>    | <u>—</u>       | <u>5.10</u>   |
| (ii)                                       | Z Ltd.                      | 20.00          | —              | 15.00         |
|                                            | Minority Interest (24%)     | <u>4.80</u>    | <u>—</u>       | <u>3.60</u>   |
|                                            | Share of X Investments Ltd. | <u>15.20</u>   | <u>—</u>       | <u>11.40</u>  |
| (2)                                        | Cost of Control:            | Y Ltd.         |                | Z Ltd.        |
|                                            | Cost of investments         | 15.00          |                | 30.00         |

## Holding Company Accounts

|     |                               |              |              |              |
|-----|-------------------------------|--------------|--------------|--------------|
|     | Less: Paid up value of shares | 5.10         | 11.40        |              |
|     | Capital profits               | <u>7.65</u>  | <u>15.20</u> |              |
|     |                               | <u>12.75</u> |              | <u>26.60</u> |
|     | Goodwill on consolidation     | <u>2.25</u>  |              | <u>3.40</u>  |
| (3) | Minority interest             | Y Ltd.       |              | Z Ltd.       |
|     | Share Capital                 | 4.90         |              | 3.60         |
|     | Capital Profits               | 7.35         |              | 4.80         |
|     | Revenue Profits               | <u>—</u>     |              | <u>—</u>     |
|     |                               | <u>12.25</u> |              | <u>8.40</u>  |

- (4) Group Balance Sheet of X Investments Ltd. and its subsidiaries  
Y Ltd. and Z Ltd.  
as at 31st December, 1996

(Rs. in crores)

|     |                                   |              |      |               |
|-----|-----------------------------------|--------------|------|---------------|
| I   | SOURCES OF FUNDS                  |              |      |               |
| (1) | Shareholders' funds:              |              |      |               |
|     | (a) Capital                       | 5.00         |      |               |
|     | (b) Reserves and surplus          | <u>20.00</u> |      | 25.00         |
| (2) | Minority interest in:             |              |      |               |
|     | (a) Y Ltd.                        | 12.25        |      |               |
|     | (b) Z Ltd.                        | <u>8.40</u>  |      | 20.65         |
| (3) | Loan funds:                       |              |      |               |
|     | (a) Secured loans                 | 25.00        |      |               |
|     | (b) Unsecured loans               | <u>75.00</u> |      |               |
|     |                                   |              |      | <u>100.00</u> |
|     | TOTAL                             |              |      | <u>145.65</u> |
| II  | APPLICATION OF FUNDS              |              |      |               |
| (1) | Fixed assets:                     |              |      |               |
|     | (a) Goodwill on consolidation of: |              |      |               |
|     | Y Ltd.                            | 2.25         |      |               |
|     | Z Ltd.                            | <u>3.40</u>  |      |               |
|     |                                   |              | 5.65 |               |
|     | (b) Others:                       |              |      |               |
|     | Gross block                       | 45.00        |      |               |
|     | Less: Depreciation                | <u>24.00</u> |      |               |

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|                               |               |               |
|-------------------------------|---------------|---------------|
|                               | <u>21.00</u>  |               |
|                               |               | 26.65         |
| (2) Investments at cost       |               | 29.00         |
| (Market value Rs. 116 crores) |               |               |
| (3) Current assets            | 297.00        |               |
| Less: Current liabilities     | <u>207.00</u> |               |
| Net current assets            |               | <u>90.00</u>  |
| TOTAL                         |               | <u>145.65</u> |

(B) X Ltd.

(i) Analysis of Profits of X Investments Ltd.:

|                                                                    | Capital Profit | Revenue Profit |
|--------------------------------------------------------------------|----------------|----------------|
| Reserves and Surplus                                               | —              | 20             |
| Minority Interest                                                  | —              | —              |
| (X Investments Ltd. being wholly owned subsidiary of X Ltd.)       |                |                |
| (ii) Minority Interest in X Investments Ltd.                       | —              | —              |
| (iii) Cost of Control:                                             |                |                |
| Cost of investments in X Investments Ltd.                          |                | 5              |
| Less: Paid-up value of shares held in X Investments Ltd. by X Ltd. | 5              |                |
| Capital Profit                                                     | <u>—</u>       | <u>5</u>       |
| Cost of Control                                                    |                | <u>—</u>       |

### Question 13

From the following Balance Sheets of a group of companies and the other information provided, draw up the consolidated Balance Sheet as on 31.3.1998. Figures given are in Rupees Lakhs:

#### Balance Sheets as on 31.3.1998

|                                           | X   | Y   | Z   |                                | X   | Y   | Z   |
|-------------------------------------------|-----|-----|-----|--------------------------------|-----|-----|-----|
| Shares capital (in shares of Rs. 10 each) | 300 | 200 | 100 | Fixed Assets less depreciation | 130 | 150 | 100 |
| Reserves                                  | 50  | 40  | 30  | Cost of investment in Y Ltd.   | 180 | —   | —   |
| Profit and loss balance                   | 60  | 50  | 40  | Cost of investment in Z Ltd.   | 40  | —   | —   |
| Bills payables                            | 10  | —   | 5   | Cost of investment in Z Ltd.   | —   | 80  | —   |

### Holding Company Accounts

|                |            |            |            |                       |            |            |            |
|----------------|------------|------------|------------|-----------------------|------------|------------|------------|
| Creditors      | 30         | 10         | 10         | Stock                 | 50         | 20         | 20         |
| Y Ltd. balance | —          | —          | 15         | Debtors               | 70         | 10         | 20         |
| Z Ltd. balance | 50         | —          | —          | Bills receivables     | —          | 10         | 20         |
|                |            |            |            | Z Ltd. balance        | —          | 10         | —          |
|                |            |            |            | X Ltd. balance        | —          | —          | 30         |
|                | <u>—</u>   | <u>—</u>   | <u>—</u>   | Cash and bank balance | <u>30</u>  | <u>20</u>  | <u>10</u>  |
|                | <u>500</u> | <u>300</u> | <u>200</u> |                       | <u>500</u> | <u>300</u> | <u>200</u> |

- X Ltd. holds 1,60,000 shares and 30,000 shares respectively in Y Ltd. and Z Ltd.; Y Ltd. holds 60,000 shares in Z Ltd. These investments were made on 1.7.1997 on which date the provision was as follows:

|                         | Y Ltd. | Z Ltd. |
|-------------------------|--------|--------|
| Reserves                | 20     | 10     |
| Profit and loss account | 30     | 16     |

- In December, 1997 Y Ltd. invoiced goods to X Ltd. for Rs. 40 lakhs at cost plus 25%. The closing stock of X Ltd. includes such goods valued at Rs. 5 lakhs.
- Z Ltd. sold to Y Ltd. an equipment costing Rs. 24 lakhs at a profit of 25% on selling price on 1.1.1998. Depreciation at 10% per annum was provided by Y Ltd. on this equipment.
- Bills payables of Z Ltd. represent acceptances given to Y Ltd. out of which Y Ltd. had discounted bills worth Rs. 3 lakhs.
- Debtors of X Ltd. include Rs. 5 lakhs being the amount due from Y Ltd.
- X Ltd. proposes dividend at 10%. (20 marks)(May 1998)

Answer

#### Consolidated Balance Sheet of X Ltd. and its subsidiaries Y Ltd. and Z Ltd. as at 31st March, 1998

| Liabilities       | Amount       | Assets                  | (Rs. in lakhs)<br>Amount |
|-------------------|--------------|-------------------------|--------------------------|
| Share capital     | 300.00       | Fixed Assets            |                          |
| Minority Interest |              | X Ltd.                  | 130.00                   |
| Y Ltd.            | 63.08        | Y Ltd.                  | 150.00                   |
| Z Ltd.            | <u>16.22</u> | Z Ltd.                  | <u>100.00</u>            |
| Capital Reserve   | 13.40        |                         | 380.00                   |
|                   |              | Less: Unrealised profit | <u>7.80</u>              |
|                   |              |                         | 372.20                   |

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|                                    |               |                           |              |               |
|------------------------------------|---------------|---------------------------|--------------|---------------|
| Other Reserves                     | 81.60         | Stock                     |              |               |
| Profit and Loss Account            | 56.90         | X Ltd.                    | 50.00        |               |
| Bills Payables                     |               | Y Ltd.                    | 20.00        |               |
| X Ltd.                             | 10.00         | Z Ltd.                    | <u>20.00</u> |               |
| Y Ltd.                             | <u>5.00</u>   |                           | 90.00        |               |
|                                    | 15.00         | Less: Unrealised profit   | <u>1.00</u>  | 89.00         |
| Less: Mutual indebtedness          | <u>2.00</u>   | Debtors                   |              |               |
|                                    | 13.00         | X Ltd.                    | 70.00        |               |
| Creditors                          |               | Y Ltd.                    | 10.00        |               |
| X Ltd.                             | 30.00         | Z Ltd.                    | <u>20.00</u> |               |
| Y Ltd.                             | 10.00         |                           | 100.00       |               |
| Z Ltd.                             | <u>10.00</u>  | Less: Mutual indebtedness | <u>5.00</u>  | 95.00         |
|                                    | 50.00         | Cash and Bank Balances    |              | 60.00         |
| Less: Mutual indebtedness          | <u>5.00</u>   | Bills Receivables         |              |               |
| Current Account Balances           | 45.00         | Y Ltd.                    | 10.00        |               |
|                                    |               | Z Ltd.                    | <u>20.00</u> |               |
| X Ltd.                             | 50.00         |                           | 30.00        |               |
| Z Ltd.                             | <u>15.00</u>  | Less: Mutual indebtedness | <u>2.00</u>  | 28.00         |
|                                    | 65.00         |                           |              |               |
| Less: Mutual indebtedness (10+ 30) | <u>40.00</u>  |                           |              |               |
| Proposed Dividend                  | <u>30.00</u>  |                           |              |               |
|                                    | <u>644.20</u> |                           |              | <u>644.20</u> |

### Working Notes:

|                                   |                | (Rs. in lakhs)  |                |
|-----------------------------------|----------------|-----------------|----------------|
| (1) Analysis of Profits of Z Ltd. | Capital Profit | Revenue Reserve | Revenue profit |
| Reserves on 1.7.1997              | 10.00          |                 |                |
| Profit and Loss A/c on 1.7.1997   | 16.00          |                 |                |
| Increase in Reserves              |                | 20.00           |                |
| Increase in Profit                |                |                 | <u>24.00</u>   |
|                                   | 26.00          | 20.00           | 24.00          |
| Less: Minority Interest (10%)     | <u>2.60</u>    | <u>2.00</u>     | <u>2.40</u>    |
|                                   | <u>23.40</u>   | <u>18.00</u>    | <u>21.60</u>   |
| Share of X Ltd.                   | 7.80           | 6.00            | 7.20           |
| Share of Y Ltd.                   | 15.60          | 12.00           | 14.40          |

## Holding Company Accounts

|                                                                                            |              |              |               |
|--------------------------------------------------------------------------------------------|--------------|--------------|---------------|
| (2) Analysis of Profits of Y Ltd.                                                          |              |              |               |
| Reserves on 1.7.1997                                                                       | 20.00        |              |               |
| Profit and Loss A/c on 1.7.1997                                                            | 30.00        |              |               |
| Increase in Reserves                                                                       |              | 20.00        |               |
| Increase in Profit                                                                         | <u>50.00</u> | <u>20.00</u> | <u>20.00</u>  |
| Share in Z Ltd.                                                                            | <u>50.00</u> | <u>12.00</u> | <u>14.40</u>  |
|                                                                                            |              | 32.00        | 34.40         |
| Less: Minority Interest (20%)                                                              | <u>10.00</u> | <u>6.40</u>  | <u>6.88</u>   |
| Share of X Ltd.                                                                            | <u>40.00</u> | <u>25.60</u> | <u>27.52</u>  |
| (3) Cost of Control                                                                        |              |              |               |
| Investments in Y Ltd.                                                                      |              |              | 180.00        |
| Investments in Z Ltd.                                                                      |              |              | <u>120.00</u> |
|                                                                                            |              |              | 300.00        |
| Less: Paid up value of investments                                                         |              |              |               |
| in Y Ltd.                                                                                  | 160.00       |              |               |
| in Z Ltd.                                                                                  | <u>90.00</u> | 250.00       |               |
| Capital Profit                                                                             |              |              |               |
| in Y Ltd.                                                                                  | 40.00        |              |               |
| in Z Ltd.                                                                                  | <u>23.40</u> | <u>63.40</u> | <u>313.40</u> |
| Capital Reserve                                                                            |              |              | <u>13.40</u>  |
| (4) Minority Interest                                                                      |              |              |               |
|                                                                                            | Y Ltd.       | Z Ltd.       |               |
| Share Capital                                                                              | 40.00        | 10.00        |               |
| Capital Profit                                                                             | 10.00        | 2.60         |               |
| Revenue Reserves                                                                           | 6.40         | 2.00         |               |
| Revenue Profits                                                                            | <u>6.88</u>  | <u>2.40</u>  |               |
|                                                                                            | 63.28        | 17.00        |               |
| Less: Unrealised profit on stock (20% of 1)                                                | .20          |              |               |
| Unrealised profit on equipment (10% of 7.8)                                                |              | <u>.78</u>   |               |
|                                                                                            | <u>63.08</u> | <u>16.22</u> |               |
| (5) Unrealised Profit on equipment sale                                                    |              |              |               |
| Cost                                                                                       | 24.00        |              |               |
| Profit                                                                                     | <u>8.00</u>  |              |               |
| Selling Price                                                                              | <u>32.00</u> |              |               |
| Unrealised profit = $8 - 8 \times \frac{10}{100} \times \frac{3}{12} = 8.00 - 0.20 = 7.80$ |              |              |               |
| (6) Profit and Loss Account – X Ltd.                                                       |              |              |               |
| Balance                                                                                    | 60.00        |              |               |

### Advanced Accounting

|                                                                                     |              |
|-------------------------------------------------------------------------------------|--------------|
| Less: Proposed Dividend                                                             | <u>30.00</u> |
|                                                                                     | 30.00        |
| Share in Y Ltd.                                                                     | 27.52        |
| Share in Z Ltd.                                                                     | <u>7.20</u>  |
|                                                                                     | 64.72        |
| Less: Unrealised profit on equipment (90% of 7.8)                                   | <u>7.02</u>  |
|                                                                                     | 57.70        |
| Less: Unrealised profit on stock $\left(5 \times \frac{25}{125} \times 80\%\right)$ | .80          |
|                                                                                     | <u>56.90</u> |
| (7) Reserves – X Ltd.                                                               |              |
| X Ltd.                                                                              | 50.00        |
| Share in Y Ltd.                                                                     | 25.60        |
| Share in Z Ltd.                                                                     | <u>6.00</u>  |
|                                                                                     | <u>81.60</u> |

### Question 14

Following are the Balance Sheets of Mumbai Limited, Delhi Limited, Amritsar Limited and Kanpur Limited as at 31st December, 2000 :

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

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



### Holding Company Accounts

|                         | Mumbai<br>Ltd. | Delhi<br>Ltd. | Amritsar<br>Ltd. | Kanpur<br>Ltd. |
|-------------------------|----------------|---------------|------------------|----------------|
| General Reserve Account | 10,00,000      | 2,00,000      | 1,00,000         | 6,00,000       |
| Profit & Loss Account   | 6,00,000       | 2,00,000      | 50,000           | 60,000         |

Required :

Prepare the consolidated Balance Sheet of the group as at 31st December, 2000  
(Calculations may be rounded off to the nearest rupee). (16 marks) (May, 2001)

Answer

#### Consolidated Balance Sheet of Mumbai Ltd. and its subsidiaries Delhi Ltd., Amritsar Ltd. and Kanpur Ltd. As at 31st December, 2000

| Liabilities                                          | Rs.                   | Assets         | Rs.                   |
|------------------------------------------------------|-----------------------|----------------|-----------------------|
| Share Capital<br>(Fully paid shares of Rs. 100 each) | 50,00,000.00          | Goodwill       | 6,37,500.00           |
| Minority Interest                                    | 31,25,312.50          | Fixed Assets   | 105,00,000.00         |
| General Reserve                                      | 25,51,041.67          | Current Assets | 15,50,000.00          |
| Profit and Loss Account                              | 14,81,145.83          |                |                       |
| Sundry Creditors                                     | 5,30,000.00           |                |                       |
|                                                      | <u>1,26,87,500.00</u> |                | <u>1,26,87,500.00</u> |

Working Notes :

(i) Analysis of profits of Kanpur Ltd.

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

## Advanced Accounting

### (ii) Analysis of profits of Amritsar Ltd.

|                                                          | Capital<br>Profit<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>Profit<br>Rs. |
|----------------------------------------------------------|--------------------------|---------------------------|--------------------------|
| General Reserve on the date<br>of purchase of shares     | 1,00,000.00              |                           |                          |
| Profit and Loss A/c on the date of<br>purchase of shares | 50,000.00                |                           |                          |
| Increase in General Reserve                              |                          | 1,50,000.00               |                          |
| Increase in Profit and Loss A/c                          |                          |                           | 2,00,000.00              |
| Share in Kanpur Ltd.                                     |                          | 33,333.33                 | 21,666.67                |
|                                                          | 1,50,000.00              | 1,83,333.33               | 2,21,666.67              |
| Less : Minority Interest (1/4)                           | 37,500.00                | 45,833.33                 | 55,416.67                |
|                                                          | 1,12,500.00              | 1,37,500.00               | 1,66,250.00              |
| Share of Mumbai Ltd. (1/2)                               | 75,000                   | 91,666.67                 | 1,10,833.33              |
| Share of Delhi Ltd. (1/4)                                | 37,500                   | 45,833.33                 | 55,416.67                |

### (iii) Analysis of profits of Delhi Ltd.

|                                                          | Capital<br>Profit<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>Profit<br>Rs. |
|----------------------------------------------------------|--------------------------|---------------------------|--------------------------|
| General Reserve on the date<br>of purchase of shares     | 2,00,000.00              |                           |                          |
| Profit and Loss A/c on the date of<br>purchase of shares | 2,00,000.00              |                           |                          |
| Increase in General Reserve                              |                          | 2,00,000.00               |                          |
| Increase in Profit and Loss A/c                          |                          |                           | 2,00,000.00              |
| Share in Kanpur Ltd.                                     |                          | 1,00,000.00               | 65,000.00                |
| Share in Amritsar Ltd.                                   |                          | 45,833.33                 | 55,416.67                |
|                                                          | 4,00,000.00              | 3,45,833.33               | 3,20,416.67              |
| Less : Minority Interest (1/4)                           | 1,00,000.00              | 86,458.33                 | 80,104.17                |
| Share of Mumbai Ltd. (3/4)                               | 3,00,000.00              | 2,59,375.00               | 2,40,312.50              |

### (iv) Cost of control

| Investments in |                  | Rs.         |
|----------------|------------------|-------------|
| Delhi Ltd.     | 35,00,000        |             |
| Amritsar Ltd.  | 16,00,000        |             |
| Kanpur Ltd.    | <u>60,00,000</u> |             |
|                |                  | 1,11,00,000 |

## Holding Company Accounts

|                                             |                                  |                     |                     |
|---------------------------------------------|----------------------------------|---------------------|---------------------|
| Paid up value of investments in             |                                  |                     |                     |
|                                             | Delhi Ltd.                       | 30,00,000           |                     |
|                                             | Amritsar Ltd.                    | 15,00,000           |                     |
|                                             | Kanpur Ltd.                      | <u>50,00,000</u>    |                     |
| Capital profits in                          |                                  |                     | (95,00,000)         |
|                                             | Delhi Ltd.                       | 3,00,000            |                     |
|                                             | Amritsar Ltd.                    | 1,12,500            |                     |
|                                             | Kanpur Ltd.                      | <u>5,50,000</u>     | <u>(9,62,500)</u>   |
| Goodwill                                    |                                  |                     | <u>6,37,500</u>     |
| (v) Minority interest                       |                                  |                     |                     |
| Share Capital :                             |                                  |                     |                     |
|                                             | Delhi Ltd. (1/4)                 | 10,00,000.00        |                     |
|                                             | Amritsar Ltd. (1/4)              | 5,00,000.00         |                     |
|                                             | Kanpur Ltd (1/6)                 | <u>10,00,000.00</u> | 25,00,000.00        |
| Share in profits & reserves                 |                                  |                     |                     |
| (Pre and Post-Acquisitions)                 |                                  |                     |                     |
|                                             | Delhi Ltd.                       | 2,66,562.50         |                     |
|                                             | Amritsar Ltd.                    | 1,38,750.00         |                     |
|                                             | Kanpur Ltd.                      | <u>2,20,000.00</u>  | <u>6,25,312.50</u>  |
|                                             |                                  |                     | <u>31,25,312.50</u> |
| (vi) General Reserve — Mumbai Ltd.          |                                  |                     |                     |
|                                             | Balance as on 31.12.2000 (given) |                     | 20,00,000.00        |
| Share in                                    |                                  |                     |                     |
|                                             | Delhi Ltd.                       | 2,59,375.00         |                     |
|                                             | Amritsar Ltd.                    | 91,666.67           |                     |
|                                             | Kanpur Ltd.                      | <u>2,00,000.00</u>  | <u>25,51,041.67</u> |
| (vii) Profit and Loss Account — Mumbai Ltd. |                                  |                     |                     |
|                                             | Balance as on 31.12.2000 (given) |                     | 10,00,000.00        |
| Share in                                    |                                  |                     |                     |
|                                             | Delhi Ltd.                       | 2,40,312.50         |                     |
|                                             | Amritsar Ltd.                    | 1,10,833.33         |                     |
|                                             | Kanpur Ltd.                      | <u>1,30,000.00</u>  | <u>14,81,145.83</u> |

## Advanced Accounting

### Question 15

A Limited is a holding company and B Limited and C Limited are subsidiaries of A Limited. Their Balance Sheets as on 31.12.2000 are given below:

|                       | A Ltd.<br>Rs.   | B Ltd.<br>Rs.   | C Ltd.<br>Rs. |                  | A Ltd.<br>Rs.   | B Ltd.<br>Rs.   | C Ltd.<br>Rs. |
|-----------------------|-----------------|-----------------|---------------|------------------|-----------------|-----------------|---------------|
| Share Capital         | 1,00,000        | 1,00,000        | 60,000        | Fixed Assets     | 20,000          | 60,000          | 43,000        |
| Reserves              | 48,000          | 10,000          | 9,000         | Investments      |                 |                 |               |
| Profit & Loss Account | 16,000          | 12,000          | 9,000         | Shares in B Ltd. | 95,000          |                 |               |
| C Ltd. Balance        | 3,000           |                 |               | Shares in C Ltd. | 13,000          | 53,000          |               |
| Sundry Creditors      | 7,000           | 5,000           |               | Stock in Trade   | 12,000          |                 |               |
| A Ltd. Balance        |                 | 7,000           |               | B Ltd. Balance   | 8,000           |                 |               |
|                       |                 |                 |               | Sundry Debtors   | 26,000          | 21,000          | 32,000        |
|                       |                 |                 |               | A Ltd. Balance   |                 |                 | 3,000         |
|                       | <u>1,74,000</u> | <u>1,34,000</u> | <u>78,000</u> |                  | <u>1,74,000</u> | <u>1,34,000</u> | <u>78,000</u> |

The following particulars are given:

- The Share Capital of all companies is divided into shares of Rs. 10 each.
- A Ltd. held 8,000 shares of B Ltd. and 1,000 shares of C Ltd.
- B Ltd. held 4,000 shares of C Ltd.
- All these investments were made on 30.6.2000.
- On 31.12.1999, the position was as shown below:

|                       | B Ltd.<br>Rs. | C Ltd.<br>Rs. |
|-----------------------|---------------|---------------|
| Reserve               | 8,000         | 7,500         |
| Profit & Loss Account | 4,000         | 3,000         |
| Sundry Creditors      | 5,000         | 1,000         |
| Fixed Assets          | 60,000        | 43,000        |
| Stock in Trade        | 4,000         | 35,500        |
| Sundry Debtors        | 48,000        | 33,000        |

- 10% dividend is proposed by each company.
- The whole of stock in trade of B Ltd. as on 30.6.2000 (Rs. 4,000) was later sold to A Ltd. for Rs. 4,400 and remained unsold by A Ltd. as on 31.12.2000.
- Cash-in-transit from B Ltd. to A Ltd. was Rs. 1,000 as at the close of business.

You are required to prepare the Consolidated Balance Sheet of the group as on 31.12.2000. (16 marks)(May, 2002)

## Holding Company Accounts

Answer

### Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd. as on 31st December, 2000

| Liabilities           | Amount<br>Rs.   | Assets              | Amount<br>Rs.   |
|-----------------------|-----------------|---------------------|-----------------|
| Share Capital         | 1,00,000        | Goodwill            | 5,525           |
| Minority Interest     | 37,820          | Fixed Assets        | 1,23,000        |
| Reserves              | 49,325          | Stock in Trade      | 12,000          |
| Profit & Loss Account | 10,980          | Less: Provision for |                 |
| Sundry Creditors      | 12,000          | unrealised profit   | <u>400</u>      |
| Proposed Dividend     | 10,000          | Sundry Debtors      | 79,000          |
|                       |                 | Cash in Transit     |                 |
|                       |                 | (8,000 – 7,000)     | <u>1,000</u>    |
|                       | <u>2,20,125</u> |                     | <u>2,20,125</u> |

Working Notes:

(1) Position on 30.06.2000

|                                  | Reserves<br>Rs.       | Profit and Loss<br>Account<br>Rs. |
|----------------------------------|-----------------------|-----------------------------------|
| B Ltd.                           |                       |                                   |
| Balance on 31.12.2000            | 10,000                | 12,000                            |
| Less: Balance on 31.12.1999      | <u>8,000</u>          | <u>4,000</u>                      |
| Increase during the year         | <u>2,000</u>          | <u>8,000</u>                      |
| Estimated increase for half year | 1,000                 | 4,000                             |
| Balance on 30.06.2000            | 9,000 (8,000 + 1,000) | 8,000 (4,000 + 4,000)             |
| C Ltd.                           |                       |                                   |
| Balance on 31.12.2000            | 9,000                 | 9,000                             |
| Balance on 31.12.1999            | <u>7,500</u>          | <u>3,000</u>                      |
| Increase during the year         | <u>1,500</u>          | <u>6,000</u>                      |
| Estimated increase for half year | 750                   | 3,000                             |
| Balance on 30.06.2000            | 8,250 (7,500 + 750)   | 6,000 (3,000 + 3,000)             |

(2) Analysis of Profits of C Ltd.

|                       | Capital<br>Profit<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>profit<br>Rs. |
|-----------------------|--------------------------|---------------------------|--------------------------|
| Reserves on 30.6.2000 | 8,250                    |                           |                          |

## Advanced Accounting

|                                  |               |            |              |
|----------------------------------|---------------|------------|--------------|
| Profit and Loss A/c on 30.6.2000 | 6,000         |            |              |
| Increase in reserves             |               | 750        |              |
| Increase in profit               |               |            | <u>3,000</u> |
|                                  | <u>14,250</u> | <u>750</u> | <u>3,000</u> |
| Less: Minority interest (1/6)    | <u>2,375</u>  | <u>125</u> | <u>500</u>   |
|                                  | <u>11,875</u> | <u>625</u> | <u>2,500</u> |
| Share of A Ltd. (1/6)            | 2,375         | 125        | 500          |
| Share of B Ltd. (4/6)            | 9,500         | 500        | 2,000        |

### (3) Analysis of Profits of B Ltd.

|                                  | Capital<br>Profit<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>profit<br>Rs. |
|----------------------------------|--------------------------|---------------------------|--------------------------|
| Reserves on 30.6.2000            | 9,000                    |                           |                          |
| Profit and Loss A/c on 30.6.2000 | 8,000                    |                           |                          |
| Increase in reserves             |                          | 1,000                     |                          |
| Increase in profit               |                          |                           | 4,000                    |
| Share in C Ltd.                  |                          | <u>500</u>                | <u>2,000</u>             |
|                                  | <u>17,000</u>            | <u>1,500</u>              | <u>6,000</u>             |
| Less: Minority interest (2/10)   | <u>3,400</u>             | <u>300</u>                | <u>1,200</u>             |
| Share of A Ltd. (8/10)           | <u>13,600</u>            | <u>1,200</u>              | <u>4,800</u>             |

### (4) Cost of control

|                                 | Rs.           | Rs.             |
|---------------------------------|---------------|-----------------|
| Investments in                  |               |                 |
| B Ltd.                          | 95,000        |                 |
| C Ltd.                          | <u>66,000</u> |                 |
|                                 |               | 1,61,000        |
| Paid up value of investments in |               |                 |
| B Ltd.                          | 80,000        |                 |
| C Ltd.                          | <u>50,000</u> |                 |
|                                 |               | (1,30,000)      |
| Capital profits in              |               |                 |
| B Ltd.                          | 13,600        |                 |
| C Ltd.                          | <u>11,875</u> |                 |
|                                 |               | <u>(25,475)</u> |
| Goodwill                        |               | <u>5,525</u>    |

### Holding Company Accounts

|                                                              |               |               |
|--------------------------------------------------------------|---------------|---------------|
| (5) Minority Interest                                        | Rs.           | Rs.           |
| Share Capital:                                               |               |               |
| B Ltd.                                                       | 20,000        |               |
| C Ltd.                                                       | <u>10,000</u> | 30,000        |
| Share in profits and reserves<br>(Pre and Post-Acquisitions) |               |               |
| B Ltd.                                                       | 4,900         |               |
| C Ltd.                                                       | <u>3,000</u>  | <u>7,900</u>  |
|                                                              |               | 37,900        |
| Less: Provision for unrealized profit<br>(20% of Rs. 400)    |               | <u>80</u>     |
|                                                              |               | <u>37,820</u> |
| <br>(6) Reserves – A Ltd.                                    |               | Rs.           |
| Balance as on 31.12.2000 (given)                             |               | 48,000        |
| Share in                                                     |               |               |
| B Ltd.                                                       |               | 1,200         |
| C Ltd.                                                       |               | <u>125</u>    |
|                                                              |               | <u>49,325</u> |
| <br>(7) Profit and Loss Account – A Ltd.                     |               | Rs.           |
| Balance as on 31.12.2000 (given)                             |               | 16,000        |
| Share in                                                     |               |               |
| B Ltd.                                                       |               | 4,800         |
| C Ltd.                                                       |               | <u>500</u>    |
|                                                              |               | 21,300        |
| Less: Proposed dividend (10% of Rs. 1,00,000)                |               | 10,000        |
| Provision for unrealised profit on stock                     |               | 320           |
| 80% of (Rs. 4,400 – Rs. 4,000)                               |               | <u>10,980</u> |

Note: The above solution has been done by direct method. Alternatively, students may follow indirect method. In indirect method, the share in pre-acquisition profits of B Ltd. in C Ltd. amounting Rs. 9,500 will be included as capital profit while analysing the profits of B Ltd. and will not be considered for the purpose of cost of control. Thus, in this case, the amounts of goodwill and minority interest will increase by Rs. 1,900 (2/10 of Rs. 9,500). Goodwill and minority interest will be shown at Rs. 7,425 and Rs. 39,720 respectively in the consolidated balance sheet. Therefore, the total of the assets and liabilities side of the consolidated balance sheet will be Rs. 2,22,025.

## Advanced Accounting

### Question 16

On 31st March, 2004 Bee Ltd. became the holding company of Cee Ltd. and Dee Ltd. by acquiring 450 lakhs fully paid shares in Cee Ltd. for Rs. 6,750 lakhs and 240 lakhs fully paid shares in Dee Ltd. for Rs. 2,160 lakhs. On that date, Cee Ltd. showed a balance of Rs. 2,550 lakhs in General Reserve and a credit balance of Rs. 900 lakhs in Profit and Loss Account. On the same date, Dee Ltd. showed a debit balance of Rs. 360 lakhs in Profit and Loss Account. While its Preliminary Expenses Account showed a balance of Rs. 30 lakhs.

After one year, on 31st March, 2005 the Balance Sheets of three companies stood as follows:

|                                                    | (All amounts in lakhs of Rupees) |               |              |
|----------------------------------------------------|----------------------------------|---------------|--------------|
| Liabilities                                        | Bee Ltd.                         | Cee Ltd.      | Dee Ltd.     |
| Fully paid equity shares of Rs. 10 each            | 27,000                           | 7,500         | 3,000        |
| General Reserve                                    | 33,000                           | 3,150         | —            |
| Profit and Loss Account                            | 9,000                            | 1,200         | 750          |
| 15 lakh fully paid 9.5% Debentures of Rs. 100 each | —                                | —             | 1,500        |
| Loan from Cee Ltd.                                 | —                                | —             | 75           |
| Bills Payable                                      | —                                | —             | 150          |
| Sundry Creditors                                   | <u>14,100</u>                    | <u>2,700</u>  | <u>930</u>   |
|                                                    | <u>83,100</u>                    | <u>14,550</u> | <u>6,405</u> |
| Assets                                             | (All amounts in lakhs of Rupees) |               |              |
|                                                    | Bee Ltd.                         | Cee Ltd.      | Dee Ltd.     |
| Machinery                                          | 39,000                           | 7,500         | 2,100        |
| Furniture and Fixtures                             | 6,000                            | 1,500         | 600          |
| Investments:                                       |                                  |               |              |
| 450 lakhs shares in Cee Ltd.                       | 6,750                            | —             | —            |
| 240 lakhs shares in Dee Ltd.                       | 2,160                            | —             | —            |
| 3 lakhs debentures in Dee Ltd.                     | 294                              | —             | —            |
| Stocks                                             | 16,500                           | 3,000         | 1,500        |
| Sundry Debtors                                     | 9,000                            | 1,350         | 1,290        |
| Cash and Bank balances                             | 3,201                            | 1,050         | 900          |
| Loan to Dee Ltd.                                   | —                                | 90            | —            |
| Bills Receivable                                   | 195                              | 60            | —            |
| Preliminary Expenses                               | <u>—</u>                         | <u>—</u>      | <u>15</u>    |
|                                                    | <u>83,100</u>                    | <u>14,550</u> | <u>6,405</u> |



## Holding Company Accounts

The following points relating to the above mentioned Balance Sheets are to be noted:

- (i) All the bills payable appearing in Dee Ltd.'s Balance Sheet were accepted in favour of Cee Ltd. out of which bills amounting to Rs. 75 lakhs were endorsed by Cee Ltd. in favour of Bee Ltd. and bills amounting to Rs. 45 lakhs had been discounted by Cee Ltd. with its bank.
- (ii) On 29th March, 2005 Dee Ltd. remitted Rs. 15 lakhs by means of a cheque to Cee Ltd. to return part of the loan; Cee Ltd. received the cheque only after 31st March, 2005.
- (iii) Stocks with Cee Ltd. includes goods purchased from Bee Ltd. for Rs. 200 lakhs. Bee Ltd. invoiced the goods at cost plus 25%.
- (iv) In August, 2004 Cee Ltd. declared and distributed dividend @ 10% for the year ended 31st March, 2004. Bee Ltd. credited the dividend received to its Profit and Loss Account.

You are required to prepare a Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2005. (16 Marks) (Nov. 2005)

Answer

### Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2005

| Liabilities                                | Rs. in lakhs  | Assets                                 | Rs. in lakhs          |
|--------------------------------------------|---------------|----------------------------------------|-----------------------|
| Share Capital                              |               | Fixed Assets                           |                       |
| Authorised                                 | ?             | Goodwill (W.N. 3)                      | 246                   |
| Issued and subscribed                      |               | Machinery                              | 48,600                |
| Fully paid equity shares of<br>Rs. 10 each | 27,000        | Furniture and Fixtures                 | 8,100                 |
| Minority interest (W.N. 2)                 | 5,487         | Current Assets, Loans<br>and Advances: |                       |
| Reserves and Surplus                       |               | (A) Current Assets                     |                       |
| General Reserve (W.N. 4)                   | 33,360        | Stock                                  | 21,000                |
| Profit and Loss A/c (W.N. 4)               | 10,040        | Less: Unrealised profit                | <u>40</u> 20,960      |
| Secured Loans                              |               | Sundry debtors                         | 11,640                |
| Debentures                                 | 1,200         | Cash and bank balances                 | 5,151                 |
| Current Liabilities                        |               | Cash in transit                        | 15                    |
| Acceptances                                | 150           | (B) Loan and Advances                  |                       |
| Less: Mutual owing                         | <u>105</u>    | Bills receivable                       | 255                   |
| Sundry creditors                           | <u>17,730</u> | Less: Mutual owing (W.N.5)             | <u>105</u> <u>150</u> |
|                                            | <u>94,862</u> |                                        | <u>94,862</u>         |

## Advanced Accounting

### Working Notes:

#### (1) Calculation of pre and post acquisition profits of subsidiaries:

|                           |            |                                   |                  | Rs. in lakhs    |
|---------------------------|------------|-----------------------------------|------------------|-----------------|
|                           |            | Pre-acquisition<br>capital profit | Post-acquisition |                 |
|                           |            |                                   | General Reserve  | Profit/Loss A/c |
| Cee Ltd.                  |            |                                   |                  |                 |
| General Reserve (Cr.)     |            | 2,550                             | 600              |                 |
| Profit and Loss A/c (Cr.) | 900        |                                   |                  |                 |
| (–) Dividend              | <u>750</u> | <u>150</u>                        | <u>—</u>         | <u>1,050</u>    |
|                           |            | <u>2,700</u>                      | <u>600</u>       | <u>1,050</u>    |
| Holding (60%)             |            | 1,620                             | 360              | 630             |
| Subsidiary (40%)          |            | <u>1,080</u>                      | <u>240</u>       | <u>420</u>      |

|                            |                                |                      | Rs. in lakhs      |
|----------------------------|--------------------------------|----------------------|-------------------|
|                            |                                | Post-acquisition     |                   |
|                            | Pre-acquisition capital profit | Preliminary expenses | Profit / Loss A/c |
| Dee Ltd.                   |                                |                      |                   |
| Profit and Loss A/c (Cr.)  | (360)                          |                      | 1,110             |
| Preliminary expenses (Dr.) | <u>(30)</u>                    | <u>15</u>            | <u>          </u> |
| (–) Dividend               | <u>(390)</u>                   | <u>15</u>            | <u>1,110</u>      |
| Holding (80%)              | (312)                          | 12                   | 888               |
| Subsidiary (20%)           | <u>(78)</u>                    | <u>3</u>             | <u>222</u>        |

#### (2) Minority Interest (Rs. in lakhs)

|                         |            |              |       |
|-------------------------|------------|--------------|-------|
| Cee Ltd.                |            |              |       |
| Share capital           |            | 3,000        |       |
| Capital profit          | 1,080      |              |       |
| Revenue General Reserve | 240        |              |       |
| Profit/Loss             | <u>420</u> | <u>1,740</u> | 4,740 |

### Holding Company Accounts

|                                       |          |            |            |              |
|---------------------------------------|----------|------------|------------|--------------|
| Dee Ltd.                              |          |            |            |              |
| Share capital                         |          |            | 600        |              |
| Capital profit                        |          | (78)       |            |              |
| Revenue profit (Cr.)                  | 222      |            |            |              |
| Add: Preliminary expenses written off | <u>3</u> | <u>225</u> | <u>147</u> | <u>747</u>   |
|                                       |          |            |            | <u>5,487</u> |

(3) Cost of Control (Rs. in lakhs)

|                                                                 |              |              |  |     |
|-----------------------------------------------------------------|--------------|--------------|--|-----|
| Cee Ltd.                                                        |              |              |  |     |
| Investment                                                      | 6,750        |              |  |     |
| Less: Dividend received and wrongly credited to Profit and Loss | <u>450</u>   | <u>6,300</u> |  |     |
| Less: Paid-up share capital (60%)                               | 4,500        |              |  |     |
| Capital profit                                                  | <u>1,620</u> | <u>6,120</u> |  | 180 |

|                                   |              |              |  |            |
|-----------------------------------|--------------|--------------|--|------------|
| Dee Ltd.                          |              |              |  |            |
| Investment in Shares              | 2,160        |              |  |            |
| in debentures                     | <u>294</u>   | 2,454        |  |            |
| Less: Paid-up share capital (80%) | 2,400        |              |  |            |
| Nominal value of debentures       | 300          |              |  |            |
| Capital profit                    | <u>(312)</u> | <u>2,388</u> |  | <u>66</u>  |
| Goodwill                          |              |              |  | <u>246</u> |

(4) Consolidated General Reserve and Profit and Loss Account

|                                  | General Reserve | Profit and Loss A/c |
|----------------------------------|-----------------|---------------------|
| Bee Ltd.                         | 33,000          | 9,000               |
| Less: Wrong dividend credited    | <u>      </u>   | <u>450</u>          |
|                                  | 33,000          | 8,550               |
| Cee Ltd.                         | 360             | 630                 |
| Dee Ltd. (888 + 12)              | <u>      </u>   | <u>900</u>          |
|                                  | 33,360          | 10,080              |
| Less: Unrealised profit on stock | <u>      </u>   | <u>40</u>           |
|                                  | <u>33,360</u>   | <u>10,040</u>       |

## Advanced Accounting

- (5) Mutual owing regarding bills = Rs. (150 – 45) lakhs = Rs. 105 lakhs.
- (6) Unrealised profit =  $\left(200 \times \frac{25}{125}\right)$  lakhs = Rs. 40 lakhs
- (7) Amount of dividend wrongly credited to Profit and Loss A/c = 60% of Rs. 750 lakhs = Rs. 450 lakhs.

### Question 17

The following are the Balance Sheets of Arun Ltd., Brown Ltd. and Crown Ltd. as at 31.12.2005:

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

### Assets:

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

- (i) All shares were acquired on 1.7.2005.
- (ii) On 1.1.2005 the balances to the various accounts were as under:

### Holding Company Accounts

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

- (iii) During 2005, Profits accrued evenly.
- (iv) In August, 2005, each company paid interim dividend of 10%. Arun Ltd. and Brown Ltd. have credited their profit and loss account with the dividends received.
- (v) During 2005, Crown Ltd. sold an equipment costing Rs.40,000 to Brown Ltd. for Rs.48,000 and Brown Ltd. in turn sold the same to Arun Ltd. for Rs.52,000.

Prepare the consolidated Balance Sheet as at 31.12.2005 of Arun Ltd. and its subsidiaries.

(20 Marks) May, 2006)

Answer

#### Consolidated Balance Sheet of Arun Ltd. and its subsidiaries as on 31.12.2005

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

#### Working Notes

##### 1. Shareholding Pattern

| In Brown Ltd.:    | Number of Shares | %age of Holding |
|-------------------|------------------|-----------------|
| Arun Ltd.         | 3,000            | 75%             |
| Minority Interest | 1,000            | 25%             |
| In Crown Ltd.:    |                  |                 |
| Arun Ltd.         | 400              | 16.667%         |
| Brown Ltd.        | 1,400            | 58.333%         |
| Minority Interest | 600              | 25%             |

##### 2. Analysis of apportionment of profit in Crown Ltd.

##### (a) Calculation of Unrealized Profit in Equipment

## Advanced Accounting

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

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

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

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

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

### (b) Reserves

|                                                     | Rs.           |                 |
|-----------------------------------------------------|---------------|-----------------|
| Closing balance                                     | 30,000        |                 |
| Opening balance                                     | <u>20,000</u> | Capital Profit  |
| Current year Appropriation                          | <u>10,000</u> |                 |
| Apportionment of Profit from 1.1.2005 to 30.6.2005  | <u>5,000</u>  | Capital Profit  |
| Apportionment of Profit from 1.7.2005 to 31.12.2005 | <u>5,000</u>  | Revenue Reserve |

### (c) Profit and Loss Account

|                                                    |                 |                |
|----------------------------------------------------|-----------------|----------------|
| Closing balance                                    | 1,00,000        |                |
| Opening balance                                    | <u>12,000</u>   | Capital Profit |
| Current year profits before interim dividend       | <u>1,12,000</u> |                |
| Apportionment of Profit from 1.1.2005 to 30.6.2005 | 56,000          |                |
| Less: Interim Dividend                             | <u>24,000</u>   |                |
|                                                    | 32,000          | Capital Profit |
| From 1.7.2005 to 31.12.2005                        | <u>56,000</u>   | Revenue Profit |

### (d) Apportionment of profits of Crown Ltd.

|          | Pre-Acquisition | Post Acquisition |                |
|----------|-----------------|------------------|----------------|
|          | Capital Profit  | Revenue Reserve  | Revenue Profit |
|          | Rs.             | Rs.              | Rs.            |
| Reserves | 25,000          | 5,000            | --             |

### Holding Company Accounts

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

### 3. Analysis of Profit of Brown Ltd

#### (a) Reserves

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

#### (b) Profit and Loss Account

|                                                                      |                 |
|----------------------------------------------------------------------|-----------------|
|                                                                      | Rs.             |
| Closing balance                                                      | 1,20,000        |
| Opening balance (Dr.)                                                | <u>20,000</u>   |
| Current year Appropriation after interim dividend                    | 1,40,000        |
| Interim Dividend                                                     | <u>40,000</u>   |
| Profit before Interim Dividend                                       | 1,80,000        |
| Less: Dividend from Crown Ltd.                                       | <u>14,000</u>   |
|                                                                      | <u>1,66,000</u> |
| Apportionment of Profit from 1.1.2005 to 30.6.2005                   | 83,000          |
| Less: Interim Dividend                                               | <u>40,000</u>   |
| Capital profit                                                       | <u>43,000</u>   |
| Apportionment of Profit from 1.7.2005 to 31.12.2005 (Revenue profit) | <u>83,000</u>   |

#### (c) Apportionment of Profit of Brown Ltd.

|                                                      | Pre-Acquisition | Post-Acquisition |                |
|------------------------------------------------------|-----------------|------------------|----------------|
|                                                      | Capital Profit  | Revenue Reserve  | Revenue Profit |
|                                                      | Rs.             | Rs.              | Rs.            |
| Reserves                                             | 40,000          | --               | --             |
| Profit & Loss Account                                |                 |                  |                |
| (Opening balance (-) 20,000+43,000)                  | 23,000          |                  | 83,000         |
| Less: Unrealised Profit of Equipment from Crown Ltd. |                 |                  | (4,667)        |

## Advanced Accounting

|                                                |                   |              |                 |
|------------------------------------------------|-------------------|--------------|-----------------|
| Share of Post-Acquisition Profit of Crown Ltd. | <u>    --    </u> | <u>2,917</u> | <u>32,667</u>   |
|                                                | <u>63,000</u>     | <u>2,917</u> | <u>1,11,000</u> |
| Arun Ltd. 75%                                  | 47,250            | 2,188        | 83,250          |
| Minority Interest 25%                          | 15,750            | 729          | 27,750          |
| 4. Minority Interest                           |                   |              |                 |

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

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

## 5. Cost of Control

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

## 6. Dividend declared

|                   | Brown Ltd.<br>Rs. | Crown Ltd.<br>Rs. |
|-------------------|-------------------|-------------------|
| Dividend declared | <u>40,000</u>     | <u>24,000</u>     |

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



### Holding Company Accounts

|                     |        |        |
|---------------------|--------|--------|
| Share of: Arun Ltd. | 30,000 | 4,000  |
| Brown Ltd.          |        | 14,000 |
| Minority            | 10,000 | 6,000  |

#### 7. Inter-Company Transactions

##### (a) Owings

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

##### (b) Fixed Assets

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

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

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

## Advanced Accounting

### Question 18

The following information has been extracted from the Books of 'X' Limited group (as at 31<sup>st</sup> December, 2006):

|                                          | X Ltd.<br>Rs.    | Y Ltd.<br>Rs.   | Z Ltd.<br>Rs.   |                      | X Ltd.<br>Rs.    | Y Ltd.<br>Rs.   | Z Ltd.<br>Rs.   |
|------------------------------------------|------------------|-----------------|-----------------|----------------------|------------------|-----------------|-----------------|
| Share capital                            |                  |                 |                 | Fixed Assets<br>Less |                  |                 |                 |
| (Fully paid equity shares of Rs.10 each) | 8,00,000         | 6,00,000        | 4,00,000        | Depreciation         | 4,20,000         | 3,76,000        | 5,22,000        |
|                                          |                  |                 |                 | Investment at Cost   | 6,30,000         | 4,00,000        | ---             |
| Profit and Loss Account                  | 2,10,000         | 1,90,000        | 1,28,000        | Current Assets       | 1,20,000         | 60,000          | 40,000          |
| Dividend received:                       |                  |                 |                 |                      |                  |                 |                 |
| From Y Ltd. in 2005                      | 60,000           |                 |                 |                      |                  |                 |                 |
| From Y Ltd. in 2006                      | 60,000           |                 |                 |                      |                  |                 |                 |
| From Z Ltd. in 2006                      |                  | 36,000          |                 |                      |                  |                 |                 |
| Current Liabilities                      | <u>40,000</u>    | <u>10,000</u>   | <u>34,000</u>   |                      |                  |                 |                 |
|                                          | <u>11,70,000</u> | <u>8,36,000</u> | <u>5,62,000</u> |                      | <u>11,70,000</u> | <u>8,36,000</u> | <u>5,62,000</u> |

All the companies pay dividends of 12 percent of paid-up share capital in March following the end of the accounting year. The receiving companies account for the dividends in their books when they are received.

'X' Limited acquired 50,000 equity shares of Y Ltd. on 31<sup>st</sup> December, 2004.

'Y' Limited acquired 30,000 equity shares of Z Ltd. on 31<sup>st</sup> December, 2005.

The detailed information of Profit and Loss Accounts is as follows:

|                                                                                                                                                                 | X Ltd.<br>Rs.   | Y Ltd.<br>Rs. | Z Ltd.<br>Rs. |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|---------------|---------------|
| Balance of Profit and Loss Account on 31 <sup>st</sup> December, 2004 after dividends of 12% in respect of calendar year 2004, but excluding dividends received | 86,000          | 78,000        | 60,000        |
| Net profit earned in 2005                                                                                                                                       | <u>1,20,000</u> | <u>84,000</u> | <u>56,000</u> |
|                                                                                                                                                                 | 2,06,000        | 1,62,000      | 1,16,000      |
| Less – Dividends of 12% (paid in 2006)                                                                                                                          | <u>96,000</u>   | <u>72,000</u> | <u>48,000</u> |
|                                                                                                                                                                 | 1,10,000        | 90,000        | 68,000        |

## Holding Company Accounts

Net profit earned in 2006 (Before taking into account proposed dividends of 12% in respect of calendar year 2006)

|                 |                 |                 |
|-----------------|-----------------|-----------------|
| <u>1,00,000</u> | <u>1,00,000</u> | <u>60,000</u>   |
| <u>2,10,000</u> | <u>1,90,000</u> | <u>1,28,000</u> |

Taking into account the transactions from 2004 to 2006 and ignoring taxation, you are required to prepare:

- (i) The Consolidated Balance Sheet of X Limited group as at 31<sup>st</sup> December, 2006.
- (ii) The Consolidated Profit and Loss Account for the year ending 31<sup>st</sup> December, 2006.
- (iii) Cost of control.
- (iv) Minority shareholders interest. (16 Marks)(May, 2007)

Answer

- (i) Consolidated Balance Sheet of X Ltd. and its subsidiaries Y Ltd. and Z Ltd.  
as on 31<sup>st</sup> December, 2006

| Liabilities                                   | Rs.              | Assets                               | Rs.              |
|-----------------------------------------------|------------------|--------------------------------------|------------------|
| Share Capital:                                |                  | Fixed Assets:                        |                  |
| 80,000 Equity shares of Rs.10 each fully paid | 8,00,000         | Goodwill [Refer (iii)]               | 18,000           |
| Minority Interest [Refer (iv)]                | 2,47,167         | Other Fixed Assets less depreciation | 13,18,000        |
| Reserves and Surplus:                         |                  | Current Assets, Loans and Advances:  |                  |
| Profit and Loss Account [Refer (ii)]          | 3,04,833         | Current Assets                       | 2,20,000         |
| Current Liabilities and Provision:            |                  |                                      |                  |
| Current Liabilities                           | 84,000           |                                      |                  |
| Proposed Dividend:                            |                  |                                      |                  |
| X Ltd.                                        | 96,000           |                                      |                  |
| Minority Interest [Refer (iv)]                | <u>24,000</u>    |                                      |                  |
|                                               | <u>15,56,000</u> |                                      | <u>15,56,000</u> |

- (ii) Consolidated Profit and Loss Account  
for the year ending 31<sup>st</sup> December, 2006 (in Rs.)

| Particulars                 | X Ltd. | Y Ltd. | Z Ltd. | Adjustments | Total    | Particulars    | X Ltd.   | Y Ltd.   | Z Ltd.   | Adjustments | Total    |
|-----------------------------|--------|--------|--------|-------------|----------|----------------|----------|----------|----------|-------------|----------|
| To Dividend (paid for 2005) | 96,000 | 72,000 | 48,000 | 96,000      | 1,20,000 | By Balance b/d | 2,06,000 | 1,62,000 | 1,16,000 | -           | 4,84,000 |
| To Minority                 | -      | 39,167 | 32,000 | -           | 71,167   | By Dividend    | 60,000   | -        | -        | -           | 60,000   |

## Advanced Accounting

|                                                                      |                 |                 |                 |               |                 |                                               |                 |                 |                 |               |                 |
|----------------------------------------------------------------------|-----------------|-----------------|-----------------|---------------|-----------------|-----------------------------------------------|-----------------|-----------------|-----------------|---------------|-----------------|
| Interest                                                             |                 |                 |                 |               |                 | received<br>in 2005<br>(for 2004)             |                 |                 |                 |               |                 |
| To Capital Reserve<br>(Cost of Control)                              | -               | 65,000          | 51,000          | -             | 1,16,000        | By Dividend received<br>in 2006<br>(for 2005) | 60,000          | 36,000          | -               | 96,000        | -               |
| To Investments Accounts<br>(Dividend received out of capital profit) | 60,000*         | 36,000*         | -               | -             | 96,000          | By Profit for the year                        | 1,00,000        | 1,00,000        | 60,000          | -             | 2,60,000        |
| To Proposed Dividend                                                 | 96,000          | -               | -               | -             | 96,000          |                                               |                 |                 |                 |               |                 |
| To Balance c/d                                                       | <u>1,74,000</u> | <u>85,833</u>   | <u>45,000</u>   | <u>--</u>     | <u>3,04,833</u> |                                               |                 |                 |                 |               |                 |
|                                                                      | <u>4,26,000</u> | <u>2,98,000</u> | <u>1,76,000</u> | <u>96,000</u> | <u>8,04,000</u> |                                               | <u>4,26,000</u> | <u>2,98,000</u> | <u>1,76,000</u> | <u>96,000</u> | <u>8,04,000</u> |

### Notes:\*

- (1) X Ltd. receives from Y Ltd., dividend amounting to Rs.60,000 for the year 2004 in the year 2005 for shares acquired in 2004. It is a capital profit, therefore it has been transferred to cost of control to reduce the cost of investment.
- (2) Y Ltd. receives a dividend of Rs.36,000 from Z Ltd. for the year 2005 in the year 2006. The shares were acquired by Y Ltd on 31<sup>st</sup> December, 2005. The entire amount is therefore, a capital profit and hence transferred to cost of control to reduce the cost of investment.

### (iii) Cost of Control:

|                                                                                | Rs.           | Rs.             |
|--------------------------------------------------------------------------------|---------------|-----------------|
| Cost of Investment in Y Ltd. on 31 <sup>st</sup> December 2004                 | 6,30,000      |                 |
| Less: Dividend of the year 2004 received in 2005 out of Pre-acquisition profit | <u>60,000</u> | 5,70,000        |
| Cost of Investment in Z Ltd.                                                   | 4,00,000      |                 |
| Less: Dividend of the year 2005 received in 2006 out of Pre-acquisition Profit | <u>36,000</u> | <u>3,64,000</u> |
|                                                                                |               | 9,34,000        |
| Less: Paid up value of shares in Y Ltd.                                        | 5,00,000      |                 |
| Paid up value of shares in Z Ltd.                                              | 3,00,000      |                 |
| Capital Profits in Y Ltd. (Refer W.N. 2)                                       | 65,000        |                 |
| Capital Profits in Z Ltd. (Refer W.N. 2)                                       | <u>51,000</u> | <u>9,16,000</u> |
| Goodwill                                                                       |               | <u>18,000</u>   |

### Holding Company Accounts

|                                                                                                    |                 |                 |
|----------------------------------------------------------------------------------------------------|-----------------|-----------------|
| (iv) Minority shareholders' interest:                                                              | Y Ltd.          | Z Ltd.          |
|                                                                                                    | Rs.             | Rs.             |
| Share Capital (Y Ltd. – 1/6 and Z Ltd. – 1/4)                                                      | 1,00,000        | 1,00,000        |
| Capital Profits (Refer W.N. 2)                                                                     | 13,000          | 17,000          |
| Revenue Profits (Refer W.N. 2)                                                                     | <u>26,167</u>   | <u>15,000</u>   |
|                                                                                                    | <u>1,39,167</u> | <u>1,32,000</u> |
| Total (1,39,167 + 1,32,000)                                                                        |                 | 2,71,167        |
| Less: Minority shareholders' share of proposed dividend<br>(shown separately in the Balance Sheet) |                 |                 |
| $(\frac{1}{6} \text{ of Rs. } 72,000 + \frac{1}{4} \text{ of Rs. } 48,000)$                        |                 | <u>24,000</u>   |
| Balance                                                                                            |                 | <u>2,47,167</u> |

#### Working Notes:

|                                                                                                  |                          |                           |
|--------------------------------------------------------------------------------------------------|--------------------------|---------------------------|
| 1. Shareholding Pattern                                                                          | Number of shares         | share of holding          |
| In Y Ltd.                                                                                        |                          |                           |
| X Ltd.                                                                                           | 50,000                   | 5/6                       |
| Minority Interest                                                                                | 10,000                   | 1/6                       |
| In Z Ltd.                                                                                        |                          |                           |
| Y Ltd.                                                                                           | 30,000                   | 3/4                       |
| Minority Interest                                                                                | 10,000                   | 1/4                       |
| 2. Analysis of Profits                                                                           | Pre -<br>acquis<br>ition | Post -<br>acquisiti<br>on |
|                                                                                                  | Capital<br>Profit        | Revenue<br>Profit         |
| Z Ltd.                                                                                           | Rs                       | Rs.                       |
| Balance on 31 <sup>st</sup> December, 2005 after dividend for 2005<br>(1,16,000 – 48,000)        | 68,000                   | -                         |
| Profit for the year ending 31 <sup>st</sup> December, 2006 before<br>proposed dividends for 2006 | <u>-</u>                 | <u>60,000</u>             |
|                                                                                                  | <u>68,000</u>            | <u>60,000</u>             |
| Share of Y Ltd. (3/4)                                                                            | 51,000                   | 45,000                    |

### Advanced Accounting

|                                                                               |               |                 |
|-------------------------------------------------------------------------------|---------------|-----------------|
| Minority Interest (1/4)                                                       | <u>17,000</u> | <u>15,000</u>   |
| Y Ltd.                                                                        |               |                 |
| Balance on 31 <sup>st</sup> December, 2004                                    | 78,000        | -               |
| Profit for the year 2005 after payment of dividend for 2005 (84,000 – 72,000) | -             | 12,000          |
| Profit for the year 2006 (before payment of dividend of the year 2006)        | -             | 1,00,000        |
| Revenue Profit from Z Ltd.                                                    | <u>-</u>      | <u>45,000</u>   |
|                                                                               | <u>78,000</u> | <u>1,57,000</u> |
| Share of X Ltd. (5/6)                                                         | 65,000        | 1,30,833        |
| Share of Minority Shareholders' Interest (1/6)                                | <u>13,000</u> | <u>26,167</u>   |

Note: This problem has been solved by following 'direct approach'.

#### Question 19

The draft Balance Sheets of 3 Companies as at 31<sup>st</sup> March, 2007 are as below:

|                                       | (In Rs.000's) |               |               |
|---------------------------------------|---------------|---------------|---------------|
| Liabilities                           | Morning Ltd.  | Evening Ltd.  | Night Ltd.    |
| Share Capital – shares of Rs.100 each | 40,000        | 20,000        | 10,000        |
| Reserves                              | 1,800         | 1,000         | 900           |
| P/L A/c (1.4.06)                      | 1,500         | 2,000         | 800           |
| Profit for 2006-07                    | 7,000         | 3,800         | 1,800         |
| Loan from Morning Ltd.                | —             | 5,000         | —             |
| Creditors                             | <u>2,500</u>  | <u>1,000</u>  | <u>1,400</u>  |
|                                       | <u>52,800</u> | <u>32,800</u> | <u>14,900</u> |
| Assets                                |               |               |               |
| Investments:                          |               |               |               |
| 1,60,000 shares in Evening            | 18,000        | —             | —             |
| 75,000 shares in Night                | 8,000         | —             | —             |
| Loan to Evening Ltd.                  | 5,000         | —             | —             |
| Sundry assets                         | <u>21,800</u> | <u>32,800</u> | <u>14,900</u> |
|                                       | <u>52,800</u> | <u>32,800</u> | <u>14,900</u> |

## Holding Company Accounts

Following additional information is also available:

- (a) Dividend is proposed by each company at 10%.
- (b) Stock transferred by Night Ltd. to Evening Ltd. fully paid for was Rs.8 lacs on which the former made a Profit of Rs.3 lacs. On 31<sup>st</sup> March, 2007, this was in the inventory of the latter.
- (c) Loan referred to is against 8% interest. Neither Morning Ltd. nor Evening Ltd. has considered the interest.
- (d) Reserves as on 1.4.2006 of Evening Ltd. and Night Ltd. were Rs.8,00,000 and Rs.7,50,000 respectively.
- (e) Cash-in-transit from Evening Ltd. to Morning Ltd. was Rs.1,00,000 as on 31.3.2007.
- (f) The shares of the subsidiaries were all acquired by Morning Ltd. on 1<sup>st</sup> April, 2006.

Prepare consolidated Balance Sheet as on 31<sup>st</sup> March, 2007. Workings should be part of the answer.  
(16 Marks) (Nov., 2007)

Answer

### Consolidated Balance Sheet of Morning Ltd. with its subsidiaries Evening Ltd. and Night Ltd.

As on 31<sup>st</sup> March, 2007

|                                |       |              |         | (Rs. in thousand)       |            |               |        |
|--------------------------------|-------|--------------|---------|-------------------------|------------|---------------|--------|
| Liabilities                    | Rs.   | Rs.          | Rs.     | Assets                  | Rs.        | Rs.           | Rs.    |
| Share Capital                  |       |              | 40,000  | Sundry Assets*          |            |               |        |
| Minority Interest              |       |              |         | Morning Ltd.            |            | 21,800        |        |
| Evening Ltd.                   |       | 4,880        |         | Evening Ltd.            | 32,800     |               |        |
| Night Ltd.                     |       | <u>3,125</u> | 8,005   | Less: Unrealized profit | <u>300</u> | 32,500        |        |
| Capital Reserve [Refer Note 5] |       |              | 902.5   | Night Ltd.              |            | <u>14,900</u> | 69,200 |
| General Reserve                |       |              |         |                         |            |               |        |
| Morning Ltd.                   |       | 1,800        |         |                         |            |               |        |
| Evening Ltd.                   |       | 160          |         |                         |            |               |        |
| Night Ltd.                     |       | <u>112.5</u> | 2,072.5 |                         |            |               |        |
| Profit & Loss A/c              |       |              |         |                         |            |               |        |
| Balance on 1.04.06             | 1,500 |              |         |                         |            |               |        |

\* The total of Sundry Assets of the Group mutually sets off the effect of Cash-in-transit of Rs.1 lac from Evening Ltd. to Morning Ltd. Hence, cash in transit has not been separately shown.

## Advanced Accounting

|                                  |              |               |               |
|----------------------------------|--------------|---------------|---------------|
| Profit during 06-07              | 7,000        |               |               |
| Add: Interest on Loan            | <u>400</u>   |               |               |
|                                  | 8,900        |               |               |
| Less: Proposed dividend          | <u>4,000</u> | 4,900         |               |
| Add: P&L Account of Evening Ltd. |              | 2,720         |               |
| Add: P&L Account of Night Ltd    | <u>1,050</u> | 8,670         |               |
| Creditors                        |              |               |               |
| Morning Ltd.                     |              | 2,500         |               |
| Evening Ltd.                     |              | 1,000         |               |
| Night Ltd                        | <u>1,400</u> | 4,900         |               |
| Proposed Dividend                |              |               |               |
| Morning Ltd.                     |              | 4,000         |               |
| Evening Ltd. (Minority)          |              | 400           |               |
| Night Ltd. (Minority)            | <u>250</u>   | <u>4,650</u>  |               |
|                                  |              | <u>69,200</u> | <u>69,200</u> |

### Workings Notes:

- A. Morning Ltd.'s holding in Evening Ltd. is 1,60,000 shares out of 2,00,000 shares, i.e., 4/5<sup>th</sup> or 80%; Minority holding 1/5<sup>th</sup> or 20%.
- B. Morning Ltd.'s holding in Night Ltd. is 75,000 shares out of 1,00,000 shares, i.e., 3/4<sup>th</sup> or 75%; Minority holding 1/4<sup>th</sup> or 25%.

### Analysis of Reserves and Profits of Subsidiary Companies

|                                                           | Evening Ltd.<br>(Rs.'000) | Night Ltd<br>Rs.('000) | Minority interest in Evening Ltd. (1/5)<br>Rs.('000) | Minority interest in Night Ltd. (1/4)<br>Rs.('000) |
|-----------------------------------------------------------|---------------------------|------------------------|------------------------------------------------------|----------------------------------------------------|
| 1. Capital Reserve (pre-acquisition reserves and profits) |                           |                        |                                                      |                                                    |
| Reserves on 1.04.2006                                     | 800                       | 750                    |                                                      |                                                    |
| Profit on 1.04.2006                                       | <u>2,000</u>              | <u>800</u>             |                                                      |                                                    |
|                                                           | 2,800                     | 1,550                  |                                                      |                                                    |
| Less: Minority interest                                   | <u>560</u>                | <u>387.5</u>           | 560                                                  | 387.5                                              |
|                                                           | <u>2,240</u>              | <u>1,162.5</u>         |                                                      |                                                    |



## Holding Company Accounts

|    |                                                                                 |               |              |                   |              |
|----|---------------------------------------------------------------------------------|---------------|--------------|-------------------|--------------|
| 2. | General Reserve                                                                 |               |              |                   |              |
|    | Reserves as per Balance Sheet                                                   | 1,000         | 900          |                   |              |
|    | Less: Capital Reserve [See Note A]                                              | <u>800</u>    | <u>750</u>   |                   |              |
|    |                                                                                 | 200           | 150          |                   |              |
|    | Less: Minority interest                                                         | <u>40</u>     | <u>37.5</u>  | 40                | 37.5         |
|    |                                                                                 | <u>160</u>    | <u>112.5</u> |                   |              |
| 3. | Profit and Loss Account                                                         |               |              |                   |              |
|    | Profit for the year as per Balance Sheet                                        | 3,800         | 1,800        |                   |              |
|    | Less: Interest on Loan (5,000 x 8%)                                             | <u>400</u>    |              |                   |              |
|    |                                                                                 | 3,400         |              |                   |              |
|    | Less: Minority Interest                                                         | <u>680</u>    | <u>450</u>   | 680               | 450          |
|    |                                                                                 | 2,720         | 1,350        |                   |              |
|    | Less: Unrealised profit on stock transfer                                       | <u>      </u> | <u>300*</u>  |                   |              |
|    |                                                                                 | <u>2,720</u>  | <u>1,050</u> |                   |              |
| 4. | Share Capital                                                                   |               |              |                   |              |
|    | As per Balance sheet                                                            | 20,000        | 10,000       |                   |              |
|    | Less: Minority interest                                                         | <u>4,000</u>  | <u>2,500</u> | <u>4,000</u>      | <u>2,500</u> |
|    | Transferred for computation of Goodwill/Capital Reserve                         | <u>16,000</u> | <u>7,500</u> | 5,280             | 3,375        |
|    | Less: Proposed dividend shown separately                                        |               |              | <u>400</u>        | <u>250</u>   |
|    | Transferred to Consolidated Balance Sheet                                       |               |              | <u>4,880</u>      | <u>3,125</u> |
| 5. | Computation of Cost of Control i.e. Goodwill / Capital Reserve on consolidation |               |              |                   |              |
|    |                                                                                 |               |              | (Rs. In thousand) |              |
|    |                                                                                 | Evening Ltd.  |              | Night Ltd.        |              |
|    | Cost of Investments                                                             | 18,000        |              | 8,000             |              |
|    | Less: Paid up value of shares [Refer Note 4]                                    | <u>16,000</u> |              | <u>7,500</u>      |              |
|    |                                                                                 | 2,000         |              | 500               |              |
|    | Less: Capital Reserve [Refer Note 1]                                            | <u>2,240</u>  |              | <u>1,162.5</u>    |              |
|    |                                                                                 | <u>-240</u>   |              | <u>-662.5</u>     |              |
|    | Total Capital Reserve (Rs.240 + Rs.662.5)                                       | 902.5         |              |                   |              |

\* As per para 17 of AS 21, 'Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full.

## Advanced Accounting

### Question 20

Astha Ltd. acquired 80% of both classes of shares in Birat Ltd. on 1.4.2007. The draft Balance Sheets of two companies on 31<sup>st</sup> March, 2008 were as follows:

| (Rs. in 000's)                                      |              |              |                                    |              |              |
|-----------------------------------------------------|--------------|--------------|------------------------------------|--------------|--------------|
| Liabilities                                         | Astha Ltd.   | Birat Ltd.   | Assets                             | Astha Ltd.   | Birat Ltd.   |
| Share Capital:                                      |              |              |                                    |              |              |
| Equity shares of Rs.10 each, full paid up           | 3,000        | 600          | Plant & machinery                  | 2,060        | 600          |
| 14% Preference shares of Rs.100 each, fully paid up | -            | 400          | Furniture & fixtures               | 600          | 540          |
| General reserve                                     | 1,900        | 40           | Investments                        |              |              |
|                                                     |              |              | in equity shares of Birat Ltd.     | 1,920        | -            |
| Profit and loss account                             | 1,600        | 720          | in preference shares of Birat Ltd. | 320          | -            |
| Creditors                                           | 300          | 320          | Stock                              | 680          | 404          |
|                                                     |              |              | Debtors                            | 560          | 316          |
|                                                     |              |              | Cash at bank                       | <u>660</u>   | <u>220</u>   |
|                                                     | <u>6,800</u> | <u>2,080</u> |                                    | <u>6,800</u> | <u>2,080</u> |

Note:

Contingent liability – Astha Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – Rs.1,55,000.

Additional Information:

- (i) General reserve balance of Birat Ltd. was the same as on 1.4.2007.
- (ii) The balance in Profit and Loss A/c of Birat Ltd. on 1.4.2007 was Rs.3,20,000, out of which dividend of 16% p.a. on the Equity capital of Rs.6,00,000 was paid for the year 2006-07.
- (iii) The dividend in respect of preference shares of Birat Ltd. for the year 2007-08 was still payable as on 31.3.2008.
- (iv) Astha Ltd. credited its Profit and Loss A/c for the dividend received by it from Birat Ltd. for the year 2006-07.
- (v) Sundry creditors of Astha Ltd. included an amount of Rs.1,20,000 for purchases from Birat Ltd., on which the later company made a loss of Rs.10,000.
- (vi) Half of the above goods were still with the closing stock of Astha Ltd. as at 31.3.2008.

## Holding Company Accounts

- (vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%. There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.
- (viii) The directors of Astha Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31<sup>st</sup> March, 2008, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer. (16 Marks)(May, 2008)

Answer

## Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd.

as at 31<sup>st</sup> March 2008

(Rs. in '000s)

|                             |                |                        |                |
|-----------------------------|----------------|------------------------|----------------|
| Liabilities                 | Amount         | Assets                 | Amount         |
| Share capital:              |                | Goodwill (W.N.5)       | 1,088.0        |
| 3,00,000 Equity shares of   |                | Plant and machinery    |                |
| Rs. 10 each fully paid up   | 3,000.0        | Astha Ltd.             | 2,060.0        |
| Minority interest (W.N.4)   | 360.4          | Birat Ltd. (W.N.7)     | <u>750.0</u>   |
| General reserves            | 1,900.0        | Furniture and fixtures |                |
| Profit and loss A/c (W.N.6) | 1,894.6        | Astha Ltd.             | 600.0          |
| Creditors                   |                | Birat Ltd. (W.N. 8)    | <u>432.0</u>   |
| Astha Ltd.                  | 300.0          | Stock                  |                |
| Birat Ltd.                  | <u>320.0</u>   | Astha Ltd.             | 680.0          |
|                             | 620.0          | Birat Ltd.             | <u>404.0</u>   |
| Less: Mutual owings         | <u>120.0</u>   |                        | 1,084.0        |
|                             | 500.0          | Add: Unrealised loss   | <u>5.0</u>     |
|                             |                |                        | 1,089.0        |
|                             |                | Debtors                |                |
|                             |                | Astha Ltd.             | 560.0          |
|                             |                | Birat Ltd.             | <u>316.0</u>   |
|                             |                |                        | 876.0          |
|                             |                | Less: Mutual owings    | <u>120.0</u>   |
|                             |                |                        | 756.0          |
|                             |                | Cash at Bank           |                |
|                             |                | Astha Ltd.             | 660.0          |
|                             |                | Birat Ltd.             | <u>220.0</u>   |
|                             |                |                        | <u>880.0</u>   |
|                             | <u>7,655.0</u> |                        | <u>7,655.0</u> |

## Advanced Accounting

Contingent liability: Claim against damages lodged by a contractor against Astha Ltd. is pending in a law suit Rs. 155 thousands (W.N. 9).

Working Notes:

|    |                                                                                                             |                |
|----|-------------------------------------------------------------------------------------------------------------|----------------|
| 1. | Calculation of capital profits (pre-acquisition)                                                            | (Rs. in '000s) |
|    | General reserve balance as on 1-04-2007                                                                     | 40.0           |
|    | Profit and loss account balance as on 1-04-2007                                                             | 320.0          |
|    | Less: Dividend at 16% p.a. on Rs. 6,00,000 for the year 2006-07                                             | <u>96.0</u>    |
|    |                                                                                                             | 224.0          |
|    |                                                                                                             | 264.0          |
|    | Add: Profit on revaluation of plant and machinery (W.N.7)                                                   | <u>200.0</u>   |
|    |                                                                                                             | 464.0          |
|    | Less: Loss on revaluation of furniture and fixtures (W.N.8)                                                 | <u>120.0</u>   |
|    |                                                                                                             | <u>344.0</u>   |
|    | Share of Astha Ltd. (80%)                                                                                   | 275.2          |
|    | Share of Minority Interest (20%)                                                                            | <u>68.8</u>    |
| 2. | Calculation of revenue profits (post-acquisition)                                                           | (Rs. in '000s) |
|    | Profits during the year 2007-08 (720.0 – 224.0)                                                             | 496.0          |
|    | Less: Preference dividend for the year 2007-08 @ 14% on Rs.4,00,000                                         | <u>56.0</u>    |
|    |                                                                                                             | 440.0          |
|    | Less: Under charging of depreciation on plant and machinery due to upward revaluation (Rs.2,00,000 x 25%)   | <u>50.0</u>    |
|    |                                                                                                             | 390.0          |
|    | Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%) | <u>12.0</u>    |
|    |                                                                                                             | <u>402.0</u>   |
|    | Share of Astha Ltd. (80%)                                                                                   | 321.6          |
|    | Share of Minority Interest (20%)                                                                            | <u>80.4</u>    |
| 3. | Calculation of dividend on preference shares of Birat Ltd.                                                  | (Rs. in '000s) |
|    | Dividend on preference shares (Rs. 4,00,000 x 14%)                                                          | <u>56.0</u>    |
|    | Share of Astha Ltd. (80%)                                                                                   | 44.8           |
|    | Share of Minority Interest (20%)                                                                            | <u>11.2</u>    |
|    |                                                                                                             | <u>56.0</u>    |

## Holding Company Accounts

|    |                                                              |              |                |
|----|--------------------------------------------------------------|--------------|----------------|
| 4. | Calculation of Minority Interest                             |              | (Rs. in '000s) |
|    | Equity share capital (20%)                                   |              | 120.0          |
|    | Preference share capital (20%)                               |              | 80.0           |
|    | Share of capital profits (W.N. 1)                            |              | 68.8           |
|    | Share of Revenue profit (W.N.2)                              |              | 80.4           |
|    | Share of preference dividend (W.N.3)                         |              | <u>11.2</u>    |
|    |                                                              |              | <u>360.4</u>   |
| 5. | Calculation of Cost of Control - Goodwill                    |              | (Rs. in '000s) |
|    | Investment by Astha Ltd. in                                  |              |                |
|    | Equity shares of Birat Ltd.                                  | 1,920.0      |                |
|    | Less: Dividend received for 2006-07 (600 x 80% 16%)          | <u>76.8</u>  | 1,843.2        |
|    | Preference shares                                            |              | <u>320.0</u>   |
|    |                                                              |              | 2,163.2        |
|    | Less: Paid up value of                                       |              |                |
|    | Equity shares (80%)                                          | 480.0        |                |
|    | Preference shares (80%)                                      | 320.0        |                |
|    | Share in Capital Profit (W.N. 1)                             | <u>275.2</u> | <u>1,075.2</u> |
|    | Goodwill                                                     |              | <u>1,088.0</u> |
| 6. | Calculation of Consolidated Profit and Loss A/c              |              | (Rs. in '000s) |
|    | Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2007 |              | 1,600.0        |
|    | Add: Revenue profit from Birat Ltd (W.N. 2)                  |              | 321.6          |
|    | Preference dividend of Birat Ltd. (W.N. 3)                   |              | 44.8           |
|    | Share of unrealised loss on stock (Rs. 10,000 x 50%)         |              | <u>5.0</u>     |
|    |                                                              |              | 1,971.4        |
|    | Less: Dividend wrongly credited                              |              | <u>76.8</u>    |
|    |                                                              |              | <u>1,894.6</u> |
| 7. | Value of Plant and Machinery of Birat Ltd.                   |              | (Rs. in '000s) |
|    | Value as on 1.04.07 ( 600 x 100/75)                          |              | 800.0          |
|    | Add: Appreciation on revaluation (25%)                       |              | <u>200.0</u>   |

## Advanced Accounting

|                                                             |               |                 |
|-------------------------------------------------------------|---------------|-----------------|
| Revalued figure                                             |               | 1,000.00        |
| Less: Depreciation                                          |               |                 |
| Already charged (800-600)                                   | 200.0         |                 |
| Due to upward revaluation (200 x 25%)                       | <u>50.0</u>   | <u>(250.0)</u>  |
|                                                             |               | <u>750.0</u>    |
| 8. Value of Furniture and Fixtures of Birat Ltd.            |               | (Rs. in '000s)  |
| Value as on 1.4.2007 (540 x 100/90)                         |               | 600.00          |
| Less: Diminution on revaluation (20%)                       |               | <u>(120.00)</u> |
| Revalued Figure                                             |               | 480.0           |
| Less: Depreciation already charged (600 - 540)              | 60.0          |                 |
| Less: Depreciation written back due to downward revaluation |               |                 |
| (120 x 10%)                                                 | <u>(12.0)</u> | <u>(48.0)</u>   |
|                                                             |               | <u>432.0</u>    |

### 9. Contingent liability:

As per para 68 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability." Therefore, it would not be correct to ignore the contingent liability.

### Question 21

The Balance Sheets of three companies Angle Ltd., Bolt Ltd., and Canopy Ltd., as at 31<sup>st</sup> December, 2007 are given below:

| Liabilities                                     | Angle Ltd.<br>Rs. | Bolt Ltd.<br>Rs. | Canopy Ltd.<br>Rs. |
|-------------------------------------------------|-------------------|------------------|--------------------|
| Share capital<br>(Equity shares of Rs.100 each) | 15,00,000         | 10,00,000        | 6,00,000           |
| Reserves                                        | 2,00,000          | 1,25,000         | 75,000             |
| Profit and Loss A/c                             | 5,00,000          | 2,75,000         | 2,50,000           |
| Sundry creditors                                | 2,00,000          | 2,50,000         | 1,00,000           |
| Bills payable                                   | -                 | -                | 50,000             |
| Angle Ltd.                                      | -                 | 1,00,000         | 80,000             |
|                                                 | <u>24,00,000</u>  | <u>17,50,000</u> | <u>11,55,000</u>   |

### Holding Company Accounts

|                            |                  |                  |                  |
|----------------------------|------------------|------------------|------------------|
| Goodwill                   | 2,50,000         | 5,80,000         | 4,50,000         |
| Plant and Machinery        | 4,00,000         | 2,50,000         | 3,25,000         |
| Furniture and Fittings     | 2,00,000         | 1,50,000         | 1,40,000         |
| Shares in-                 |                  |                  |                  |
| Bolt Ltd. (7,500 shares)   | 9,00,000         | -                | -                |
| Canopy Ltd. (1,000 shares) | 1,50,000         |                  |                  |
| Canopy Ltd. (3,500 shares) | -                | 5,20,000         | -                |
| Stock in trade             | 1,00,000         | 1,50,000         | 1,60,000         |
| Sundry debtors             | 1,40,000         | 70,000           | 70,000           |
| Bills receivable           | 50,000           | 20,000           | -                |
| Due from-                  |                  |                  |                  |
| Bolt Ltd.                  | 1,20,000         | -                | -                |
| Canopy Ltd.                | 80,000           | -                | -                |
| Cash in hand               | <u>10,000</u>    | <u>10,000</u>    | <u>10,000</u>    |
| Total                      | <u>24,00,000</u> | <u>17,50,000</u> | <u>11,55,000</u> |

- (a) All shares were acquired on 1<sup>st</sup> July, 2006.  
(b) On 1<sup>st</sup> January, 2006, the balances were:

|                                                     | Angle Ltd.<br>Rs. | Bolt Ltd.<br>Rs. | Canopy Ltd.<br>Rs. |
|-----------------------------------------------------|-------------------|------------------|--------------------|
| Reserves                                            | 1,00,000          | 1,00,000         | 50,000             |
| Profit and Loss account                             | 50,000            | (50,000)Dr.      | 30,000             |
| Profit during 2006 were earned evenly over the year | 3,00,000          | 2,50,000         | 1,00,000           |

- (c) Each company declared a dividend of 10% in the year 2007 on its shares out of Profits for the year 2006; Angle Ltd. and Bolt Ltd. have credited their Profit and Loss account with the dividends received.  
(d) The increase in reserves in case of Angle Ltd., Bolt Ltd., and Canopy Ltd., was effected in the year 2006.  
(e) All the bills payable appearing in Canopy Ltd.'s Balance Sheet were accepted in favour of Bolt Ltd., out of which bills amounting Rs.30,000 were endorsed by Bolt Ltd., in favour of Angle Ltd.  
(f) Stock with Bolt Ltd. includes goods purchased from Angle Ltd., for Rs.18,000. Angle Ltd., invoiced the goods at cost plus 20%.

Prepare consolidated Balance Sheet of the group as at 31<sup>st</sup> December, 2007. Working should be part of the answer. Ignore taxation including dividend distribution tax, disclose minority interest as per AS 21 . (20 Marks)

## Advanced Accounting

Answer

### Consolidated Balance Sheet of Angle Ltd. and its subsidiaries

#### Bolt Ltd and Canopy Ltd

as at 31<sup>st</sup> December, 2007

| Liabilities                     | Rs.             | Assets                                | Rs.             |
|---------------------------------|-----------------|---------------------------------------|-----------------|
| Share Capital                   | 15,00,000       | Goodwill                              |                 |
| (Equity shares of Rs.100 each)  |                 | Angle Ltd. 2,50,000                   |                 |
| Minority Interest (W.N. 6)      |                 | Bolt Ltd. 5,80,000                    |                 |
| Bolt Ltd.                       | 3,97,396        | Canopy Ltd. <u>4,50,000</u>           | 12,80,000       |
| Canopy Ltd.                     | <u>2,31,250</u> | Add: Cost of control(W.N.7)           | <u>1,55,833</u> |
|                                 | 6,28,646        |                                       | 14,35,833       |
| Reserves                        | 2,16,927        | Plant & Machinery                     |                 |
| (2,00,000+14,844+2,083)         |                 | Angle Ltd.                            | 4,00,000        |
| Profit and Loss Account (W.N.4) | 7,62,260        | Bolt Ltd.                             | 2,50,000        |
|                                 |                 | Canopy Ltd.                           | <u>3,25,000</u> |
| Sundry Creditors                |                 |                                       | 9,75,000        |
| Angle Ltd. 2,00,000             | 5,50,000        | Furniture & Fittings                  |                 |
| Bolt Ltd. 2,50,000              |                 | Angle Ltd.                            | 2,00,000        |
| Canopy Ltd. <u>1,00,000</u>     |                 | Bolt Ltd.                             | 1,50,000        |
| Bills Payable                   | 50,000          | Canopy Ltd.                           | <u>1,40,000</u> |
| Less: Mutually held             | <u>50,000</u>   |                                       | 4,90,000        |
|                                 | Nil             | Stock-in-Trade                        |                 |
|                                 |                 | Angle Ltd.                            | 1,00,000        |
|                                 |                 | Bolt Ltd.                             | 1,50,000        |
|                                 |                 | Canopy Ltd.                           | <u>1,60,000</u> |
|                                 |                 |                                       | 4,10,000        |
|                                 |                 | Less: Provision for unrealised Profit | <u>3,000</u>    |
|                                 |                 |                                       | 4,07,000        |
|                                 |                 | Sundry Debtors                        |                 |
|                                 |                 | Angle Ltd.                            | 1,40,000        |
|                                 |                 | Bolt Ltd.                             | 70,000          |
|                                 |                 | Canopy Ltd.                           | <u>70,000</u>   |
|                                 |                 |                                       | 2,80,000        |
|                                 |                 | Bills Receivable                      |                 |
|                                 |                 | Angle Ltd.                            | 50,000          |
|                                 |                 | Bolt Ltd.                             | <u>20,000</u>   |
|                                 |                 |                                       | 70,000          |
|                                 |                 | Less: Mutually held                   | <u>50,000</u>   |
|                                 |                 |                                       | 20,000          |
|                                 |                 | Cash-in-hand                          |                 |
|                                 |                 | Angle Ltd.                            | 10,000          |



### Holding Company Accounts

|                                                   |               |        |
|---------------------------------------------------|---------------|--------|
| Bolt Ltd.                                         | 10,000        |        |
| Canopy Ltd.                                       | <u>10,000</u> | 30,000 |
| Cash-in-Transit / Dues<br>from Bolt Ltd. (W.N. 8) |               |        |

|                  |                  |
|------------------|------------------|
|                  | <u>20,000</u>    |
| <u>36,57,833</u> | <u>36,57,833</u> |

#### Disclosure of Minority Interest in accordance with AS 21

Amount of Equity attributable to minorities on the date of Investment ie. 1.7.2006

|                                                           | Bolt Ltd        | Canopy Ltd.     |
|-----------------------------------------------------------|-----------------|-----------------|
| Share capital                                             | 2,50,000        | 1,50,000        |
| Share in Capital Reserve as on 1.1.06                     | 25,000          | 12,500          |
| Share in Capital Profits as on 1.1.06                     | (12,500)        | 7,500           |
| Share in Capital Profits for the period 1.1.06 to 30.6.06 | <u>31,250</u>   | <u>12,500</u>   |
|                                                           | <u>2,93,750</u> | <u>1,82,500</u> |
| Total amount of Equity attributable to minorities         | 4,76,250        |                 |

#### Disclosure in accordance with AS 21

Minority Interest as on 31.12.2007

|                                                                                                                      |                 |
|----------------------------------------------------------------------------------------------------------------------|-----------------|
| Amount of equity as on the date of Investment ie. 1.7.2006                                                           | 4,76,250        |
| Add: Movement in equity and proportionate share of Profit less dividend<br>from the date of Investment upto 31.12.07 | <u>1,52,396</u> |
|                                                                                                                      | <u>6,28,646</u> |

#### Working Notes:

##### 1. Ascertainment of Profits for the year 2007

|                                             | Angle Ltd.      | Bolt Ltd.       | Canopy Ltd.     |
|---------------------------------------------|-----------------|-----------------|-----------------|
|                                             | Rs.             | Rs.             | Rs.             |
| Balance as on 1 <sup>st</sup> January, 2006 | 50,000          | (50,000)        | 30,000          |
| Add: Profits earned during 2006             | <u>3,00,000</u> | <u>2,50,000</u> | <u>1,00,000</u> |
|                                             | 3,50,000        | 2,00,000        | 1,30,000        |
| Less: Dividend Declared                     | <u>1,50,000</u> | <u>1,00,000</u> | <u>60,000</u>   |
|                                             | 2,00,000        | 1,00,000        | 70,000          |
| Less: Transfer to Reserve                   | <u>1,00,000</u> | <u>25,000</u>   | <u>25,000</u>   |

## Advanced Accounting

|                                               |                 |                 |                 |
|-----------------------------------------------|-----------------|-----------------|-----------------|
|                                               | 1,00,000        | 75,000          | 45,000          |
| Profit for the year 2007 (Balancing Figure)   | <u>4,00,000</u> | <u>2,00,000</u> | <u>2,05,000</u> |
| Balance as on 31 <sup>st</sup> December, 2007 | <u>5,00,000</u> | <u>2,75,000</u> | <u>2,50,000</u> |

### 2. Undistributed profits for the year 2006

|                            | Bold Ltd.<br>Rs. | Canopy Ltd.<br>Rs. |
|----------------------------|------------------|--------------------|
| Profits for the year 2006  | 2,50,000         | 1,00,000           |
| Less: Dividends declared   | <u>1,00,000</u>  | <u>60,000</u>      |
|                            | 1,50,000         | 40,000             |
| Less: Transfer to Reserves | <u>25,000</u>    | <u>25,000</u>      |
|                            | <u>1,25,000</u>  | <u>15,000</u>      |

### 3. Analysis of Profits

|                                                                           | Capital<br>Profits<br>Rs. | Revenue<br>Reserve<br>Rs. | Revenue<br>Profits<br>Rs. |
|---------------------------------------------------------------------------|---------------------------|---------------------------|---------------------------|
| Canopy Ltd.                                                               |                           |                           |                           |
| Reserves as on 1 <sup>st</sup> January, 2006                              | 50,000                    |                           |                           |
| Transfer to Reserve in the year 2006 [(75,000-50,000)/2]                  | 12,500                    | 12,500                    |                           |
| Profit & Loss Account                                                     |                           |                           |                           |
| Balance as on 1 <sup>st</sup> January, 2006                               | 30,000                    |                           |                           |
| Profit for 2006 remaining undistributed<br>[(1,00,000-25,000-60,000)/2]   | 7,500                     |                           | 7,500                     |
| Profit for the year 2007 (2,50,000-30,000-15,000)                         | <u>      </u>             | <u>      </u>             | <u>2,05,000</u>           |
| (A) 1,00,000                                                              | 1,00,000                  | 12,500                    | 2,12,500                  |
| Minority Interest [ $\frac{1}{4}$ th of (A) ]                             | <u>25,000</u>             | <u>3,125</u>              | <u>53,125</u>             |
|                                                                           | 75,000                    | 9,375                     | 1,59,375                  |
| Share of Angle Ltd. [ $\frac{1}{6}$ th of (A)]                            | <u>16,667</u>             | <u>2,083</u>              | <u>35,417</u>             |
| Share of Bolt Ltd.                                                        | <u>58,333</u>             | <u>7,292</u>              | <u>1,23,958</u>           |
| Bolt Ltd.                                                                 |                           |                           |                           |
| Reserves as on 1 <sup>st</sup> January, 2006                              | 1,00,000                  |                           |                           |
| Transfer to Reserves 2006 [(1,25,000-1,00,000)/2]                         | 12,500                    | 12,500                    |                           |
| Profit & Loss Account - Balance (Dr.) as on 1 <sup>st</sup> January, 2006 | (50,000)                  |                           |                           |
| Undistributed Profits for 2006 [(2,50,000-25,000-1,00,000)/2]             | 62,500                    |                           | 62,500                    |
| Share in profits of Canopy Ltd.                                           | 58,333                    | 7,292                     | 1,23,958                  |
| Profit for the year, 2007 (2,75,000+50,000-1,25,000)                      | <u>      </u>             | <u>      </u>             | <u>2,00,000</u>           |
| (B) 1,83,333                                                              | 1,83,333                  | 19,792                    | 3,86,458                  |
| Less: Minority Interest [ $\frac{1}{4}$ th of (B)]                        | <u>45,833</u>             | <u>4,948</u>              | <u>96,615</u>             |
| Share of Angle Ltd.                                                       | <u>1,37,500</u>           | <u>14,844</u>             | <u>2,89,843</u>           |

## Holding Company Accounts

### 4. Consolidated Profit and Loss Account of Angle Ltd.

|                                                                     | Rs.             |
|---------------------------------------------------------------------|-----------------|
| Profit & Loss Account balance as on 31.12.2007                      | 5,00,000        |
| Add: Share in revenue profits of Canopy Ltd.                        | 35,417          |
| Share in revenue profits of Bolt Ltd.                               | <u>2,89,843</u> |
| Less: Pre-acquisition dividend                                      | 8,25,260        |
| Angle Ltd. $\frac{1}{2}$ (Rs. 75,000 + Rs. 10,000)                  | 42,500          |
| Bolt Ltd. ( $\frac{1}{2}$ of Rs. 35,000)                            | <u>17,500</u>   |
|                                                                     | <u>60,000</u>   |
|                                                                     | 7,65,260        |
| Less: Unrealised Profit in Closing Stock ( $20/120 \times 18,000$ ) | <u>3,000</u>    |
|                                                                     | <u>7,62,260</u> |

### 5. Consolidated Reserves of Angle Ltd.

|                                               | Rs.             |
|-----------------------------------------------|-----------------|
| Reserves as on 31.12.2007                     | 2,00,000        |
| Add: Share in revenue reserves of Canopy Ltd. | 2,083           |
| Add: Share in revenue reserves of Bolt Ltd.   | <u>14,844</u>   |
|                                               | <u>2,16,927</u> |

### 6. Minority Interest

|                           | Bolt Ltd.<br>Rs. | Canopy Ltd.<br>Rs. |
|---------------------------|------------------|--------------------|
| Share Capital             | 2,50,000         | 1,50,000           |
| Share of Capital Profits  | 45,833           | 25,000             |
| Share of Revenue Reserves | 4,948            | 3,125              |
| Share of Revenue Profits  | <u>96,615</u>    | <u>53,125</u>      |
| Total                     | <u>3,97,396</u>  | <u>2,31,250</u>    |
| Grand total               |                  | <u>6,28,646</u>    |

### 7. Cost of Control/Goodwill

|                                                                                                | Rs.      | Rs.           |
|------------------------------------------------------------------------------------------------|----------|---------------|
| Cost of investments (9,00,000+1,50,000+5,20,000)                                               |          | 15,70,000     |
| Less: Dividend Attributable to Pre-Acquisition Profits for 6 months i.e. $[(75,000+45,000)/2]$ |          | <u>60,000</u> |
|                                                                                                |          | 15,10,000     |
| Less: Face value of Shares                                                                     |          |               |
| Bolt Ltd.                                                                                      | 7,50,000 |               |

### Advanced Accounting

|      |                                      |               |                  |
|------|--------------------------------------|---------------|------------------|
|      | Canopy Ltd.                          | 4,50,000      |                  |
|      | Capital Profits                      |               |                  |
|      | Bolt Ltd.                            | 1,37,500      |                  |
|      | Canopy Ltd.                          | <u>16,667</u> | <u>13,54,167</u> |
|      | Goodwill                             |               | <u>1,55,833</u>  |
| 8    | Cash in Transit /Dues from Bolt Ltd. |               |                  |
|      |                                      | Rs.           | Rs.              |
| (i)  | Due to Angle Ltd.                    |               |                  |
|      | From Bolt Ltd.                       | 1,20,000      |                  |
|      | From Canopy Ltd.                     | <u>80,000</u> | 2,00,000         |
| (ii) | Due by Angle Ltd.                    |               |                  |
|      | To Bolt Ltd.                         | 1,00,000      |                  |
|      | To Canopy Ltd.                       | <u>80,000</u> | <u>1,80,000</u>  |
|      |                                      |               | <u>20,000</u>    |

## FINANCIAL REPORTING FOR FINANCIAL INSTITUTIONS

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Topics covered:

- Non Bank Finance Companies (Q. Nos. 1 to 3)
- Merchant Bankers (Q. No. 4,5)
- Stock Brokers (Q. No. 6)

## Advanced Accounting

### Question 1

Write short notes on:

- (a) Earning value (equity share). (5 marks)(November, 2003)  
(b) "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.

(4 marks)(November, 2004)

### Answer

- (a) Earning value means the value of an equity share calculated by taking the average profits after tax as reduced by preference dividend and adjustments for extraordinary and non-recurring items of the immediately three preceding years and further divided by the number of equity shares and capitalised at the following rate:

|                                     |     |
|-------------------------------------|-----|
| Predominantly manufacturing company | 8%  |
| Predominantly trading company       | 10% |
| Any other company including NBFC    | 12% |

Earning value is zero in a loss making company.

- (b) "Non-Performing Asset" as per NBFC Prudential Norms (RBI) directions means:
- (i) An asset, in respect of which, interest has remained past due for six months;
  - (ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;
  - (iii) A bill which remained overdue for six months;
  - (iv) The interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances that remained overdue for a period of six months;
  - (v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;
  - (vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;
  - (vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

## Financial Reporting for Financial Institutes

### Question 2

While closing its books of account on 31st March, 2005 a Non-Banking Finance Company has its advances classified as follows:

|                                      | Rs.in lakhs |
|--------------------------------------|-------------|
| Standard assets                      | 16,800      |
| Sub-standard assets                  | 1,340       |
| Secured positions of doubtful debts: |             |
| – upto one year                      | 320         |
| – one year to three years            | 90          |
| – more than three years              | 30          |
| Unsecured portions of doubtful debts | 97          |
| Loss assets                          | 48          |

Calculate the amount of provision, which must be made against the Advances.

(8 Marks)( Nov. 2005)

### Answer

(a) Calculation of provision required on advances as on 31st March, 2005:

|                                      | Amount<br>Rs. in lakhs | Percentage<br>of provision | Provision<br>Rs. in lakhs |
|--------------------------------------|------------------------|----------------------------|---------------------------|
| Standard assets                      | 16,800                 | NIL                        | NIL                       |
| Sub-standard assets                  | 1,340                  | 10                         | 134                       |
| Secured portions of doubtful debts—  |                        |                            |                           |
| – upto one year                      | 320                    | 20                         | 64                        |
| – one year to three years            | 90                     | 30                         | 27                        |
| – more than three years              | 30                     | 50                         | 15                        |
| Unsecured portions of doubtful debts | 97                     | 100                        | 97                        |
| Loss assets                          | 48                     | 100                        | <u>48</u>                 |
|                                      |                        |                            | <u>385</u>                |

### Question 3

Anischit Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it as on 31.3.2008:

(Figures in Rs. Lakhs)

|                   | Cost  | Market Price |
|-------------------|-------|--------------|
| Scripts:          |       |              |
| A. Equity Shares- |       |              |
| A                 | 60.00 | 61.20        |
| B                 | 31.50 | 24.00        |

### Advanced Accounting

|    |                        |       |        |
|----|------------------------|-------|--------|
|    | C                      | 60.00 | 36.00  |
|    | D                      | 60.00 | 120.00 |
|    | E                      | 90.00 | 105.00 |
|    | F                      | 75.00 | 90.00  |
|    | G                      | 30.00 | 6.00   |
| B. | Mutual funds-          |       |        |
|    | MF-1                   | 39.00 | 24.00  |
|    | MF-2                   | 30.00 | 21.00  |
|    | MF-3                   | 6.00  | 9.00   |
| C. | Government securities- |       |        |
|    | GV-1                   | 60.00 | 66.00  |
|    | GV-2                   | 75.00 | 72.00  |

- Can the company adjust depreciation of a particular item of investment within a category?
- What should be the value of investments as on 31.3.2008?
- Is it possible to off-set depreciation in investment in mutual funds against appreciation of the value of investment in equity shares and government securities?

( 6 Marks) (Nov. 2008)

### Answer

- Quoted current investments for each category shall be valued at cost or market value, whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Therefore, depreciation of a particular item of investments can be adjusted within the same category of investments.
- Value of Investments as on 31.3.2008

| Type of Investment         | Valuation Principle           | Value<br>Rs.in lakhs |
|----------------------------|-------------------------------|----------------------|
| Equity Shares (Aggregated) | Lower of cost or market Value | 406.50               |
| Mutual Funds               | NAV (Market value, assumed)   | 54.00                |
| Government securities      | Cost                          | 135.00               |
|                            |                               | <u>595.50</u>        |

As per para 14 of AS 13 "Accounting for Investments", the carrying amount for current investments is the lower of cost and market price. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not



### Financial Reporting for Financial Institutes

with each individual investment, and accordingly, the investments may be computed at the lower of cost and market value computed categorywise.

- (iii) Inter category adjustments of appreciation and depreciation in values of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation of the value of investments in equity shares and Government securities.

#### Question4

For what purposes inspection of records and documents of Merchant Banker is ordered by SEBI? ( 4 marks)(November, 2002)

#### Answer

SEBI has the right to appoint one or more persons as inspecting authority to undertake inspection of the books of account, records and documents of the merchant banker for any of the following purposes:

- (i) To see that books of account are being maintained in the required manner;
- (ii) To ensure that provisions of SEBI Act, rules and regulations are complied with;
- (iii) To investigate into complaints received from investors, other merchant bankers, or any other person on any matter having a bearing on the activities of merchant banker;
- (iv) To investigate suo moto in the interest of securities business or investors' interest into the affairs of merchant bankers.

#### Question 5

Write short note on Capital adequacy requirements of merchant bankers.

(4 Marks) (May, 2007)

#### Answer

Capital adequacy requirements have been specified by SEBI under the SEBI (Merchant Bankers) Registration, 1992.

Registration 7 specifies that the requirement of capital adequacy shall not be less than the net worth of the person making the application for grant of registration.

The specified net worth in this connection will be computed as under:

|                                                                                                                                                                                                                                                                                                                                                                             | Minimum requirement |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|
| 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 the financial structure, tie-up of financiers and final allotment and refund of subscriptions and act as advisor, consultant, manager, underwriter, portfolio manager etc. | Rs. 5 crores        |

### Advanced Accounting

|                                                                                                           |             |
|-----------------------------------------------------------------------------------------------------------|-------------|
| Category II – Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager | Rs.50 lakhs |
| Category III – Merchant bankers who act as underwriter, adviser, consultant to the issue.                 | Rs.20 lakhs |
| Category IV – Merchant bankers who act only as an advisor or consultant to the issue.                     | Nil         |

For the purposes of the regulation, a merchant banker has been defined as any person engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities is as manager, consultant, advisory or rendering corporate advising more in relation to issue management.

#### Question 6

Write short note on Books of account required to be maintained by a Stock Broker.

(4 marks) (May, 2003)(Nov. 2007)

#### Answer

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;

### **Financial Reporting for Financial Institutes**

- (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.

## Advanced Accounting

NOTE

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

Topics covered:

- Value Added Statement (Q. Nos. 1 to 9)
- Economic Valued Added Statement (Q. Nos. 10, 11)
- Corporate Social Reporting (Q. Nos. 12 to 15)
- Human Resource Accounting (Q. Nos. 16 to 21)
- Segment Reporting (Q. Nos. 22 to 24)
- Accounting for Financial Instruments (Q. Nos. 25 to 27)
- Environmental Accounting (Q. No. 28)

## Advanced Accounting

### Question 1

From the following Profit and Loss Account of Kalyani Ltd., prepare a Gross Value Added Statement. Show also the reconciliation between Gross Value Added and Profit before Taxation.

Profit and Loss Account for the year ended 31st March, 1995

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

Notes:

|                                                                                                                                                                               |                |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| (1) Production and Operational Expenses                                                                                                                                       | (Rs. in lakhs) |
| Increase in Stock                                                                                                                                                             | 30.50          |
| Consumption of Raw Materials                                                                                                                                                  | 80.57          |
| Consumption of Stores+                                                                                                                                                        | 5.30           |
| Salaries, Wages, Bonus and Other Benefits                                                                                                                                     | 12.80          |
| Cess and Local Taxes                                                                                                                                                          | 3.20           |
| Other Manufacturing Expenses                                                                                                                                                  | <u>34.20</u>   |
|                                                                                                                                                                               | <u>166.57</u>  |
| (2) Administration expenses include inter-alia Audit fees of Rs. 1 lakh, Salaries and commission to directors Rs. 2.20 lakhs and Provision for doubtful debts Rs. 2.50 lakhs. |                |
| (3) Interest and Other Charges:                                                                                                                                               | (Rs. in lakhs) |
| On Fixed Loans from Financial Institutions                                                                                                                                    | 3.90           |
| Debentures                                                                                                                                                                    | 1.80           |
| On Working Capital Loans from Bank                                                                                                                                            | <u>2.30</u>    |
|                                                                                                                                                                               | <u>8.00</u>    |

(15 marks) (May, 1996)

## Developments in Accounting

Answer

### Kalyani Ltd. Value Added Statement for the year ended 31st March, 1995

|                                                          | Rs. in lakhs | Rs. in lakhs  | %             |
|----------------------------------------------------------|--------------|---------------|---------------|
| Sales                                                    |              | 206.42        |               |
| Less: Cost of bought in material and services:           |              |               |               |
| Production and operational expenses                      | 150.57       |               |               |
| Administration expenses                                  | 3.92         |               |               |
| Interest on working capital loans                        | <u>2.30</u>  | <u>156.79</u> |               |
| Value Added by manufacturing and trading activities      |              | 49.63         |               |
| Add: Other income                                        |              | <u>10.20</u>  |               |
| Total Value Added                                        |              | <u>59.83</u>  |               |
| Application of Value Added:                              |              |               |               |
| To Pay Employees:                                        |              |               |               |
| Salaries, Wages, Bonus and other benefits                |              | 12.80         | 21.39         |
| To Pay Directors:                                        |              |               |               |
| Salaries and Commission                                  |              | 2.20          | 3.68          |
| To Pay Government:                                       |              |               |               |
| Cess and Local Taxes                                     | 3.20         |               |               |
| Income Tax                                               | <u>3.00</u>  |               |               |
|                                                          |              | 6.20          | 10.36         |
| To Pay Providers of Capital:                             |              |               |               |
| Interest on Debentures                                   | 1.80         |               |               |
| Interest on Fixed Loans                                  | 3.90         |               |               |
| Dividend                                                 | <u>3.00</u>  |               |               |
|                                                          |              | 8.70          | 14.54         |
| To Provide for maintenance and Expansion of the company: |              |               |               |
| Depreciation                                             | 5.69         |               |               |
| General Reserve (24.30 – 0.46)                           | 23.84        |               |               |
| Retained profit (1.75 – 1.35)                            | <u>0.40</u>  |               |               |
|                                                          |              | <u>29.93</u>  | <u>50.03</u>  |
|                                                          |              | <u>59.83</u>  | <u>100.00</u> |

#### Reconciliation Between Total Value Added and Profit Before Taxation:

|                                           | (Rs. in lakhs) | (Rs. in lakhs) |
|-------------------------------------------|----------------|----------------|
| Profit before tax                         |                | 30.24          |
| Add back:                                 |                |                |
| Depreciation                              | 5.69           |                |
| Salaries, Wages, Bonus and other benefits | 12.80          |                |
| Directors' Remuneration                   | 2.20           |                |

## Advanced Accounting

|                         |             |              |
|-------------------------|-------------|--------------|
| Cess and Local Taxes    | 3.20        |              |
| Interest on Debentures  | 1.80        |              |
| Interest on Fixed Loans | <u>3.90</u> | <u>29.59</u> |
| Total Value Added       |             | <u>59.83</u> |

### Question 2

From the following Profit & Loss Account of Brightex Co. Ltd., prepare a gross value added statement for the year ended 31.12.1998:

Show also the reconciliation between gross value added and profit before taxation.

Profit and Loss Account for the year ended 31.12.1998

|                                                 | Notes | (Rs.'000)  | (Rs.'000)    |
|-------------------------------------------------|-------|------------|--------------|
| Income :                                        |       |            |              |
| Sales                                           |       |            | 6,240        |
| Other Income                                    |       |            | <u>55</u>    |
|                                                 |       |            | 6,295        |
| Expenditure:                                    |       |            |              |
| Production and operational expenses             | 1     | 4,320      |              |
| Administration expenses (Factory)               | 2     | 180        |              |
| Interest & Other charges                        | 3     | 624        |              |
| Depreciation                                    |       | <u>16</u>  | <u>5,140</u> |
| Profit before tax                               |       |            | 1,155        |
| Provision for tax                               |       |            | <u>55</u>    |
|                                                 |       |            | 1,100        |
| Balance as per last Balance Sheet               |       |            | <u>60</u>    |
|                                                 |       |            | 1,160        |
| Transferred to fixed assets replacement reserve |       | 400        |              |
| Dividend paid                                   |       | <u>160</u> | <u>560</u>   |
| Surplus carried to Balance Sheet                |       |            | <u>600</u>   |

Notes:

- Production & Operation expenses :
 

|                                  |              |
|----------------------------------|--------------|
| Consumption of raw materials     | 3,210        |
| Consumption of stores            | 40           |
| Local tax                        | 8            |
| Salaries to administrative staff | 620          |
| Other manufacturing expenses     | <u>442</u>   |
|                                  | <u>4,320</u> |
- Administration expenses include salaries and commission to directors 5
- Interest on other charges include :
 

|                                                                   |     |
|-------------------------------------------------------------------|-----|
| (a) Interest on bank overdraft (Overdraft is of temporary nature) | 109 |
| (b) Fixed loan from I.C.I.C.I.                                    | 51  |
| (c) Working capital loan from I.F.C.I.                            | 20  |



## Developments in Accounting

- (d) Excise duties amount to one-tenth of total value added by manufacturing and trading activities.  
(16 marks)(May, 1999)

Answer

| Brightex Co. Ltd<br>Value Added Statement<br>For the year ended 31st December, 1998 |                     |                     |               |
|-------------------------------------------------------------------------------------|---------------------|---------------------|---------------|
|                                                                                     | Rs. In<br>Thousands | Rs. In<br>thousands | %             |
| Sales                                                                               |                     | 6,240               |               |
| Less: Cost of bought in material and services:                                      |                     |                     |               |
| Production and operational expenses<br>(4,320 – 8 – 620)                            | 3,692               |                     |               |
| Administration expenses (180 – 5)                                                   | 175                 |                     |               |
| Interest on bank overdraft                                                          | 109                 |                     |               |
| Interest on working capital loan                                                    | 20                  |                     |               |
| Excise duties (Refer to working note)                                               | 180                 |                     |               |
| Other/miscellaneous charges(444 – 180)                                              | <u>264</u>          | <u>4,440</u>        |               |
| Value added by manufacturing and trading activities                                 |                     | 1,800               |               |
| Add: Other income                                                                   |                     | <u>55</u>           |               |
| Total Value Added                                                                   |                     | <u>1,855</u>        |               |
| Application of Value Added:                                                         |                     |                     |               |
| To pay Employees :                                                                  |                     |                     |               |
| Salaries to Administrative staff                                                    |                     | 620                 | 33.42         |
| To pay Directors:                                                                   |                     |                     |               |
| Salaries and Commission                                                             |                     | 5                   | 0.27          |
| To Pay Government :                                                                 |                     |                     |               |
| Local Tax                                                                           | 8                   |                     |               |
| Income Tax                                                                          | <u>55</u>           | 63                  | 3.40          |
| To Pay Providers of Capital :                                                       |                     |                     |               |
| Interest on Fixed Loan                                                              | 51                  |                     |               |
| Dividend                                                                            | <u>160</u>          | 211                 | 11.37         |
| To provide For Maintenance and Expansion of the Company :                           |                     |                     |               |
| Depreciation                                                                        | 16                  |                     |               |
| Fixed Assets Replacement Reserve                                                    | 400                 |                     |               |
| Retained Profit (600 - 60)                                                          | <u>540</u>          | <u>956</u>          | <u>51.54</u>  |
|                                                                                     |                     | <u>1,855</u>        | <u>100.00</u> |

Reconciliation Between Total Value Added and Profit Before Taxation:

|                   | Rs. In<br>Thousands | Rs. In<br>thousands |
|-------------------|---------------------|---------------------|
| Profit before Tax |                     | 1,155               |
| Add back:         |                     |                     |

## Advanced Accounting

|                                  |     |              |
|----------------------------------|-----|--------------|
| Depreciation                     | 16  |              |
| Salaries to Administrative Staff | 620 |              |
| Director's Remuneration          | 5   |              |
| Interest on Fixed Loan           | 51  |              |
| Local Tax                        | 8   | <u>700</u>   |
| Total Value Added                |     | <u>1,855</u> |

Working Note :

Calculation of Excise Duty

|                                               |           | Rs. In thousands |
|-----------------------------------------------|-----------|------------------|
| Interest and other charges                    |           | 624              |
| Less : Interest on bank overdraft             | 109       |                  |
| Interest on loan from ICICI                   | 51        |                  |
| Interest on loan from IFCI                    | <u>20</u> | <u>180</u>       |
| Excise duties and other/miscellaneous charges |           | <u>444</u>       |

Assuming that these miscellaneous charges have to be taken for arriving at Value Added (in the first part of Value Added Statement), the excise duty will be computed as follows.

Let excise duty be x; thus miscellaneous/ other charges = 444 - x

$$\text{Thus } x = 1/10 \times [6,240 - \{3692 + 175 + 109 + 20 + x + (444 - x)\}]$$

$$= 1/10 \times [6240 - 4440] = 180$$

$$\text{Other/ miscellaneous charges} = 444 - 180 = 264$$

The above solution is given accordingly.

However, if other/miscellaneous charges are taken as any type of application of Value Added. (i.e, to be taken in the application part), then excise duty (x) will be computed as follows:

$$x = 1/10 \times [6240 - (3692 + 175 + 109 + 20 + x)]$$

$$x = 1/10 \times [2244 - x]$$

$$11x = 2244$$

$$x = 204$$

And thus total value added will be 2040 + 55 (other income) = 2095

And accordingly, application part will be prepared, taking miscellaneous charges.

Rs('000) 240 [i.e, 444 - 204] as the application of value added.

### Question 3

From the following Profit and Loss Account of X Limited, prepare Gross Value Added Statement and show the reconciliation between Gross Value Added and Profit before taxation:

Profit and Loss Account for the year ended 31st March, 2002

| Income       | (Rs. in lakhs) | (Rs. in lakhs) |
|--------------|----------------|----------------|
| Sales        |                | 800            |
| Other Income |                | <u>50</u>      |
|              |                | 850            |
| Expenditure  |                |                |

### Developments in Accounting

|                                                    |           |            |
|----------------------------------------------------|-----------|------------|
| Production and Operational Expenses                | 600       |            |
| Administrative Expenses                            | 30        |            |
| Interest and Other Charges                         | 30        |            |
| Depreciation                                       | <u>20</u> | <u>680</u> |
| Profit before taxes                                |           | 170        |
| Provision for taxes                                |           | <u>30</u>  |
|                                                    |           | 140        |
| Balance as per last Balance Sheet                  |           | <u>10</u>  |
|                                                    |           | <u>150</u> |
| Transferred to:                                    |           |            |
| General Reserve                                    |           | 80         |
| Proposed Dividend                                  |           | 20         |
| Surplus carried to Balance Sheet                   |           | <u>50</u>  |
|                                                    |           | <u>150</u> |
| Break-up of some of the Expenditure is as follows: |           |            |
| Production and Operational Expenses:               |           |            |
| Consumption of Raw Materials and Stores            |           | 320        |
| Salaries, Wages and Bonus                          |           | 60         |
| Cess and Local Taxes                               |           | 20         |
| Other Manufacturing Expenses                       |           | <u>200</u> |
|                                                    |           | <u>600</u> |
| Administrative Expenses:                           |           |            |
| Audit Fee                                          |           | 6          |
| Salaries and Commission to Directors               |           | 8          |
| Provision for Doubtful Debts                       |           | 6          |
| Other Expenses                                     |           | <u>10</u>  |
|                                                    |           | <u>30</u>  |
| Interest and other Charges:                        |           |            |
| On Working Capital Loans from Bank                 |           | 10         |
| On Fixed Loans from ICICI                          |           | 15         |
| On Debentures                                      |           | <u>5</u>   |
|                                                    |           | <u>30</u>  |

(16 marks)(May, 2002)

## Advanced Accounting

Answer

### X Limited Gross Value Added Statement for the year ended 31st March, 2002

|                                                             | Rs. in<br>lakhs | Rs. in<br>lakhs |               |
|-------------------------------------------------------------|-----------------|-----------------|---------------|
| Sales                                                       |                 |                 |               |
| Less: Cost of bought in material or services:               |                 | 800             |               |
| Production and Operational Expenses (320 + 200)             | 520             |                 |               |
| Administrative Expenses (6 + 6 + 10)                        | 22              |                 |               |
| Interest on working capital loans                           | <u>10</u>       | <u>552</u>      |               |
| Value added by manufacturing and trading activities         |                 | 248             |               |
| Add: Other Income                                           |                 | <u>50</u>       |               |
| Total Value Added                                           |                 | <u>298</u>      |               |
| Application of Value Added:                                 |                 |                 |               |
| To Pay Employees:                                           |                 |                 | %             |
| Salaries, Wages and Bonus                                   |                 | 60              | 20.14         |
| To Pay Directors:                                           |                 |                 |               |
| Salaries and Commission                                     |                 | 8               | 2.68          |
| To Pay Government:                                          |                 |                 |               |
| Cess and Local taxes                                        | 20              |                 |               |
| Income Tax                                                  | <u>30</u>       | 50              | 16.78         |
| To Pay Providers of Capital:                                |                 |                 |               |
| Interest on Debentures                                      | 5               |                 |               |
| Interest on Fixed Loans                                     | 15              |                 |               |
| Dividend                                                    | <u>20</u>       | 40              | 13.42         |
| To Provide for Maintenance and<br>Expansion of the Company: |                 |                 |               |
| Depreciation                                                | 20              |                 |               |
| General Reserve                                             | 80              |                 |               |
| Retained Profit (50 – 10)                                   | <u>40</u>       | <u>140</u>      | <u>46.98</u>  |
|                                                             |                 | <u>298</u>      | <u>100.00</u> |

### Reconciliation between Gross Value Added and Profit before Taxation

|                   | Rs. in lakhs | Rs. in lakhs |
|-------------------|--------------|--------------|
| Profit before tax |              | 170          |
| Add back:         |              |              |

## Developments in Accounting

|                           |           |            |
|---------------------------|-----------|------------|
| Depreciation              | 20        |            |
| Salaries, Wages and Bonus | 60        |            |
| Directors' Remuneration   | 8         |            |
| Cess and Local Taxes      | 20        |            |
| Interest on Debentures    | 5         |            |
| Interest on Fixed Loans   | <u>15</u> | <u>128</u> |
| Total Value Added         |           | <u>298</u> |

### Question 4

On the basis of the following income statement pertaining to Brite Ltd., you are required to prepare:

- (a) Gross value added statement; and
- (b) Statement showing reconciliation of gross value added with Profit Before Taxation.

#### Profit and Loss Account of Brite Ltd. for the year ended 31st March, 2003

|                                           | Rs. in thousands | Rs. in thousands |
|-------------------------------------------|------------------|------------------|
| Income                                    |                  |                  |
| Sales less returns                        |                  | 15,27,956        |
| Dividends and interest                    |                  | 130              |
| Miscellaneous income                      |                  | <u>474</u>       |
|                                           | (A)              | <u>15,28,560</u> |
| Expenditure                               |                  |                  |
| Production and operational expenses:      |                  |                  |
| Decreases in inventory of finished goods  | 26,054           |                  |
| Consumption of raw materials              | 7,40,821         |                  |
| Power and lighting                        | 1,20,030         |                  |
| Wages, salaries and bonus                 | 3,81,760         |                  |
| Staff welfare expenses                    | 26,240           |                  |
| Excise duty                               | 14,540           |                  |
| Other manufacturing expenses              | <u>32,565</u>    | 13,42,010        |
| Administrative expenses:                  |                  |                  |
| Directors' remuneration                   | 7,810            |                  |
| Other administrative expenses             | <u>32,640</u>    | 40,450           |
| Interest on:                              |                  |                  |
| 9% Mortgage debentures                    | 14,400           |                  |
| Long-term loan from financial institution | 10,000           |                  |
| Bank overdraft                            | <u>100</u>       | 24,500           |
| Depreciation on fixed assets              |                  | <u>50,600</u>    |
|                                           | (B)              | <u>14,57,560</u> |

## Advanced Accounting

|                                              |               |
|----------------------------------------------|---------------|
| Profit before Taxation, (A) — (B)            | 71,000        |
| Provision for Income-tax @ 35.875%           | <u>25,470</u> |
| Profit after Taxation                        | 45,530        |
| Balance of account as per last Balance Sheet | <u>6,300</u>  |
|                                              | <u>51,830</u> |

|                                     |              |               |
|-------------------------------------|--------------|---------------|
| Transferred to:                     |              |               |
| General reserve 40% of Rs. 45,530   | 18,212       |               |
| Proposed dividend @ 22%             | 22,000       |               |
| Tax on distributed profits @ 12.81% | <u>2,818</u> | <u>43,030</u> |
| Surplus carried to Balance Sheet    |              | <u>8,800</u>  |

(15 marks)(November, 2003)

Answer

Brite Ltd.

Value Added Statement for the year ended 31<sup>st</sup> March, 2003

|                                                                     | Rs. in thousands | Rs. in thousands |
|---------------------------------------------------------------------|------------------|------------------|
| Sales less returns                                                  |                  | 15,27,956        |
| Less: Cost of bought in materials and services, as per working note | 9,19,470         |                  |
| Administrative expenses                                             | 32,640           |                  |
| Interest on bank overdraft                                          | <u>100</u>       | <u>9,52,210</u>  |
| Value added by manufacturing and trading activities                 |                  | 5,75,746         |
| Add: Dividends and interest                                         |                  | 130              |
| Miscellaneous income                                                |                  | <u>474</u>       |
| Total value added                                                   |                  | <u>5,76,350</u>  |

### Application of valued added

|                                                          | Rs. in thousands | Rs. in thousands | %     |
|----------------------------------------------------------|------------------|------------------|-------|
| To pay Employees:                                        |                  |                  |       |
| Wages, salaries and bonus                                | 3,81,760         |                  |       |
| Staff welfare expenses                                   | <u>26,240</u>    | 4,08,000         | 70.79 |
| To pay Directors:                                        |                  |                  |       |
| Directors' remuneration                                  |                  | 7,810            | 1.36  |
| To pay Government:                                       |                  |                  |       |
| Excise duty                                              | 14,540           |                  |       |
| Income tax                                               | 25,470           |                  |       |
| Tax on distributed profits                               | <u>2,818</u>     | 42,828           | 7.43  |
| To pay providers of capital:                             |                  |                  |       |
| Interest on 9% debentures                                | 14,400           |                  |       |
| Interest on long-term loan from financial institution    | 10,000           |                  |       |
| Dividend to shareholders                                 | <u>22,000</u>    | 46,400           | 8.05  |
| To provide for maintenance and expansion of the company: |                  |                  |       |

### Developments in Accounting

|                                             |              |                 |               |
|---------------------------------------------|--------------|-----------------|---------------|
| Depreciation on Fixed assets                | 50,600       |                 |               |
| Transfer to General reserve                 | 18,212       |                 |               |
| Retained profit, Rs.(8,800-6,300)(in 000's) | <u>2,500</u> | <u>71,312</u>   | <u>12.37</u>  |
|                                             |              | <u>5,76,350</u> | <u>100.00</u> |

Statement showing reconciliation of Total value added with Profit before taxation

|                                                       | Rs. in thousands | Rs. in thousands |
|-------------------------------------------------------|------------------|------------------|
| Profit Before Taxation                                |                  | 71,000           |
| Add back:                                             |                  |                  |
| Wages, salaries and bonus                             | 3,81,760         |                  |
| Staff welfare expenses                                | 26,240           |                  |
| Excise duty                                           | 14,540           |                  |
| Directors' remuneration                               | 7,810            |                  |
| Interest on 9% mortgage debentures                    | 14,400           |                  |
| Interest on long-term loan from financial institution | 10,000           |                  |
| Depreciation on fixed assets                          | <u>50,600</u>    | <u>5,05,350</u>  |
| Total Value Added                                     |                  | <u>5,76,350</u>  |

Working Note:

Calculation of cost of bought in materials and services:

|                                         | Rs. in thousands |
|-----------------------------------------|------------------|
| Decrease in inventory of finished goods | 26,054           |
| Consumption of raw materials            | 7,40,821         |
| Power and lighting                      | 1,20,030         |
| Other manufacturing expenses            | <u>32,565</u>    |
|                                         | <u>9,19,470</u>  |

### Question 5

The following is the Profit and Loss Account of Galaxy Ltd. for the year ended 31.03.2004. Prepare a Gross Value Added Statement of Galaxy Ltd. and show also the reconciliation between Gross Value Added and Profit before taxation.

Profit and Loss Account for the year ended 31.03.2004

|                                     | Notes | Amount<br>(Rs. in lakhs) |
|-------------------------------------|-------|--------------------------|
| Income:                             |       |                          |
| Sales                               | —     | 890                      |
| Other Income                        | —     | <u>55</u>                |
|                                     |       | 945                      |
| Expenditure:                        |       |                          |
| Production and operational expenses | (a)   | 641                      |
| Administration expenses (Factory)   | (b)   | 33                       |
| Interest                            | (c)   | 29                       |
| Depreciation                        |       | <u>17</u>                |
|                                     |       | <u>720</u>               |

## Advanced Accounting

|                                   |            |            |
|-----------------------------------|------------|------------|
| Profit before taxes               | —          | 225        |
| Provision for taxes (d)           | —          | <u>30</u>  |
| Profit after tax                  | —          | 195        |
| Balance as per last Balance Sheet | —          | <u>10</u>  |
|                                   |            | <u>205</u> |
| Transferred to General Reserve    | 45         | —          |
| Dividend paid                     | <u>95</u>  | —          |
|                                   | 140        | —          |
| Surplus carried to Balance Sheet  | <u>65</u>  | —          |
|                                   | <u>205</u> | —          |

### Notes:

- (a) Production and Operational expenses Rs. in lakhs
- |                                          |            |
|------------------------------------------|------------|
| Consumption of raw materials             | 293        |
| Consumption of stores                    | 59         |
| Salaries, Wages, Gratuities etc. (Admn.) | 82         |
| Cess and Local taxes                     | 98         |
| Other manufacturing expenses             | <u>109</u> |
|                                          | <u>641</u> |
- (b) Administration expenses include salaries, commission to Directors Rs.9.00 lakhs  
Provision for doubtful debts Rs. 6.30 lakhs.
- (c) Interest on loan from ICICI Bank for working capital Rs. in lakhs
- |                                                      |           |
|------------------------------------------------------|-----------|
| Interest on loan from ICICI Bank for working capital | 9         |
| Interest on loan from ICICI Bank for fixed loan      | 10        |
| Interest on loan from IFCI for fixed loan            | 8         |
| Interest on Debentures                               | <u>2</u>  |
|                                                      | <u>29</u> |
- (d) The charges for taxation include a transfer of Rs. 3.00 lakhs to the credit of Deferred Tax Account.
- (e) Cess and Local taxes include Excise Duty, which is equal to 10% of cost of bought-in material.  
(16 marks)(November, 2004)

### Answer

#### Galaxy Ltd.

#### Gross Value Added Statement for the year ended 31st March, 2004

|                                                      | Rs. in lakhs | Rs. in lakhs |
|------------------------------------------------------|--------------|--------------|
| Sales                                                |              | 890          |
| Less: Cost of bought in materials and services:      |              |              |
| Production and operational expenses (293 + 59 + 109) | 461          |              |
| Administration expenses (33 – 9)                     | 24           |              |
| Interest on working capital loan                     | 9            |              |
| Excise duty (Refer working note)                     | <u>55</u>    | <u>549</u>   |
| Value added by manufacturing and trading activities  |              | 341          |
| Add: Other income                                    |              | <u>55</u>    |
| Total value added                                    |              | <u>396</u>   |



## Developments in Accounting

### Application of Value Added

|                                                         |           |            | %             |
|---------------------------------------------------------|-----------|------------|---------------|
| To Employees                                            |           |            |               |
| Salaries, wages, gratuities etc.                        |           | 82         | 20.71%        |
| To Directors                                            |           |            |               |
| Salaries and commission                                 |           | 9          | 2.27%         |
| To Government                                           |           |            |               |
| Cess and local taxes (98 – 55)                          | 43        |            |               |
| Income tax                                              | <u>27</u> | 70         | 17.68%        |
| To Providers of capital                                 |           |            |               |
| Interest on debentures                                  | 2         |            |               |
| Interest on fixed loan                                  | 18        |            |               |
| Dividends                                               | <u>95</u> | 115        | 29.04%        |
| To Provide for maintenance and expansion of the company |           |            |               |
| Depreciation                                            | 17        |            |               |
| General reserve                                         | 45        |            |               |
| Deferred tax                                            | 3         |            |               |
| Retained profits (65 – 10)                              | <u>55</u> | <u>120</u> | <u>30.30%</u> |
|                                                         |           | <u>396</u> | <u>100%</u>   |

Statement showing reconciliation of Gross Value Added with Profits before taxation

Rs. in lakhs

|                                   |                          |
|-----------------------------------|--------------------------|
| Profits before taxes              | 225                      |
| Add:                              |                          |
| Depreciation                      | 17                       |
| Directors' remuneration           | 9                        |
| Salaries, wages & gratuities etc. | 82                       |
| Cess and local taxes              | 43                       |
| Interest on debentures            | 2                        |
| Interest on fixed loan            | <u>18</u>                |
| Total value added                 | <u>171</u><br><u>396</u> |

Working Note:

Calculation of Excise Duty

Say cost of bought in materials and services is 'x'

Excise Duty is 10% of x = x/10

$x = 461 + 24 + 9 + x/10$

$x = 494 + x/10 = 549$  (approx.)\*

Excise Duty =  $549 - 494 = \text{Rs. } 55$

---

\* The above calculated excise duty is not exactly 10% of cost of bought in material amounting Rs. 549. The difference is due to approximation.

## Advanced Accounting

### Question 6

On the basis of the following Profit and Loss Account of Zed Limited and the supplementary information provided thereafter, prepare Gross Value Added Statement of the company for the year ended 31st March, 2005. Also prepare another statement showing reconciliation of Gross Value Added with Profit before Taxation.

Profit and Loss Account of Zed Limited for the year ended 31st March, 2005.

|                                                 | Amount<br>(Rs. in lakhs) | Amount<br>(Rs. in lakhs) |
|-------------------------------------------------|--------------------------|--------------------------|
| Income                                          |                          |                          |
| Sales                                           |                          | 5,010                    |
| Other Income                                    |                          | <u>130</u>               |
|                                                 |                          | <u>5,140</u>             |
| Expenditure                                     |                          |                          |
| Production and Operational Expenses             | 3,550                    |                          |
| Administrative Expenses                         | 185                      |                          |
| Interest                                        | 235                      |                          |
| Depreciation                                    | <u>370</u>               | <u>4,340</u>             |
| Profit before Taxation                          |                          | 800                      |
| Provision for Taxation                          |                          | <u>280</u>               |
| Profit after Taxation                           |                          | 520                      |
| Credit Balance as per last Balance Sheet        |                          | <u>40</u>                |
|                                                 |                          | <u>560</u>               |
| Appropriations                                  |                          |                          |
| Transfer to General Reserve                     |                          | 100                      |
| Preference Dividend (Interim) paid              |                          | 50                       |
| Proposed Preference Dividend (Final)            |                          | 50                       |
| Proposed Equity Dividend                        |                          | 300                      |
| Balance carried to Balance Sheet                |                          | <u>60</u>                |
|                                                 |                          | <u>560</u>               |
| Supplementary Information                       |                          |                          |
| Production and Operational Expenses consist of: |                          |                          |
| Raw Materials and Stores consumed               |                          | 1,900                    |
| Wages, Salaries and Bonus                       |                          | 610                      |
| Local Taxes including Cess                      |                          | 220                      |
| Other Manufacturing Expenses                    |                          | <u>820</u>               |
|                                                 |                          | <u>3,550</u>             |
| Administrative Expenses consist of:             |                          |                          |
| Salaries and Commission to Directors            |                          | 60                       |

### Developments in Accounting

|                                      |            |
|--------------------------------------|------------|
| Audit Fee                            | 24         |
| Provision for Bad and Doubtful Debts | 20         |
| Other Administrative Expenses        | <u>81</u>  |
|                                      | <u>185</u> |
| Interest is on:                      |            |
| Loan from Bank for Working Capital   | 35         |
| Debentures                           | <u>200</u> |
|                                      | <u>235</u> |

(12 marks) November, 2005)

Answer

#### Gross Value Added Statement of Zed Ltd. for the year ended 31st March, 2005

|                                                                 | Rs. in lakhs | Rs. in lakhs |
|-----------------------------------------------------------------|--------------|--------------|
| Sales                                                           |              | 5,010        |
| Less: Cost of raw materials, stores and other services consumed | 2,720        |              |
| Administrative expenses                                         | 125          |              |
| Interest on loan from bank for working capital                  | <u>35</u>    | <u>2,880</u> |
| Value added by manufacturing and trading activities             |              | 2,130        |
| Add: Other income                                               |              | <u>130</u>   |
| Total value added                                               |              | <u>2,260</u> |

#### Application of Value Added

|                                      | Rs.in lakhs | Rs. in lakhs | %     |
|--------------------------------------|-------------|--------------|-------|
| To pay employees                     |             |              |       |
| Wages, salaries and bonus            |             | 610          | 26.99 |
| To pay directors                     |             |              |       |
| Salaries and commission to Directors |             | 60           | 2.66  |
| To pay Government                    |             |              |       |
| Local taxes including cess           | 220         |              |       |
| Income tax                           | <u>280</u>  | 500          | 22.12 |
| To pay providers of capital          |             |              |       |
| Interest on debentures               | 200         |              |       |
| Preference dividend                  | 100         |              |       |

### Advanced Accounting

|                                                              |            |              |              |
|--------------------------------------------------------------|------------|--------------|--------------|
| Equity dividend                                              | <u>300</u> | 600          | 26.55        |
| To provide for the maintenance and expansion of the company: |            |              |              |
| Depreciation                                                 | 370        |              |              |
| Transfer to general reserve                                  | 100        |              |              |
| Retained profit Rs.(60 – 40) lakhs                           | <u>20</u>  | <u>490</u>   | <u>21.68</u> |
|                                                              |            | <u>2,260</u> | <u>100</u>   |

#### Statement showing Reconciliation between Gross Value Added with Profit before Taxation

|                                      | Rs. in lakhs | Rs. in lakhs |
|--------------------------------------|--------------|--------------|
| Profit before taxation               |              | 800          |
| Add back:                            |              |              |
| Wages, salaries and bonus            | 610          |              |
| Salaries and commission to Directors | 60           |              |
| Local taxes including cess           | 220          |              |
| Interest on debentures               | 200          |              |
| Depreciation                         | <u>370</u>   | <u>1,460</u> |
| Gross Value Added                    |              | <u>2,260</u> |

### Question 7

Value Added Ltd. furnishes the following Profit and Loss A/c:

Profit and Loss A/c for the year ended 31<sup>st</sup> March, 2007

|                            | Notes | Rs.('000)     |
|----------------------------|-------|---------------|
| Income                     |       |               |
| Turnover                   | 1     | 29,872        |
| Other Income               |       | <u>1,042</u>  |
|                            |       | <u>30,914</u> |
| Expenditure                |       |               |
| Operating expenses         | 2     | 26,741        |
| Interest on 8% Debenture   |       | 987           |
| Interest on Cash Credit    | 3     | 151           |
| Excise duty                |       | <u>1,952</u>  |
|                            |       | <u>29,831</u> |
| Profit before depreciation |       | 1,083         |
| Less: Depreciation         |       | <u>342</u>    |

### Developments in Accounting

|                                                    |   |            |
|----------------------------------------------------|---|------------|
| Profit before tax                                  |   | 741        |
| Provision for tax                                  | 4 | <u>376</u> |
| Profit after tax                                   |   | 365        |
| Less: Transfer to Fixed Assets Replacement Reserve |   | <u>65</u>  |
|                                                    |   | 300        |
| Less: Dividend paid                                |   | <u>125</u> |
| Retained Profit                                    |   | <u>175</u> |

Notes:

- (1) Turnover is based on invoice value and net of sales tax.
- (2) Salaries, wages and other employee benefits amounting to Rs.14,761 ('000) are included in operating expenses.
- (3) Cash Credit represents a temporary source of finance. It has not been considered as a part of capital.
- (4) Transfer of Rs.54 ('000) to the credit of deferred tax account is included in provision for tax.

Prepare value added statement for the year ended 31<sup>st</sup> March, 2007 and reconcile total value added with profit before taxation. (8 Marks) (Nov. 2007)

Answer

#### Value Added Ltd.

#### Value Added Statement for the year ended 31<sup>st</sup> March, 2007

|                                                     | Rs.('000)  | Rs.('000)     | %     |
|-----------------------------------------------------|------------|---------------|-------|
| Turnover                                            |            | 29,872        |       |
| Less: Cost of bought in materials and services:     |            |               |       |
| Operating expenses (26,741 –14,761)                 | 11,980     |               |       |
| Excise duty                                         | 1,952      |               |       |
| Interest on Cash Credit                             | <u>151</u> | <u>14,083</u> |       |
| Value added by manufacturing and trading activities |            | 15,789        |       |
| Add: Other income                                   |            | <u>1,042</u>  |       |
| Total value added                                   |            | <u>16,831</u> |       |
| Application of value added:                         |            |               |       |
| To Pay to employees:                                |            |               |       |
| Salaries, wages and other employee benefits         |            | 14,761        | 87.70 |
| To Pay to Government:                               |            |               |       |

### Advanced Accounting

|                                                          |            |               |             |
|----------------------------------------------------------|------------|---------------|-------------|
| Corporation tax (376 – 54)                               |            | 322           | 1.91        |
| To Pay to providers of capital:                          |            |               |             |
| Interest on 8% Debentures                                | 987        |               |             |
| Dividends                                                | <u>125</u> | 1,112         | 6.61        |
| To Provide for maintenance and expansion of the company: |            |               |             |
| Depreciation                                             | 342        |               |             |
| Fixed Assets Replacement Reserve                         | 65         |               |             |
| Deferred Tax Account                                     | 54         |               |             |
| Retained Profit                                          | <u>175</u> | <u>636</u>    | <u>3.78</u> |
|                                                          |            | <u>16,831</u> | <u>100</u>  |

Note: Deferred tax account could alternatively be shown as an item 'To pay to government'.

#### Reconciliation between total value added and profit before taxation

|                                    | Rs.('000)  | Rs.('000)     |
|------------------------------------|------------|---------------|
| Profit before tax                  |            | 741           |
| Add back: Depreciation             | 342        |               |
| Wages, salaries and other benefits | 14,761     |               |
| Debenture interest                 | <u>987</u> | <u>16,090</u> |
| Total Value Added                  |            | <u>16,831</u> |

### Question 8

From the following Profit and Loss account of New Mode Reporting Ltd., prepare a gross value added statement for the year ended 31<sup>st</sup> December, 2007. Show also the reconciliation between GVA and Profit before taxation:

#### Profit and Loss Account

|                                        | Rs.'000s   | Rs.'000s      |
|----------------------------------------|------------|---------------|
| Income                                 |            |               |
| Sales                                  | 12,480     |               |
| Other income                           | <u>110</u> | 12,590        |
| Expenditure                            |            |               |
| Production and Operational expenditure | 8,640      |               |
| Administrative expenses                | 360        |               |
| Interest and other charges             | 1,248      |               |
| Depreciation                           | <u>32</u>  | <u>10,280</u> |
| Profit before tax                      |            | 2,310         |

## Developments in Accounting

|                                                        |            |              |
|--------------------------------------------------------|------------|--------------|
| Less: Provision for tax                                |            | <u>110</u>   |
| Profit after tax                                       |            | 2,200        |
| Add: balance as per last Balance Sheet                 |            | <u>120</u>   |
|                                                        |            | 2,320        |
| Less:     Transfer to Fixed assets replacement Reserve | 800        |              |
| Dividend paid                                          | <u>320</u> | <u>1,120</u> |
| Surplus carried to Balance Sheet                       |            | <u>1,200</u> |

Additional information:

- (i)     Production and Operational expenses consists of

|                                  |           |
|----------------------------------|-----------|
|                                  | Rs.       |
| Consumption of Raw materials     | 64,20,000 |
| Consumption of Stores            | 80,000    |
| Local tax                        | 16,000    |
| Salaries to Administrative staff | 12,40,000 |
| Other Manufacturing expenses     | 8,84,000  |

- (ii)    Administrative expenses include salaries and commission to directors – Rs.10,000

- (iii)   Interest and other charges include-

|                                      |          |
|--------------------------------------|----------|
|                                      | Rs.      |
| (a)   Interest on bank overdraft     |          |
| (overdraft is of temporary nature)   | 2,18,000 |
| (b)   Fixed loan from SIDBI          | 1,02,000 |
| (c)   Working capital loan from IFCI | 40,000   |
| (d)   Excise duties                  | ?        |

- (iv)   Excise duties amount to one-tenth of total value added by manufacturing and trading activities.

(10 Marks (Nov. 2008))

## Advanced Accounting

Answer

(a) New Mode Reporting Ltd.  
Value Added Statement  
for the year ended 31<sup>st</sup> December, 2007

(Figures in Rs.'000)

|                                                        |            |              |
|--------------------------------------------------------|------------|--------------|
| Sales                                                  |            | 12,480       |
| Less: Cost of Materials and Services:                  |            |              |
| Production and Operational Expenses (8,640 – 16-1,240) | 7,384      |              |
| Administrative Expenses (360 – 10)                     | 350        |              |
| Interest on Bank Overdraft                             | 218        |              |
| Interest on Working Capital Loan                       | 40         |              |
| Excise Duties (Refer to working note)                  | 360        |              |
| Other/miscellaneous charges (888 – 360)                | <u>528</u> | 8,880        |
| Value added by manufacturing and trading activities    |            | <u>3,600</u> |
| Add: Other Income                                      |            | 110          |
| Gross value added from operations                      |            | <u>3,710</u> |

### Application of Gross Value Added

|                                                          | Rs. in '000 | Rs.in'000    | %             |
|----------------------------------------------------------|-------------|--------------|---------------|
| To Pay Employees:                                        |             |              |               |
| Salaries to Administrative Staff                         |             | 1240         | 33.42         |
| To Pay Directors:                                        |             |              |               |
| Salaries and Commission                                  |             | 10           | 0.27          |
| To Pay Government:                                       |             |              |               |
| Local Taxes                                              | 16          |              |               |
| Income Tax                                               | <u>110</u>  | 126          | 3.40          |
| To Pay Providers of Capital:                             |             |              |               |
| Interest on Fixed Loan                                   | 102         |              |               |
| Dividend                                                 | <u>320</u>  | 422          | 11.37         |
| To Provide for maintenance and expansion of the company: |             |              |               |
| depreciation                                             | 32          |              |               |
| Fixed Assets Replacement Reserve                         | 800         |              |               |
| Retained Profit (1200 – 120)                             | <u>1080</u> | <u>1912</u>  | <u>51.54</u>  |
|                                                          |             | <u>3,710</u> | <u>100.00</u> |



## Developments in Accounting

### Reconciliation between Gross Value added and Profit Before Taxation

|                                    |           | Rs.in'000   |
|------------------------------------|-----------|-------------|
| Profit before Tax                  |           | 2,310       |
| Add Back: Depreciation             | 32        |             |
| Salaries to Administrative Staff   | 1240      |             |
| Directors' Salaries and Commission | 10        |             |
| Interest on Fixed Loan             | 102       |             |
| Local Tax                          | <u>16</u> | <u>1400</u> |
| Total value added                  |           | <u>3710</u> |

#### Working Note:

|                                  | Rs.'000   | Rs.'000    |
|----------------------------------|-----------|------------|
| Calculation of excise duty       |           |            |
| Interest and other charges       |           | 1,248      |
| Less: Interest on bank overdraft | 218       |            |
| Interest on SIDBI loan           | 102       |            |
| Interest on IFCI loan            | <u>40</u> | <u>360</u> |
| Excise duty and other charges    |           | <u>888</u> |

Assuming that these other /miscellaneous charges will be deducted for arriving at the value added, the excise duty will be calculated as follows:-

Let Excise Duties be denoted by - E

Then, other charges = 888 - E

Excise duty are  $\frac{1}{10}$ th of value added

Hence  $E = \frac{1}{10} [12,480 - \{7,384 + 350 + 218 + 40 + E + (888 - E)\}]$

$= \frac{1}{10} [12,480 - 8,880]$

$= \frac{1}{10} \times 3,600 = 360$

Other/miscellaneous charge  $888 - 360 = \text{Rs.}528$

The above solution has been given accordingly.

Alternatively, if other/miscellaneous charges are considered as application of value added (i.e., not deducted for deriving the value added), calculation of Excise Duties (E) will be as follows:

$E = \frac{1}{10} [12,480 - (7,384 + 350 + 218 + 40 + E)]$

$E = \frac{1}{10} \times (4,488 - E)$

$11E = 4,488$

$E = \text{Rs.}408$

### Advanced Accounting

And thus other/miscellaneous charges will be  $\text{Rs.}888 - 408 = \text{Rs.}480$

Gross Value added in this case will be  $\text{Rs. } 4,080 + 110 \text{ (Other income)} = \text{Rs.}4,190$

And accordingly, application part will be prepared after taking other/miscellaneous charges.

#### Question 9

What are the advantages of preparation of Value Added (VA) statements?

(6 marks) (May, 2008)

#### Answer

Various advantages of preparation of Value Added (VA) Statements are as under:

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour-intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

#### Question 10

- (a) Explain the concept of 'Economic value added' (EVA for short) and its uses.

(6 marks)(November, 2002)

- (b) What is economic value added and how is it calculated? Discuss.

(4 marks)(November, 2003)

**Answer**

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

EVA as a residual income measure of financial performance, is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

In addition, EVA is a management tool to focus managers on the impact of their decisions in increasing shareholders' wealth. These include both strategic decisions such as what investments to make, which businesses to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment, whether to make short or long production runs etc.

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

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

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

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

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

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

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well

## Advanced Accounting

as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

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

To better align managers interests with shareholders' - the EVA framework needs to be holistically applied in an integrated approach - simply measuring EVA is not enough; it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

However, EVA as a strategic tool has the following limitations:

1. Not easy to use; too complicated for small businesses.
2. Recommends inexpensive debts in order to reduce the cost of capital.
3. A passive tool, measures past performance.

### Question 11

The following information is available of a concern; calculate E.V.A.:

|                              |                   |
|------------------------------|-------------------|
| Debt capital 12%             | Rs. 2,000 crores  |
| Equity capital               | Rs. 500 crores    |
| Reserve and surplus          | Rs. 7,500 crores  |
| Capital employed             | Rs. 10,000 crores |
| Risk-free rate               | 9%                |
| Beta factor                  | 1.05              |
| Market rate of return        | 19%               |
| Equity (market) risk premium | 10%               |
| Operating profit after tax   | Rs.2,100 crores   |
| Tax rate                     | 30%               |

(4 marks)(Nov. 2006)

### Answer

$$\text{E.V.A.} = \text{NOPAT} - \text{COCE}$$

$$\text{NOPAT} = \text{Net Operating Profit after Tax}$$

$$\text{COCE} = \text{Cost of Capital Employed}$$

$$\begin{aligned}\text{COCE} &= \text{Weighted Average Cost Of Capital} \times \text{Average Capital Employed} \\ &= \text{WACC} \times \text{Capital Employed}\end{aligned}$$

## Developments in Accounting

|                            |                                  |
|----------------------------|----------------------------------|
| Debt Capital               | Rs.2,000 crores                  |
| Equity capital 500 + 7,500 | = Rs.8,000 crores                |
| Capital employed           | = 2,000+8,000 = Rs.10,000 crores |
| Debt to capital employed   | = $\frac{2,000}{10,000} = 0.20$  |
| Equity to Capital employed | = $\frac{8,000}{10,000} = 0.80$  |
| Debt cost before Tax       | 12%                              |
| Less: Tax (30% of 12%)     | <u>3.6%</u>                      |
| Debt cost after Tax        | <u>8.4%</u>                      |

According to Capital Asset Pricing Model (CAPM)

Cost of Equity Capital = Risk Free Rate + Beta × Equity Risk Premium

Or

= Risk Free Rate + Beta (Market Rate – Risk Free Rate)

= 9 + 1.05 × (19-9)

= 9 + 1.05 × 10 = 19.5%

WACC = Equity to CE × Cost of Equity capital + Debt to CE × Cost of debt

= 0.8 × 19.5% + 0.20 × 8.40%

= 15.60% + 1.68% = 17.28%

COCE = WACC × Capital employed

= 17.28% × 10,000 crores = 1728 crores

E.V.A. = NOPAT – COCE

= Rs. 2,100 – Rs. 1,728 = Rs. 372 crores

### Question 12

- (a) “The content of corporate social report is essentially based on social objectives.” Discuss.  
(7 marks)(November, 1998)
- (b) Enumerate the major heads identified for corporate social reporting purposes.  
(8 marks)(November, 1999)
- (c) Write short note on Corporate Social Reporting.  
(4 marks)(May, 2003)

## Advanced Accounting

### Answer

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

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

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

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

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

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

- (b) 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 alongwith the categories of beneficiaries and cost involved.

## Advanced Accounting

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.
- (c) Corporate Social Reporting is the information communicate with respect to discharge of social responsibilities of corporate entity. The transition in accounting function from historical cost based profitability accounting to social responsibility accounting is a good fit to the present-day data requirement of the "Users of accounts".

The content of Corporate Social Report is essentially based on the social objectives, namely Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

Considering the major socio-economic problems of the country, eight major heads can be identified for social reporting purpose:

- (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.

Initially, it is difficult to express social costs incurred by a corporate enterprise and social benefits generated in money terms. Until suitable methodologies are available for conversion of social cost-benefit in money terms, it is desirable to begin with descriptive social report. Further research is necessary in this area either to improve heads of corporate social reporting in the context of dynamic socio-economic environment.

### Question 13

From the following information taken from the books of F Ltd. relating to staff and community benefits, prepare a statement classifying the various items under the appropriate heads, required under Corporate Social Reporting.



## Developments in Accounting

|                                                                           | Rs.                  |
|---------------------------------------------------------------------------|----------------------|
| Environmental Improvements                                                | 20,10,000            |
| Medical facilities                                                        | 45,00,000            |
| Training Programmes                                                       | 10,25,000            |
| Generation of Job Opportunities                                           | 60,75,000            |
| Municipal Taxes                                                           | 10,70,000            |
| Increase in cost of living in the vicinity due to a thermal power station | 16,55,000            |
| Concessional transport, water supply                                      | 11,25,000            |
| Extra work put in by staff and officers for drought relief                | 18,50,000            |
| Leave encashment and leave travel benefits                                | 52,00,000            |
| Educational facilities for children of staff members                      | 21,60,000            |
| Subsidised canteen facilities                                             | 14,40,000            |
| Generation of business                                                    | 25,00,000            |
|                                                                           | (6 marks)(May, 2004) |

Answer

F Ltd.

### Statement relating to staff and community benefits

|                                                                           | Rs.                |
|---------------------------------------------------------------------------|--------------------|
| <b>I. Social Benefits and Cost to Staff</b>                               |                    |
| <b>A. Social Benefits to Staff</b>                                        |                    |
| 1. Medical facilities                                                     | 45,00,000          |
| 2. Training programmes                                                    | 10,25,000          |
| 3. Concessional transport, water supply                                   | 11,25,000          |
| 4. Leave encashment and leave travel benefits                             | 52,00,000          |
| 5. Educational facilities for children of staff members                   | 21,60,000          |
| 6. Subsidised canteen facilities                                          | <u>14,40,000</u>   |
| Total                                                                     | <u>1,54,50,000</u> |
| <b>B. Social Costs to Staff</b>                                           |                    |
| Extra work put in by staff and officers for drought relief                | <u>18,50,000</u>   |
| <b>Net Social Benefits to Staff (A – B)</b>                               | <u>1,36,00,000</u> |
| <b>II. Social Benefits and Cost to Community</b>                          |                    |
| <b>A. Social Benefits to Community</b>                                    |                    |
| 1. Environmental improvements                                             | 20,10,000          |
| 2. Generation of job opportunities                                        | 60,75,000          |
| 3. Municipal taxes                                                        | 10,70,000          |
| 4. Generation of business                                                 | <u>25,00,000</u>   |
| Total                                                                     | <u>1,16,55,000</u> |
| <b>B. Social Costs to Community</b>                                       |                    |
| Increase in cost of living in the vicinity due to a thermal power station | <u>16,55,000</u>   |
| <b>Net Social Benefits to Community (A – B)</b>                           | <u>1,00,00,000</u> |

## Advanced Accounting

### Question 14

After the HAVOC caused by TSUNAMI, a group of companies undertakes during the period from January, 2005 to March, 2005 various commercial activities, having granted considerable subsidy, along the related coast line. The management intends to highlight the results of such activities while publishing financial statements for the year 2004-2005. What is the scope? (4 marks)(May,2005)

#### Answer

Corporate social reporting is information communique with respect to discharge of social responsibilities of corporate entity. Through 'Corporate Social Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

In the given case, the group of companies has positively contributed to the social cause and the commercial activities undertaken by them come under the purview of corporate social reporting. Normally, such information is not required to be given mandatorily in the financial report due to the lack of any generally accepted standard of social responsibility for business entities. However, everyone agrees that all business entities should be socially responsible but how the individual entity weighs its priorities of social responsibility depends on the personal choice or preference of the group of persons in the management of an enterprise.

The group of companies (referred in the question) can voluntarily highlight the results of various commercial activities, undertaken by them along the related coast line through a 'note to accounts' while publishing financial statements for the year ended 2004-2005. Infact bringing out the results of such Tsunami relief activities in the Tsunami affected areas may imbibe a sense of social responsibility among other entities through 'Corporate Social Report'.

### Question 15

From the following information of Steel India Ltd. for the year ended 31<sup>st</sup> March, 2008, prepare their Social Balance Sheet as on that date:

- A specialist has valued their human assets at Rs.828 lakhs.
- Their investments were classified as:

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

- Water, electricity and gas supply systems totalled Rs.1 lakh.

- Their Net owned funds were Rs.26 lakhs. (6 Marks) (May, 2008)

## Developments in Accounting

Answer

### Social Balance Sheet of Steel India Ltd. as at 31.03.2008

(Rs. in lakhs)

Liabilities:

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

Assets:

Social Capital Investment:

(a) Buildings

|                 |             |       |
|-----------------|-------------|-------|
| (i) Residential | 17.00       |       |
| (ii) Hospital   | 1.00        |       |
| (iii) School    | 1.40        |       |
| (iv) Welfare    | <u>0.80</u> | 20.20 |

(b) Equipments

|                 |             |      |
|-----------------|-------------|------|
| (i) Residential | 2.80        |      |
| (ii) Hospital   | 1.00        |      |
| (iii) School    | <u>1.00</u> | 4.80 |

(c) Water, Electricity and Gas supply systems 1.00

|                                            |               |
|--------------------------------------------|---------------|
| Human assets (as valued by the specialist) | <u>828.00</u> |
| Total                                      | <u>854.00</u> |

### Question 16

Write short notes on:

- (a) Jaggi and Lau model on valuation on group basis of Human Resources. (4 marks)(May, 2003)
- (b) Opportunity cost (HRA). (5 marks)(November, 2003)
- (c) Human Resource Accounting. (5 marks) (Nov. 2007)

Answer

- (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

## Advanced Accounting

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) **Opportunity Cost:** It is one of the Economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.
  - (c) **Human Resource Accounting (HRA)** is an attempt to identify, quantify and report investments made in human resources of an organization. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information. Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resource. Human resources are not thus recognized as 'assets' in the Balance Sheet. While investments in human resources are not considered as assets and not amortised over the economic service life, the result is that the income and expenditure statement comprising current revenue and expenditure gives a distorted picture of the real affairs of the organization.

Accountants have been severely criticized by the Behavioural Scientists for their failure to value human resources, as this has come out as a handicap for effective management.

Human resource accounting provides scope for planning and decision making in relation to proper manpower planning. Also, such accounting can bring out the effect of various

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new rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes and laws.

### Question 17

Briefly describe the method of valuation of human resources as suggested by Jaggi and Lau. Also point out the special merit and demerit of this method.

(8 marks) ( May, 2006)

### Answer

Jaggi and Lau suggested a model for valuation of human resources. According to them, 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 organization or not. An individual's expected service tenure in an organization 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 organization in future. This model attempts 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 organization on 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 tried to simplify the process of measuring the value of human resources by considering a group of employees as basis of valuation. 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.

### Merit

Jaggi and Lau model approached the valuation of human resources on the basis of grouping of employees. Under this method, calculations get simplified and the chances of errors get reduced.

### Demerit

This model ignores individual skills of the employees. The varied skills of the employees is not recognized in the valuation process under Jaggi and Lau model.

### Question 18

Briefly describe the progress made by India so far in the field of human resource accounting.

(4 marks)(May, 2004)

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### Answer

Human resource accounting can be defined as the process of identifying, measuring and communicating information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.

### Question 19

Give an account of the growing scope of human capital reporting. (4 marks)(May, 2005)

### Answer

Of late there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (which can be measured in monetary terms) to a more comprehensive approach of reporting under which human resources are also considered as measurable assets. Having followed the methods of accounting of fixed assets, one can take into account the employee-related costs like cost of recruitment, training and orientation of employees, for the purpose of capitalization and then the appropriate portion thereof can be amortised each year over the estimated years of effect of such costs.

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

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

### Question 20

Why Human Resources Asset is not recognised in the Balance sheet?

(4 marks) (Nov. 2008)

### Answer

Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice

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does not assign significance to the human resources. Human resources are not recognized in balance sheet as there are no measurement criteria for recognition of human resources. Human resource accounting is at developing stage and no accounting principles have been established for valuation of human assets. Costs incurred on human resources are recognised as expenses in profit and loss account. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information.

### Question 21

A company has a capital base of Rs.1 crore and has earned profits to the tune of Rs.11 lakhs. The Return on Investment (ROI) of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by Rs.2.5 lakhs over and above the target profit.

Determine the amount of maximum bid price for that particular executive and the maximum salary that could be offered to him. (6 marks) November 2006)

### Answer

|                       |   |                |
|-----------------------|---|----------------|
| (b) Capital Base      | = | Rs.1,00,00,000 |
| Actual Profit         | = | Rs. 11,00,000  |
| Target Profit @ 12.5% | = | Rs. 12,50,000  |

Expected Profit on employing the particular executive

$$= \text{Rs.}12,50,000 + 2,50,000 = \text{Rs.}15,00,000$$

Additional Profit = Expected Profit – Actual Profit

$$= 15,00,000 - 11,00,000 = \text{Rs.}4,00,000$$

$$\text{Maximum bid price} = \frac{\text{Additional Profit}}{\text{Rate of Return on Investment}}$$

$$= \frac{4,00,000}{12.5} \times 100 = \text{Rs.}32,00,000$$

Maximum salary that can be offered = 12.5% of Rs.32,00,000 i.e., 4,00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., Rs.4,00,000.

### Question 22

State the possible objections to segmental reporting. (7 marks)(May, 1998)

### Answer

Objections to segmental reporting: The possible objections to segmental reporting can be enumerated as below:

- (i) It is generally felt that segmental revenues and expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence

## Advanced Accounting

of a strong product line. Also many joint costs are only separable arbitrarily.

- (ii) Much of segmental results depend on the inter-departmental transfer pricings which are not always logically established.
- (iii) Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio.
- (iv) Since the users are in no position to know the proper base for cost allocation, the segment results would be less than meaningful.
- (v) The last objection consists of the competitive implications to the firm. Some academics contend that company secrets will be disclosed while others referred to the competitive hardship suffered by some firms if segmented data is required. Suppose that Company X, a small company, has a segment identical to one in Company Y, a huge conglomerate. Company X would have to disclose the segment while Company Y would not because the segment is not considered material to Y's operations.

However, considering the problems of joint cost allocation, often it is suggested to follow a contribution margin approach for reporting segmental results. By this only identifiable costs are deducted from segment revenues and gross segment margins may only be indicated. But for all practical purposes, this becomes a useless exercise when proportion of identifiable cost is insignificant.

### Question 23

M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

|                         | Rs. ('000)   |
|-------------------------|--------------|
| Division A              |              |
| Sales to B              | 3,050        |
| Other Sales (Home)      | 60           |
| Export Sales            | <u>4,090</u> |
|                         | <u>7,200</u> |
| Division B              |              |
| Sales to C              | 30           |
| Export Sales to Europe  | <u>200</u>   |
|                         | <u>230</u>   |
| Division C              |              |
| Export Sales to America | <u>180</u>   |



## Developments in Accounting

|                                     |                           | Divisions     |                |                |
|-------------------------------------|---------------------------|---------------|----------------|----------------|
|                                     | Head Office<br>Rs. ('000) | A<br>Rs('000) | B<br>Rs.('000) | C<br>Rs.('000) |
| Operating Profit or Loss before tax |                           | 160           | 20             | (8)            |
| Re-allocated cost from Head Office  |                           | 48            | 24             | 24             |
| Interest cost                       |                           | 4             | 5              | 1              |
| Fixed assets                        | 50                        | 200           | 40             | 120            |
| Net current assets                  | 48                        | 120           | 40             | 90             |
| Long-term liabilities               | 38                        | 20            | 10             | 120            |

Prepare a Segmental Report for publication in M Ltd. Group. (8 marks)(November, 2000)

Answer

| M Ltd.<br>Segmental Report |              |            |            |                                  |                                     |
|----------------------------|--------------|------------|------------|----------------------------------|-------------------------------------|
|                            | Divisions    |            |            | Inter<br>segment<br>Eliminations | Rs. ('000)<br>Consolidated<br>Total |
|                            | A            | B          | C          |                                  |                                     |
| Segment Revenue            |              |            |            |                                  |                                     |
| Sales:                     |              |            |            |                                  |                                     |
| Domestic                   | 60           | —          | —          | —                                | 60                                  |
| Export                     | <u>4,090</u> | <u>200</u> | <u>180</u> | <u>—</u>                         | <u>4,470</u>                        |
| External Sales             | 4,150        | 200        | 180        | —                                | 4,530                               |
| Inter-segment Sales        | <u>3,050</u> | <u>30</u>  | <u>—</u>   | <u>3,080</u>                     | <u>—</u>                            |
| Total Revenue              | <u>7,200</u> | <u>230</u> | <u>180</u> | <u>3,080</u>                     | <u>4,530</u>                        |
| Segment result (given)     | 160          | 20         | (8)        |                                  | 172                                 |
| Head office expenses       |              |            |            |                                  | <u>(96)</u>                         |
| Operating profit           |              |            |            |                                  | 76                                  |
| Interest expense           |              |            |            |                                  | <u>(10)</u>                         |
| Profit before tax          |              |            |            |                                  | 66                                  |
| Other information          |              |            |            |                                  |                                     |
| Fixed assets               | 200          | 40         | 120        |                                  | 360                                 |
| Net current assets         | <u>120</u>   | <u>40</u>  | <u>90</u>  |                                  | <u>250</u>                          |
| Segment assets             | <u>320</u>   | <u>80</u>  | <u>210</u> |                                  | <u>610</u>                          |

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|                                   |    |    |     |     |
|-----------------------------------|----|----|-----|-----|
| Unallocated corporate assets      |    |    |     | 98  |
| Segment liabilities               | 20 | 10 | 120 | 150 |
| Unallocated corporate liabilities |    |    |     | 38  |

### Sales Revenue by Geographical Market

|                | Home Sales | Export Sales (by division A) | Export to Europe | Export to America | (Rs.'000)<br>Consolidated Total |
|----------------|------------|------------------------------|------------------|-------------------|---------------------------------|
| External Sales | 60         | 4,090                        | 200              | 180               | 4,530                           |

### Question 24

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

|                              | Rs.('000)     |
|------------------------------|---------------|
| Forging Shop Division        |               |
| Sales to Bright Bar Division | 4,575         |
| Other Domestic Sales         | 90            |
| Export Sales                 | <u>6,135</u>  |
|                              | <u>10,800</u> |
| Bright Bar Division          |               |
| Sales to Fitting Division    | 45            |
| Export Sales to Rwanda       | <u>300</u>    |
|                              | <u>345</u>    |
| Fitting Division             |               |
| Export Sales to Maldives     | <u>270</u>    |

| Particulars                  | Head Office | Forging Shop Division | Bright Bar Division | Fitting Division |
|------------------------------|-------------|-----------------------|---------------------|------------------|
|                              | Rs. ('000)  | Rs. ('000)            | Rs. ('000)          | Rs. ('000)       |
| Pre-tax operating result     |             | 240                   | 30                  | (12)             |
| Head office cost reallocated |             | 72                    | 36                  | 36               |
| Interest costs               |             | 6                     | 8                   | 2                |
| Fixed assets                 | 75          | 300                   | 60                  | 180              |
| Net current assets           | 72          | 180                   | 60                  | 135              |
| Long-term liabilities        | 57          | 30                    | 15                  | 180              |

## Developments in Accounting

Answer

### Diversifiers Ltd. Segmental Report

| Particulars                                        |               |                         |            |                               | (Rs.'000)             |
|----------------------------------------------------|---------------|-------------------------|------------|-------------------------------|-----------------------|
|                                                    | Forging shop  | Divisions<br>Bright Bar | Fitting    | Inter Segment<br>Eliminations | Consolidated<br>Total |
| Segment revenue                                    |               |                         |            |                               |                       |
| Sales:                                             |               |                         |            |                               |                       |
| Domestic                                           | 90            | —                       | —          | —                             | 90                    |
| Export                                             | 6,135         | 300                     | 270        | —                             | 6,705                 |
| External Sales                                     | <u>6,225</u>  | <u>300</u>              | <u>270</u> | —                             | <u>6,795</u>          |
| Inter-segment sales                                | 4,575         | 45                      | —          | 4,620                         | —                     |
| Total revenue                                      | <u>10,800</u> | <u>345</u>              | <u>270</u> | <u>4,620</u>                  | <u>6,795</u>          |
| Segment result (given)                             | 240           | 30                      | (12)       |                               | 258                   |
| Head office expenses                               |               |                         |            |                               | <u>(144)</u>          |
| Operating profit                                   |               |                         |            |                               | 114                   |
| Interest expense                                   |               |                         |            |                               | <u>(16)</u>           |
| Profit before tax                                  |               |                         |            |                               | <u>98</u>             |
| Information in relation to assets and liabilities: |               |                         |            |                               |                       |
| Fixed assets                                       | 300           | 60                      | 180        | —                             | 540                   |
| Net current assets                                 | <u>180</u>    | <u>60</u>               | <u>135</u> | —                             | <u>375</u>            |
| Segment assets                                     | <u>480</u>    | <u>120</u>              | <u>315</u> | —                             | 915                   |
| Unallocated corporate assets (75 + 72)             | —             | —                       | —          | —                             | <u>147</u>            |
| Total assets                                       |               |                         |            |                               | <u>1,062</u>          |
| Segment liabilities                                | 30            | 15                      | 180        | —                             | 225                   |
| Unallocated corporate liabilities                  |               |                         |            |                               | <u>57</u>             |
| Total liabilities                                  |               |                         |            |                               | <u>282</u>            |

### Sales Revenue by Geographical Market

|                |            |                                            |                  |                    | (Rs.'000)          |
|----------------|------------|--------------------------------------------|------------------|--------------------|--------------------|
|                | Home Sales | Export Sales<br>(by forging shop division) | Export to Rwanda | Export to Maldives | Consolidated Total |
| External sales | 90         | 6,135                                      | 300              | 270                | 6,795              |

## Advanced Accounting

### Question 25

- (a) What are derivatives and what are its characteristics? (5 marks)(November, 2003)
- (b) Explain currency options related to foreign exchange. (4 marks)(May, 2004)
- (c) Write short note on Interest Rate Swaps. (4 marks) (May, 2007)

### Answer

- (a) Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index or reference rate), in a contracted manner. The underlying asset can be equity, forex, commodity or any other asset. For example, farmers may wish to sell their harvest of wheat at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of the derivative is driven by the spot price of wheat which is the "underlying asset".

Derivative financial instruments can either be on the balance-sheet or off the balance sheet and include options contract, interest rate swaps, interest rate flows, interest rate collars, forward contracts, futures etc. A derivative instrument is therefore a financial instrument or other contract with the following three characteristics:

- (a) It has one or more underlying and one or more notional amounts or payments provisions or both. These terms determine the amount of settlement or settlements and in some cases, whether or not settlement is required;
- (b) It requires no initial net investment or an initial net investment that is smaller than what is required for similar responses to changes in market factors.
- (c) Its terms require or permit net settlement; it can readily be settled net by means outside the contract or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Accounting for foreign exchange derivatives is guided by AS 11 (Revised 2003). The ICAI has also issued a Guidance Note dealing with the accounting procedures to be adopted while accounting for Equity Index Options and Equity Stock Options.

- (b) Currency Options give the client the right, but not the obligation, to buy/sell a specific amount of currency at a specific price on a specific date. Currency options provide a tool for hedging foreign exchange risk arising out of the firm's operations. Currency options enable the business house to remove downside risk without limiting the upside potential. Options can be put option or call option. A put option is a contract that specifies the currency that the holder has the right to sell. A call option is a contract that specifies the currency that the holder has the right to buy.
- (c) Interest rate swap can be defined as a financial contract between two parties (called counter parties) to exchange on a particular date in the future, one series of cash flows (fixed interest) for another series of cash flows (variable or floating interest) in the same currency on the same principal (an agreed amount called notional principal) for an agreed period of time. The contract will specify the interest rates, the benchmark rate to be followed, the notional principal amount for the transaction, etc. Interest rates are of two types, fixed interest rates and floating rates which vary according to changes in a

standard benchmark interest rate. An investor holding a security which pays a floating interest rate is exposed to interest rate risk. The investor can manage this risk by entering into an interest rate swap.

**Question 26**

Mr. Investor buys a stock option of ABC Co. Ltd. in July, 2003 with a strike price on 30.07.2003 of Rs. 250 to be expired on 30.08.2004. The premium is Rs. 20 per unit and the market lot is 100. The margin to be paid is Rs. 120 per unit.

Show the accounting treatment in the books of Buyer when:

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

(12 marks)(November, 2004)

**Answer**

| Accounting entries in the books of buyer |                                                                                                                |     |        |        |
|------------------------------------------|----------------------------------------------------------------------------------------------------------------|-----|--------|--------|
| 2003                                     | At the time of inception                                                                                       |     | Rs.    | Rs.    |
| July                                     | Stock option premium account                                                                                   | Dr. | 2,000  |        |
|                                          | To Bank account                                                                                                |     |        | 2,000  |
|                                          | (Being premium paid to buy a stock option)                                                                     |     |        |        |
|                                          | Deposit for margin money account                                                                               | Dr. | 12,000 |        |
|                                          | To Bank account                                                                                                |     |        | 12,000 |
|                                          | (Being margin money paid on stock option)                                                                      |     |        |        |
|                                          | At the time of settlement                                                                                      |     |        |        |
| August                                   | (i) Option is settled by delivery of the asset                                                                 |     |        |        |
|                                          | Shares of ABC Ltd. account                                                                                     | Dr. | 25,000 |        |
|                                          | To Deposit for margin money account                                                                            |     |        | 12,000 |
|                                          | To Bank account                                                                                                |     |        | 13,000 |
|                                          | (Being option exercised and shares acquired, Rs. 12,000 margin money adjusted and the balance amount was paid) |     |        |        |
|                                          | Profit and loss account                                                                                        | Dr. | 2,000  |        |
|                                          | To Stock option premium account                                                                                |     |        | 2,000  |
|                                          | (Being the premium transferred to profit and loss account on exercise of option)                               |     |        |        |
|                                          | (ii) Option is settled in cash                                                                                 |     |        |        |
|                                          | Profit and loss account                                                                                        | Dr. | 2,000  |        |
|                                          | To Stock option premium account                                                                                |     |        | 2,000  |
|                                          | (Being the premium transferred to profit and loss account)                                                     |     |        |        |
|                                          | Bank account (Rs. 100 × 10)                                                                                    | Dr. | 1,000  |        |
|                                          | To Profit and loss account                                                                                     |     |        | 1,000  |
|                                          | (Being profit on exercise of option)                                                                           |     |        |        |

## Advanced Accounting

|                                                                           |     |        |        |
|---------------------------------------------------------------------------|-----|--------|--------|
| Bank account                                                              | Dr. | 12,000 |        |
| To Deposit for margin money account                                       |     |        | 12,000 |
| (Being margin on equity stock option received back on exercise of option) |     |        |        |

### Question 27

On 24<sup>th</sup> January, 2006 Chinnaswamy of Chennai sold goods to Watson of Washington, U.S.A. for an invoice price of \$40,000 when the spot market rate was Rs.44.20 per US \$. Payment was to be received after three months on 24<sup>th</sup> April, 2006. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, Chinnaswamy immediately acquired a forward contract to sell on 24<sup>th</sup> April, 2006 US \$ 40,000 @ Rs.43.70. Chinnaswamy closed his books of account on 31<sup>st</sup> March, 2006 when the spot rate was Rs.43.20 per US \$. On 24<sup>th</sup> April, 2006, the date of receipt of money by Chinnaswamy, the spot rate was Rs.42.70 per US \$.

Pass journal entries in the books of Chinnaswamy to record the effect of all the above mentioned effects. (8 Marks)( May, 2006)

### Answer

| Journal Entries in the books of Chinnaswamy |                                                                                                                       |               |           |
|---------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|---------------|-----------|
| 2006                                        |                                                                                                                       | Rs.           | Rs.       |
| Jan. 24                                     | Watson                                                                                                                | Dr. 17,68,000 |           |
|                                             | To Sales Account                                                                                                      |               | 17,68,000 |
|                                             | (Credit sales made to Watson of Washington, USA for \$40,000 recorded at spot market rate of Rs.44.20 per US \$)      |               |           |
| " "                                         | Forward (Rs.) Contract Receivable Account                                                                             | Dr. 17,48,000 |           |
|                                             | Deferred Discount Account                                                                                             | Dr. 20,000    |           |
|                                             | To Forward (\$) Contract Payable                                                                                      |               | 17,68,000 |
|                                             | (Forward contract acquired to sell on 24 <sup>th</sup> April, 2006 US \$40,000 @ Rs.43.70)                            |               |           |
| March 31                                    | Exchange Loss Account                                                                                                 | Dr. 40,000    |           |
|                                             | To Watson                                                                                                             |               | 40,000    |
|                                             | (Record of exchange loss @ Re.1 per \$ due to market rate becoming Rs.43.20 per US \$ rather than Rs.44.20 per US \$) |               |           |
| " "                                         | Forward (\$) Contract Payable                                                                                         | Dr. 40,000    |           |
|                                             | To Exchange Gain Account                                                                                              |               | 40,000    |
|                                             | (Decrease in liability on forward contract due to fall in exchange rate)                                              |               |           |
| " "                                         | Discount Account                                                                                                      | Dr. 14,667    |           |
|                                             | To Deferred Discount Account                                                                                          |               | 14,667    |
|                                             | (Record of proportionate discount expense for 66 days out of 90 days)                                                 |               |           |

## Developments in Accounting

|          |                                                                                                                                      |     |           |           |
|----------|--------------------------------------------------------------------------------------------------------------------------------------|-----|-----------|-----------|
| April 24 | Bank Account                                                                                                                         | Dr. | 17,08,000 |           |
|          | Exchange Loss Account                                                                                                                | Dr. | 20,000    |           |
|          | To Watson                                                                                                                            |     |           | 17,28,000 |
|          | (Receipt of \$40,000 from Watson, USA customer @ Rs.42.70 per US \$; exchange loss being Rs.20,000)                                  |     |           |           |
| " "      | Forward (\$) Contract Payable Account                                                                                                | Dr. | 17,28,000 |           |
|          | To Exchange Gain Account                                                                                                             |     |           | 20,000    |
|          | To Bank Account                                                                                                                      |     |           | 17,08,000 |
|          | (Settlement of forward contract by payment of \$40,000)                                                                              |     |           |           |
| " "      | Bank Account                                                                                                                         | Dr. | 17,48,000 |           |
| " "      | To Forward (Rs.) Contract Receivable                                                                                                 |     |           | 17,48,000 |
|          | (Receipt of cash in settlement of forward contract receivable)                                                                       |     |           |           |
| " "      | Discount Account                                                                                                                     | Dr. | 5,333     |           |
|          | To Deferred Discount Account                                                                                                         |     |           | 5,333     |
|          | (Recording of discount expense for 24 days:<br>$\text{Rs.20,000} \times \frac{24 \text{ days}}{90 \text{ days}} = \text{Rs.5,333}$ ) |     |           |           |

### Question 28

Write a short notes on:

- (a) Accounting issues involved in Environmental Accounting. (6 marks)(May, 2003)(May, 2007)
- (b) Environmental Accounting. (4 marks)(Nov.2004)(Nov. 2005)

### Answer

- (a) Major accounting issues involved in environmental accounting can be explained as follows:
- 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.
  - Capitalisation of environmental expenditures vis-a-vis expensing them during the current accounting period: Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is resorted to and/or persuaded to follow environmental accounting, the adverse impact in EPS is a major concern. Accordingly many Western Corporations prefer to capitalise

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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 (UNCTAD) 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.

- (b) The term ‘environment’ includes everything in all its manifest forms, on the earth, beneath the earth and above the earth. A business enterprise takes support of social and ecological system in order to maximize wealth. Economic activity, social welfare and a diverse environment, all are linked and ultimately depend on each other. The functioning of an enterprise may have some favourable and some adverse effects on the environment. Hence, it is felt that there is a need for maintaining accounts of the effects of activities of business entity on the environment. Environmental accounting can be defined as a system (methodology) for measuring environmental performance and communicating the results of these measurements to users. It helps in presenting the utilization of natural resources by an enterprise, the costs incurred to use them and the income earned therefrom in a transparent manner. Environmental accounting, entirely a new concept, is a faithful attempt to identify the resources exhausted and the costs rendered reciprocally to the enterprise by a business corporation. Thus environmental accounting stands for recording and documenting environmental performance to facilitate effectiveness of environmental management system with reference to compliance, safety and quality control. It provides a data base for taking corrective steps and future action for developing organisation's environmental strategy and for identifying environmentally based opportunities for gaining an edge over one's competitors. If proper environmental accounting system is established, the enterprise will be able to anticipate environmental damage and therefore can prevent it from happening.

Of course environmental accounting is still in an early stage of evolution and it is being groomed under the voluntary leadership of a variety of enterprises around the world. Recognising the importance of protecting and preserving the environment, a number of laws have been enacted throughout the world.



## ACCOUNTING FOR NOT-FOR-PROFIT ORGANISATIONS

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Topics covered:

- Fund Based Accounting (Q. No. 1)
- Special Features of Accounting for Educational Institutions (Q. Nos. 2 to 9)
- Special Features of Accounting for Hospitals and Other Health Organisations (Q. No. 10,11)
- Special Features of Accounting for Other Not-For-Profit Organisations (Q. No. 12)

## Advanced Accounting

### Question 1

Explain the concept of fund theory and fund based accounting. (4 marks)(November, 2000)

#### Answer

Fund theory and fund based accounting: Although, the profit motive is the driving force for any business entity, there are certain organisations which are run without profit motive. Such organisations may be governmental institutions or any non-profit institutions like colleges, universities, charitable hospitals etc. The accounting for these not-for profit entities is primarily based on the fund theory. The fund theory is based on the equation – Assets = Restrictions on assets. Assets represent prospective services to the fund and liabilities represent restrictions against the assets of the fund. For example, in case of a university, the most commonly used specific funds are endowment funds, development funds etc. Each of these funds has its specific assets restricted for particular purposes. Under the fund theory, the balance sheet is considered an 'inventory statement' of assets and those restrictions applicable to the assets. Revenues represent an increase in assets into the fund that are completely free of equity restrictions other than the final restriction imposed by the residual equity. The residual equity represents a final restriction on the assets and establishes the equality of assets and equities. Expenses represent the release of services for designated purposes specified in the objective of the fund. Thus, the fund theory calls for fund based accounting rather than entity based accounting.

A fund may be defined as an accounting entity "with a self balancing set of accounts regarding cash and/or other resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations". Thus, every fund is aimed at fulfilling some purpose and the services embodied in the assets are the primary means to achieve that purpose. Fund based accounting essentially involves preparation of financial statements fundwise and consolidation of those statements to represent the financial results/position of the organisation as a whole.

### Question 2

What are, the special features of accounting for Educational Institutions? (7 marks)(May,1996)

#### Answer

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.

## **Accounting for Not-For-Profit Organisations**

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

## Advanced Accounting

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.

### Question 3

- (a) How would you describe 'Development Funds' maintained by Not-for-profit Organisations? (6 marks)(May, 2002)
- (b) Write short note on Annuity and life income funds. (5marks)(November, 2003)
- (c) What do you mean by restricted funds and unrestricted funds as found in the books of account of not-for-profit organizations? (4 marks) (May, 2004)
- (d) Distinguish between mandatory transfers and non-mandatory transfers made by a college in its books of account. (4 marks)(May, 2004)

### Answer

- (a) Development Funds are utilised for developmental purposes like acquisition of buildings and equipments, major repairs to fixed assets etc. Separate fund may be maintained for each development activity. Alternatively, a combined development fund may be maintained to account for each acquisition and/or construction of fixed assets. The major sources of receipts for this fund are government or private grants/gifts (restricted to acquisition of fixed properties), income and gains of investments of unutilised fund (if any), transfers from other funds. Any expenditure incurred for the purpose of construction or acquisition of building, laboratory etc. is 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. So long as the asset is not fully acquired or constructed, the proportionate fund cannot be transferred to unrestricted fund. Depreciation can be charged, on fixed assets only after its completion or acquisition. Such depreciation should be shown as part of operating expenses of unrestricted revenue fund.
- (b) The annuity and life income funds account for resources that are given to a non profit organisation provided that the organisation agrees to make periodic payment to a stated

## Accounting for Not-For-Profit Organisations

person. In case of annuity funds the agreement stipulates that periodic payments are made to a certain person for a specified amount for a specified period of time. Life income funds distribute their income to the individuals as long as they live. When the beneficiary dies, the funds become the property of the organisation and are used as specified in the gift agreement.

Annuity funds pay a fixed amount periodically whereas life income fund payments vary with the amount of income earned.

- (c) In a not-for-profit organization, revenue funds are received to meet operating expenses but the use of revenue funds may be restricted or unrestricted. Restricted funds account for resources whose use, by the not-for-profit organization, is restricted by the donor. For example, a grant may be received by a university from the Government for the specific purpose of research on cancer. This grant will constitute a restricted fund. The unrestricted funds account for resources that may be expended to carry out the primary purposes of the institution (e.g. instructions, research, maintenance etc.) and are not restricted to specific purposes. However, the not-for-profit organization may convert part of the unrestricted fund into a restricted fund by earmarking a certain sum for a specified purpose.
- (d) The terms mandatory and non-mandatory transfers are unique to college and universities accounting and reporting. Mandatory transfers are transfers out of the revenue funds to other funds resulting from binding legal agreements or grant agreements. Non-mandatory transfers are discretionary transfers specified by the governing board for a variety of purposes such as new additions to building, repairs and replacement of plant etc. Non-mandatory transfers may also be made from specific funds to the revenue funds. Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds. Also the governing board may designate unrestricted revenue fund resources for specific purposes in future periods. These board-designated funds are internal designations similar to appropriations of retained earnings for a commercial entity.

### Question 4

Henri Management institute furnishes you the following information in respect of Development Fund for the year 2001-2002:

|                                                                        | Rs. in lakhs |
|------------------------------------------------------------------------|--------------|
| Government grants received for construction of Buildings               | 50           |
| Private grants for acquisition of Land                                 | 30           |
| Transfer from unrestricted fund for purchase of Furniture              | 10           |
| Income from fixed deposits (Fixed deposit for one year – Rs. 40 lakhs) | 2            |
| Cost of Land                                                           | 10           |
| Advance payment made for acquisition of further Land                   | 5            |

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|                                                           |    |
|-----------------------------------------------------------|----|
| Furniture purchased                                       | 1  |
| Payment made to contractors for construction of Buildings | 12 |

Prepare a statement of changes in balances of Development Fund for the year 2001-2002 and a Balance Sheet for the Development Fund as on 31st March, 2002.

(10 marks)(May, 2002)

Answer

#### Statement of Changes –Development Fund

| Receipts                        | Rs. in lakhs | Rs. in lakhs |
|---------------------------------|--------------|--------------|
| Government Grants               | 50           |              |
| Private Grants                  | 30           |              |
| Income from Fixed Deposits      | 2            |              |
| Transfer from unrestricted fund | <u>10</u>    | 92           |
| Deductions/Transfers            |              |              |
| Cost of land acquired           | 10           |              |
| Furniture purchased             | <u>1</u>     | <u>11</u>    |
|                                 |              | <u>81</u>    |

#### Balance Sheet – Development Fund

as on 31st March, 2002

| Liabilities  | Amount       | Assets                          | Amount       |
|--------------|--------------|---------------------------------|--------------|
|              | Rs. in lakhs |                                 | Rs. in lakhs |
| Fund Balance | 81           | Capital work in progress        | 12           |
|              |              | Advance payment for Land        | 5            |
|              |              | Fixed Deposits                  | 40           |
|              | —            | Bank Balance (See Working Note) | <u>24</u>    |
|              | <u>81</u>    |                                 | <u>81</u>    |

Working Note:

#### Bank Balance as on 31st March, 2002

| Bank Account |                   |     |    | Rs. in lakhs   |     |
|--------------|-------------------|-----|----|----------------|-----|
|              |                   | Rs. |    |                | Rs. |
| To           | Government Grants | 50  | By | Fixed Deposits | 40  |
| To           | Private Grants    | 30  | By | Cost of Land   | 10  |

### Accounting for Not-For-Profit Organisations

|    |                                 |           |    |                          |           |
|----|---------------------------------|-----------|----|--------------------------|-----------|
| To | Interest from Fixed Deposits    | 2         | By | Advance payment for Land | 5         |
| To | Transfer from Unrestricted Fund | 10        | By | Payments to Contractors  | 12        |
|    |                                 |           | By | Furniture                | 1         |
|    |                                 | —         | By | Balance c/d              | <u>24</u> |
|    |                                 | <u>92</u> |    |                          | <u>92</u> |

Note: In the general balance sheet, Land (Rs. 10,00,000) and Furniture (Rs. 1,00,000) will be shown as assets and the unrestricted fund balance will increase by Rs. 11,00,000 as transfer from development fund.

#### Question 5

A University receives two grants — one from the Ministry of Human Resources to be used for Aids Research. This grant is for Rs. 45,00,000, which includes Rs. 3,00,000 to cover indirect expenses incurred in administering the grant. The second grant of Rs. 35,00,000 received from a reputed Trust is to be used to set up a centre to conduct seminars on Aids related matters from time to time. During the year, it also received Rs. 5,00,000 worth of equipment donated by a well wisher to be used for Aids research. During the year 2001-2002, the University spent Rs. 32,25,000 of the government grant and incurred Rs. 3,00,000 overhead expenses. Rs. 28,00,000 were spent from the grant received from the Trust.

Show the necessary Journal Entries.

(5 marks)(November, 2003)

Answer

#### Journal Entries

|       |                                                                                                             | Dr.<br>Rs.    | Cr<br>Rs. |
|-------|-------------------------------------------------------------------------------------------------------------|---------------|-----------|
| (i)   | Bank A/c                                                                                                    | Dr. 80,00,000 |           |
|       | To Revenue Fund (Restricted) A/c                                                                            |               | 80,00,000 |
|       | (To record grants received from the Government Department and Private organisation)                         |               |           |
| (ii)  | Expenses A/c                                                                                                | Dr. 60,25,000 |           |
|       | To Bank A/c                                                                                                 |               | 60,25,000 |
|       | (To account for Rs.32,25,000 spent from out of Government grant and Rs.28,00,000 from out of Private grant) |               |           |
| (iii) | Equipment A/c                                                                                               | Dr. 5,00,000  |           |
|       | To Restricted Revenue Fund A/c                                                                              |               | 5,00,000  |
|       | (To record the receipt of donation of assets from a well wisher)                                            |               |           |
| (iv)  | Revenue Fund (Restricted) A/c                                                                               | Dr. 60,25,000 |           |

### Advanced Accounting

|     |                                             |     |           |
|-----|---------------------------------------------|-----|-----------|
|     | To Income (Govt. grant) A/c                 |     | 32,25,000 |
|     | To Income (Private grant) A/c               |     | 28,00,000 |
|     | (To recognise revenue)                      |     |           |
| (v) | Revenue Fund (Restricted ) A/c              | Dr. | 3,00,000  |
|     | To Bank A/c                                 |     | 3,00,000  |
|     | (To account for overhead expenses incurred) |     |           |

Note: Actually, the expenses are incurred in unrestricted revenue fund and reimbursed to the above.

#### Question 6

From the following details of Loan Fund of Kanpur Institute of Technology for the year 2003-2004, you are required to prepare a statement showing changes in the Loan Fund Balance :

|                                        |           |
|----------------------------------------|-----------|
|                                        | Rs.       |
| Fund balance as on 1.4.2003            | 25,00,000 |
| Grants from the Government and Society | 12,00,000 |
| Grants from Revenue Fund               | 50,000    |
| Other transfer from Unrestricted Fund  | 70,000    |
| Investment income                      | 60,000    |
| Interest on Loan                       | 40,000    |
| Refund to Granters                     | 25,000    |
| Bad Debts written off                  | 15,000    |
| Administration and collection costs    | 25,000    |

(4 marks)(November, 2004)

#### Answer

#### Kanpur Institute of Technology Statement of changes – Loan funds

|                                        |               |           |
|----------------------------------------|---------------|-----------|
|                                        |               | Rs.       |
| Balance as on 1st April, 2003          |               | 25,00,000 |
| Additions during the year 2003-2004:   |               |           |
| Grants from government and society     | 12,00,000     |           |
| Investment income                      | 60,000        |           |
| Interest on loan                       | 40,000        |           |
| Grants from revenue fund               | 50,000        |           |
| Other transfer from unrestricted funds | <u>70,000</u> | 14,20,000 |
| Deductions during the year 2003-04:    |               |           |



### Accounting for Not-For-Profit Organisations

|                                     |               |                  |
|-------------------------------------|---------------|------------------|
| Refund to granters                  | 25,000        |                  |
| Bad debts written off               | 15,000        |                  |
| Administration and collection costs | <u>25,000</u> | <u>(65,000)</u>  |
| Balance as on 31st March, 2004      |               | <u>38,55,000</u> |

#### Question 7

The Institute for Global Management Research maintains a combined Development Fund in respect of which the following information is available for the year ended 31st March, 2005:

|                                                               | Rs.       |
|---------------------------------------------------------------|-----------|
| Govt. Grants received for acquisition of land                 | 60,00,000 |
| Private Grants received for construction of buildings         | 30,00,000 |
| Foreign Private Grant for purchase of computing equipment USD | 5,00,000  |
| Transfer from unrestricted fund for purchase of furniture     | 10,00,000 |
| Cost of Assets so far acquired:                               |           |
| Land                                                          | 59,00,000 |
| Buildings in progress (payments to Contractors)               | 15,00,000 |
| Furniture                                                     | 3,00,000  |

The USD grant has been received into a bank account in USA on 29.3.2005 and is expected to be utilized therefrom for purchases to be made abroad. The rate of exchange on 31.3.2005 is 1 USD = Rs. 44.

You are required to prepare

- A Statement showing changes in the Development Fund for the year; and
- Balance Sheet of the Development Fund as at 31.3.2005. ( 8 Marks)(Nov. 2005)

#### Answer

#### The Institute for Global Management Research Statement of Changes in Development Fund

|                                         | Rs.              | Rs.                |
|-----------------------------------------|------------------|--------------------|
| Receipts                                |                  |                    |
| Government grants                       | 60,00,000        |                    |
| Private grants                          | 30,00,000        |                    |
| Foreign private grant (in USD 5,00,000) | 2,20,00,000      |                    |
| Transfer from unrestricted fund         | <u>10,00,000</u> | 3,20,00,000        |
| Deductions/Transfers                    |                  |                    |
| Cost of land acquired                   | 59,00,000        |                    |
| Furniture purchased                     | <u>3,00,000</u>  | <u>62,00,000</u>   |
| Balance as at 31.3.2005                 |                  | <u>2,58,00,000</u> |

## Advanced Accounting

| Development Fund<br>Balance Sheet as at 31.3.2005 |                    |                       |                    |
|---------------------------------------------------|--------------------|-----------------------|--------------------|
| Liabilities                                       | Rs.                | Assets                | Rs.                |
| Fund Balance                                      | 2,58,00,000        | Buildings in progress | 15,00,000          |
|                                                   |                    | Bank balances         |                    |
|                                                   |                    | in India              | 23,00,000          |
|                                                   |                    | outside India         | <u>2,20,00,000</u> |
|                                                   | <u>2,58,00,000</u> |                       | <u>2,43,00,000</u> |
|                                                   |                    |                       | <u>2,58,00,000</u> |

| Bank A/c (in India) |                    |                                          |                    |
|---------------------|--------------------|------------------------------------------|--------------------|
|                     | Rs.                |                                          | Rs.                |
| To Government grant | 60,00,000          | By Land                                  | 59,00,000          |
| To Private grant    | 30,00,000          | By Furniture                             | 3,00,000           |
| To Transfer         | 10,00,000          | By Payments to contractors for buildings | 15,00,000          |
|                     |                    | By Balance c/d                           | <u>23,00,000</u>   |
|                     | <u>1,00,00,000</u> |                                          | <u>1,00,00,000</u> |

### Question 8

Indian Engineering and Technological Institute, an autonomous body furnishes the following information:

On 1.4.2006, unutilised restricted government grant (capital) balance is Rs.40,00,000; unutilised unrestricted government grant (revenue) balance is Rs.9,00,000; Institute's own corpus fund is Rs.25,00,000. Besides, a private endowment fund of Rs.18,50,000 is there on that date. The entire endowment fund is in fixed deposit with a bank fetching interest of 9.5% p.a. half-yearly transferred on 30<sup>th</sup> September and 31<sup>st</sup> March to a current account meant for scholarship and awards. The said current account has a debit balance of Rs.1,37,500. Apart from this, total cash and bank balance as on 1.4.06 is Rs.85,00,000.

Following transactions took place during the year 2006-07:

- (1) Salary paid out of own fund is Rs.65,00,000.
- (2) Salary to the research associates of a Government sponsored research scheme is Rs.4,00,000 paid out of unrestricted government grant.
- (3) Cost of renovation of the administrative building borne out of the Institute's own fund is Rs.4,75,000. The renovation work was completed on 21<sup>st</sup> November, 2006 which was also the date of payment. Book value of the building was Rs.38,00,000

## Accounting for Not-For-Profit Organisations

on 1.4.06. The rate of depreciation is 5% p.a. calculated at full year's rate if the asset exists for a period exceeding 6 months, and at half-year's rate in other cases. The same principle is followed by the Institute in all cases of depreciation.

- (4) Tuition fees were received Rs.85,00,000.
- (5) Scholarships and awards of Rs.1,43,000 were given on 9th December, 2006.
- (6) A laboratory building was under construction for the last two years. Balance of capital work-in-progress on 1.4.06 was Rs.28,00,000. The work has been completed on 25<sup>th</sup> May, 2006. Final payment was made earlier on 29.4.2006. Total expenditure comes to Rs.37,00,000. Rate of depreciation on the laboratory building is 5%. The entire expenditure will be spent from the restricted government (capital) Grant on certain conditions attached by the government. The Institute follows the principles of AS 12 in the case of use of revenue and capital grant. Since certain conditionality will apply over a period of time, it is decided that deferred income method will be followed.

Show the following Ledger accounts:

- (i) Restricted Government Grant (capital) A/c.
- (ii) Unrestricted Government Grant (revenue) A/c.
- (iii) Current A/c of Endowment and Scholarship.
- (iv) Cash and Bank A/c.

(8 Marks) (Nov. 2007)

Answer

### (a) Restricted Government Grant (Capital) Account

| Dr.                                                                                                                              |                       | Cr.                             |
|----------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------------------------|
|                                                                                                                                  | Rs.                   | Rs.                             |
| 31.3.07 To Income and Expenditure A/c -<br>Grant against laboratory<br>building<br>(recognized to the extent of<br>amount spent) | 37,00,000             | 1.4.06 By Balance b/d 40,00,000 |
| To Balance c/d                                                                                                                   | <u>3,00,000</u>       |                                 |
|                                                                                                                                  | <u>40,00,000</u>      | <u>40,00,000</u>                |
|                                                                                                                                  | 1.4.07 By Balance b/d | 3,00,000                        |

### Unrestricted Government Grant (Revenue) Account

|                                                                                | Rs.             |                       | Rs.             |
|--------------------------------------------------------------------------------|-----------------|-----------------------|-----------------|
| 31.3.07 To Income & Expenditure A/c<br>(salary paid to research<br>associates) | 4,00,000        | 1.4.06 By Balance b/d | 9,00,000        |
| To Balance c/d                                                                 | <u>5,00,000</u> |                       |                 |
|                                                                                | <u>9,00,000</u> |                       | <u>9,00,000</u> |

## Advanced Accounting

1.4.07 By Balance b/d 5,00,000

### Current Account of Endowment and Scholarship

|         |    |                                                               | Rs.             |         |    |                      | Rs.             |
|---------|----|---------------------------------------------------------------|-----------------|---------|----|----------------------|-----------------|
| 1.4.06  | To | Balance b/d                                                   | 1,37,500        | 9.12.06 | By | Scholarship & awards | 1,43,000        |
| 30.9.06 | To | Interest on fixed deposit (9.5% of Rs.18,50,000 for 6 months) | 87,875          | 31.3.07 | By | Balance c/d          | 1,70,250        |
| 31.3.07 | To | Interest on fixed deposit (9.5% of Rs.18,50,000 for 6 months) | <u>87,875</u>   |         |    |                      |                 |
|         |    |                                                               | <u>3,13,250</u> |         |    |                      | <u>3,13,250</u> |
| 1.4.07  | To | Balance b/d                                                   | 1,70,250        |         |    |                      |                 |

### Cash and Bank Account

|         |    |             | Rs.                |          |    |                                     | Rs.                |
|---------|----|-------------|--------------------|----------|----|-------------------------------------|--------------------|
| 1.4.06  | To | Balance b/d | 85,00,000          | 29.4.06  | By | Capital WIP (37,00,000 – 28,00,000) | 9,00,000           |
| 31.3.07 | To | Tuition fee | 85,00,000*         | 21.11.06 | By | Administrative Building A/c         | 4,75,000           |
|         |    |             |                    | 31.3.07  | By | Salary                              | 65,00,000          |
|         |    |             |                    | 31.3.07  | By | Salary to research associates       | 4,00,000           |
|         |    |             |                    |          |    |                                     |                    |
|         |    |             |                    | 31.3.07  | By | Balance c/d                         | 87,25,000          |
|         |    |             | <u>1,70,00,000</u> |          |    |                                     | <u>1,70,00,000</u> |
| 1.4.07  | To | Balance b/d | 87,25,000          |          |    |                                     |                    |

## Question 9

From the following details in respect of loan funds of Excellent School of Management for 2007-08, prepare a statement showing changes in fund balance during the year:

|                                                 | Rs.       |
|-------------------------------------------------|-----------|
| Fund balance at the end of the year             | 30,30,000 |
| Loan fund matching grant from revenues funds    | 30,000    |
| Private and Government grants                   | 11,00,000 |
| Other transfers from unrestricted revenue funds | 1,50,000  |

\* Besides unrestricted government grant, tuition fee is also one of the primary source of income for unrestricted fund account. The question requires the preparation of unrestricted govt. grant account, therefore it is assumed that tuition fee has been credited to unrestricted fund account other than unrestricted government grant account.

**Accounting for Not-For-Profit Organisations**

|                                     |        |
|-------------------------------------|--------|
| Interest on loans                   | 60,000 |
| Investment income                   | 35,000 |
| Loan cancellations and write offs   | 15,000 |
| Refunded to grantors                | 60,000 |
| Administrative and Collection costs | 25,000 |

(8 Marks) (Nov. 2008)

Answer

Excellent School of Management  
Statement of Changes - Loan Funds

|                                                                                          | Rs.              |
|------------------------------------------------------------------------------------------|------------------|
| (i) Fund Balance at the beginning of the year<br>(Balancing Figure – Refer Working Note) | 17,55,000        |
| (ii) Additions during 2007-08                                                            |                  |
| Private and Government Grants                                                            | 11,00,000        |
| Interest on loans                                                                        | 60,000           |
| Investment Income                                                                        | <u>35,000</u>    |
|                                                                                          | <u>11,95,000</u> |
| (iii) Deductions during 2007-08                                                          |                  |
| Loan cancellations and write offs                                                        | 15,000           |
| Refunded to Grantors                                                                     | 60,000           |
| Administrative and Collection Costs                                                      | <u>25,000</u>    |
|                                                                                          | <u>1,00,000</u>  |
| (iv) Transfer from other funds during 2007-08                                            |                  |
| Loan fund Matching Grant                                                                 | 30,000           |
| Other transfers from unrestricted Revenue Funds                                          | <u>1,50,000</u>  |
|                                                                                          | <u>1,80,000</u>  |
| (v) Net Additions [(ii)- (iii)+ (iv)]                                                    | 12,75,000        |
| (vi) Fund Balance at the end of the year                                                 | 30,30,000        |
| Working Note:                                                                            |                  |
| Fund Balance at the end of the year                                                      | 30,30,000        |
| Less: Net Additions                                                                      | <u>12,75,000</u> |
| Fund Balance at the beginning of the year                                                | <u>17,55,000</u> |

## Advanced Accounting

### Question 10

Devine Public Health Hospital runs only an intensive care unit. For this purpose, it has hired a building at a rent of Rs. 10,000 per month. The unit has undertaken to bear the cost of repairs and maintenance charges.

The unit consisted of 50 beds and 5 more beds can be safely accommodated, when the situation demands at a charge of Rs. 5 per bed per day.

During the year 1998-99, it revealed that only for 120 days in the year, the unit had full capacity of 50 patients per day and for another 80 days, it had on an average 40 beds only occupied per day. The total hire charges for the extra beds incurred for the whole year amount to Rs. 4,000.

Expert doctors from outstation were engaged and the fees were paid on the basis of the number of patients attended and time spent by them and on an average, it worked out to Rs. 20,000 per month in 1998-99. The other expenses for the year were as under:

|                                                                          |                   |
|--------------------------------------------------------------------------|-------------------|
| Permanent staff                                                          |                   |
| 4 Supervisors, each at a salary of                                       | Rs. 500 per month |
| 8 Nurses, each at a salary of                                            | Rs. 300 per month |
| 4 Ward boys, each at a salary of                                         | Rs. 150 per month |
| Repairs and maintenance                                                  | Rs. 7,200         |
| Cost of food supplied to patients                                        | Rs. 88,000        |
| Laundry charges                                                          | Rs. 56,000        |
| Medicine supplied                                                        | Rs. 70,000        |
| Cost of Oxygen X-Ray other than directly borne for treatment of patients | Rs. 1,08,000      |
| Janitor and other services for them                                      | Rs. 25,000        |
| Administration charges allotted to the unit                              | Rs. 99,100        |

The unit has recovered an overall amount of Rs. 100 per day on an average from each patient. The cost of Janitor and other services is variable as it is related to number of patient-days.

Prepare a Revenue Statement for the year 1998-99 and indicate the profit per patient day made by the unit.

Pass Journal entries for the next year, if the unit receives (a) donated medicines and medicinal supplies of Rs. 25,000 and (b) medicine expenses of Rs. 85,000 for the year includes Rs. 5,000 donated supplies. (10 marks) (May, 2000)

## Accounting for Not-For-Profit Organisations

Answer

### Devine Public Health Hospital – intensive care unit Revenue Statement for the year ended on 31st March, 1999

|                                                      | Rs.             | Rs.             |
|------------------------------------------------------|-----------------|-----------------|
| Income received (Rs. 100 × 10,000 patient – days)    |                 | 10,00,000       |
| Variable costs                                       |                 |                 |
| Cost of food                                         | 88,000          |                 |
| Laundry charges                                      | 56,000          |                 |
| Cost of medicines                                    | 70,000          |                 |
| Cost of Janitor & other services                     | 25,000          |                 |
| Doctors' fees (Rs. 20,000 × 12)                      | 2,40,000        |                 |
| Hire charges for extra beds                          | <u>4,000</u>    |                 |
|                                                      |                 | 4,83,000        |
| Fixed costs                                          |                 |                 |
| Salaries [{(4 × 500) + (8 × 300) + (4 × 150)} × 12]  | 60,000          |                 |
| Rent (Rs. 10,000 × 12)                               | 1,20,000        |                 |
| Repairs and Maintenance charges                      | 7,200           |                 |
| Administration charges                               | 99,100          |                 |
| Cost of Oxygen and X-ray etc.                        | <u>1,08,000</u> |                 |
|                                                      |                 | <u>3,94,300</u> |
| Profit                                               |                 | <u>1,22,700</u> |
| Number of patient – days in 1998-99                  |                 |                 |
| 50 beds × 120 days                                   | 6,000           |                 |
| 40 beds × 80 days                                    | 3,200           |                 |
| Extra bed – days (Rs. 4,000/5)                       | <u>800</u>      |                 |
| Total patient – days                                 | <u>10,000</u>   |                 |
| Profit per patient – day = $\frac{1,22,700}{10,000}$ |                 | = Rs.12.27      |

## Advanced Accounting

### Journal Entries

|                                                               |     | Dr.<br>Rs. | Cr.<br>Rs. |
|---------------------------------------------------------------|-----|------------|------------|
| Inventories                                                   | Dr. | 25,000     |            |
| To Operating revenue                                          |     |            | 25,000     |
| (Being donated medicines and medicinal supplies received)     |     |            |            |
| Operating Expenses (Medicines)                                | Dr. | 85,000     |            |
| To Inventories                                                |     |            | 5,000      |
| To Bank                                                       |     |            | 80,000     |
| (Being medicine expenses including donated supplies recorded) |     |            |            |

### Question 11

Sky Hospital – a non-profit seeking entity receives medicines worth Rs.5,00,000 by way of donations from a donor. During the year its issues of all medicines totals Rs.16,00,000. The closing inventory of donated medicines is Rs.1,00,000. Show relevant summary Journal Entries in the books of the Hospital in respect of the above.

(5 Marks)(May, 2008)

### Answer

### Journal Entries

| Date | Particulars                                              |     | Dr. (Rs.) | Cr. (Rs.) |
|------|----------------------------------------------------------|-----|-----------|-----------|
|      | Inventory of Medicines (Donated) A/c                     | Dr. | 5,00,000  |           |
|      | To Operating Revenue A/c                                 |     |           | 5,00,000  |
|      | (Being receipt of donated medicines during the year)     |     |           |           |
|      | Operating Expenses – Medicines A/c                       | Dr. | 16,00,000 |           |
|      | To Inventory of Medicines A/c (Donated)                  |     |           | 4,00,000  |
|      | To Inventory of Medicines (Purchased)                    |     |           | 12,00,000 |
|      | (Being consumption / issue of medicines during the year) |     |           |           |

### Question 12

Write short Note on Special features of accounting for non-profit entities (other than Hospitals and Educational Institutions).  
(6 marks) (November, 1997)



## **Accounting for Not-For-Profit Organisations**

### **Answer**

Special Features of Accounting for Not-For-Profit Entities' (other than Hospitals and Educational Institutions): Other not-for-profit organisations (other than Hospitals and Educational Institutions) include Civic organisations, Cultural organisations, Labour unions, Political parties, Religious associations etc. For these organisations, fund based accounting is used. These mainly use four types of fund: Operating-Fund (restricted and unrestricted), Development Fund, Endowment Fund and Life Membership Fund. For the operating funds, the accrual basis of accounting is used to recognise revenue and expenses. While the unrestricted operating fund accounts for all unrestricted resources received and expenses incurred for the primary purpose of the organisation, the restricted operating fund accounts for resources received from donors with restrictions imposed on their use. Development Funds are utilised for developmental purposes like acquisition of building and equipments, major repairs to fixed assets etc. These fixed assets are shown in the balance sheet of development fund. The major sources of receipts for this fund are government or private grants/gifts (restricted to acquisition of fixed properties), income and gains of investments of unutilised fund (if any), transfers from other funds.

Membership fees, the main source of revenue, are directly taken to unrestricted operating fund. However, life time contribution is directly credited to life membership fund which is simultaneously invested in outside securities. Income from such investment is credited to unrestricted operating fund. When a life member expires or his membership is terminated for some reasons, the proportionate fund balance is transferred from life membership fund to unrestricted operating fund. As regards contributions and transfers, they are directly credited to endowment fund.

The financial statements prepared by these organisations include balance sheets (fundwise), statement of activities and statement of cash flows (fundwise). The primary operating statement is the statement of activity which accounts for revenue and expenses and the resultant surplus or deficit.

## Advanced Accounting

NOTE

This image shows a full page of white paper with horizontal black ruling lines. The lines are evenly spaced and run across the width of the page, providing a template for writing or drawing. There are no margins, text, or other markings on the page.

## IASs, US GAAPs AND STANDARDS IN INDIA

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Topic covered:

- Comparative position of basic concepts of IASs, USGAAPs and ASs in India (Q. No. 1)

## Advanced Accounting

### Question 1

Write short note on some key differences between IAS, US GAAP and Indian AS with respect to

- (i) Fixed Assets
- (ii) Changes in Accounting Policy and Prior period items. (4 marks)(November, 2004)

Answer

|                                                           | IAS                                                                                                                                                                                                                                         | US GAAPs                                                                                                                                                                                                                                                                                          | Indian AS                                                                                                                                                                                                                                                                                                                                                                     |
|-----------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (i) Fixed Assets                                          | Fixed assets are carried at historical cost. Revaluation of fixed assets is allowed but the capitalisation of exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets is not permitted. | Fixed assets are carried at historical cost. Only downward revaluation is permitted for impairment. Exchange fluctuations on loans taken for purchase of fixed assets are expensed when incurred.                                                                                                 | Fixed assets are usually carried at historical cost, revaluations of Fixed Assets are permitted in AS 10. AS 28 permits impairment of assets if specified conditions are satisfied. AS 11 (Revised 2003) requires that exchange differences arising on repayment of liabilities incurred for acquiring fixed assets should be recognized in the statement of profit and loss. |
| (ii) Changes in Accounting Policy and Prior period items. | Prior period items are accounted by restating to prior years and making adjustments to retained profits. The effect of change in accounting policies is disclosed separately in the profit and loss statement.                              | Prior period items are accounted by restating to prior years and adjustments to retained profits. Changes in accounting policies are not accounted by restating prior years but the effect of such changes is separately disclosed in the Profit and Loss statement in the same manner as in IAS. | As per AS 5, changes in accounting policies and prior period items are reported on prospective basis, if material, beginning with the year of change. Unlike in US GAAPs and IAS, AS 5 requires the restatement of comparatives to account for accounting errors, the adjustment is required to be made in the current year with disclosures of the prior period amounts.     |

**Question 2**

Briefly explain any two of the following terms:

- (i) IFRS
- (ii) Convergence of Accounting Standards with IFRS. (2x4= 8 Marks)(Nov. 2008)

**Answer**

- (i) IFRS: The term IFRS refers to the International Financial Reporting Standards issued by International Accounting Standard Board (IASB). It also encompasses the International Accounting Standards (IAS) issued by the International Accounting Standard Committee (IASC). Interpretations of IASs and IFRSs are developed by the International Financial Reporting Interpretations Committee (IFRIC). IFRIC is the new name for the Standing Interpretations Committee (SIC) approved by the IASC Foundation Trustees in March 2002. IFRS includes these interpretations also.
- (ii) Convergence of Accounting Standards with IFRS: In general, convergence of Accounting Standards (AS) with International Financial Reporting Standards (IFRS) means to achieve harmony with IFRS. The term convergence can be considered as "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national AS are in convergence with IFRS". IAS 1 requires financial statements to comply with all requirements of IFRS. This does not mean that IFRS should be adopted word by word. The local standard setters can add disclosure requirements or can remove some requirements which do not create non compliance with IFRS. Thus, convergence with IFRS means adoption of IFRS with exceptions wherever necessary.

## Advanced Accounting

NOTE

[illegible]

PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

(a) Following is the information of two companies for the year ended 31<sup>st</sup> March, 2009:

|                                                                                                              | Aikya Ltd.<br>(Rs.) | Bakya Ltd.<br>(Rs.) |
|--------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| Equity shares of Rs.10 each                                                                                  | 8,00,000            | 10,00,000           |
| 10 per cent Preference shares of Rs.10 each                                                                  | 6,00,000            | 4,00,000            |
| Profit after tax                                                                                             | 3,00,000            | 3,00,000            |
| Assume that the market expectation is 18 percent and 80 percent of the profits are distributed as dividends. |                     |                     |

- (i) What is the rate you would pay to the equity shares -
    - (a) If you are buying a small lot?
    - (b) If you are buying a controlling interest in shares?
  - (ii) If you plan to invest only in Preference shares, which company's preference share would you choose?
- (b) From the following particulars of three companies, ascertain the value of goodwill. Terms and conditions are as follows:
- (i) Assets are to be revalued.
  - (ii) Goodwill is to be valued at four years' purchase of average super profits for three years. Such average is to be calculated after adjustment of depreciation at ten per cent on the amount of increase/decrease on revaluation of fixed assets. Income tax is to be ignored.
  - (iii) Normal profit on capital employed is to be taken at 10 per cent, capital employed being considered on the basis of net revalued amounts of tangible assets.

The summarized Balance Sheets and relevant information are given below:

|                             |        |        |        | (Rs. in Lakhs)     |        |        |        |
|-----------------------------|--------|--------|--------|--------------------|--------|--------|--------|
| Liabilities                 | P Ltd. | Q Ltd. | R Ltd. | Assets             | P Ltd. | Q Ltd. | R Ltd. |
| Equity shares of Rs.10 each | 12.00  | 14.00  | 6.00   | Goodwill           | -      | 1.00   | -      |
| Reserves                    | 2.00   | 1.00   | 2.00   | Net tangible block | 16.00  | 12.00  | 10.00  |
| 10 percent debentures       | 4.00   | -      | 2.00   | Current assets     | 6.00   | 5.00   | 2.00   |

**FINAL EXAMINATION : JUNE, 2009**

Trade and  
expenses  
creditors

|       |       |       |
|-------|-------|-------|
| 4.00  | 3.00  | 2.00  |
| 22.00 | 18.00 | 12.00 |

|       |       |       |
|-------|-------|-------|
| 22.00 | 18.00 | 12.00 |
|-------|-------|-------|

|                                                                             | P Ltd.<br>Rs. | Q Ltd.<br>Rs.     | R Ltd.<br>Rs. |
|-----------------------------------------------------------------------------|---------------|-------------------|---------------|
| Revaluation of tangible block                                               | 20,00,000     | 10,00,000         | 12,00,000     |
| Revaluation of current assets                                               | 7,00,000      | 2,80,000          | 1,60,000      |
| Average annual profit for three years<br>before charging debenture interest | 3,60,000      | 2,88,000          | 1,56,000      |
|                                                                             |               | (10+6 = 16 Marks) |               |

Answer

- (a) (i) (a) Buying a small lot of equity shares: If the purpose of valuation is to provide database to aid a decision of buying a small (non-controlling) portion of the equity of the companies, dividend capitalization method is most appropriate. Under this method, value of equity share is given by:

$$\frac{\text{Dividend Per Share}}{\text{Market Capitalisation Rate}} \times 100$$

$$\text{Aikya Ltd: } \frac{\text{Rs.2.40}}{18} \times 100 = \text{Rs.13.33 (approx.)}$$

$$\text{Bakya Ltd: } \frac{\text{Rs.2.08}}{18} \times 100 = \text{Rs.11.56 (approx.)}$$

[Refer Working Note for computation of dividend per share]

- (b) Buying controlling interest in equity shares: If the purpose of valuation is to provide database to aid a decision of buying controlling interest in the company, Earnings per share (EPS) capitalization method is the most appropriate. Under this method, value of equity share is given by:

$$\frac{\text{Earning Per Share (EPS)}}{\text{Market Capitalisation Rate}} \times 100$$

$$\text{Aikya Ltd: } \frac{\text{Rs.3}}{18} \times 100 = \text{Rs.16.67 (approx.)}$$

$$\text{Bakya Ltd: } \frac{\text{Rs.2.60}}{\text{Rs.18}} \times 100 = \text{Rs.14.44 (approx.)}$$

[Refer Working Note for computation of earnings per share]



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- (ii) Preference Dividend coverage ratios of both companies are to be compared to make such decision. Dividend coverage ratio is given by:

$$\frac{\text{Profit after Tax}}{\text{Preference Dividend}}$$

$$\text{Aikya Ltd: } \frac{\text{Rs. 3,00,000}}{\text{Rs. 60,000}} = 5 \text{ times}$$

$$\text{Bakya Ltd: } \frac{\text{Rs. 3,00,000}}{\text{Rs. 40,000}} = 7.5 \text{ times}$$

If we are planning to invest only in Preference Shares, we would prefer shares of Bakya Ltd., as there is more coverage for preference dividend.

Working Note:

Computation of earnings per share and dividend per share

|                                               | Aikya Ltd.<br>Rs. | Bakya Ltd.<br>Rs. |
|-----------------------------------------------|-------------------|-------------------|
| Profit after tax                              | 3,00,000          | 3,00,000          |
| Less: Preference Dividend                     | <u>60,000</u>     | <u>40,000</u>     |
| Earnings available to equity shareholders (A) | <u>2,40,000</u>   | <u>2,60,000</u>   |
| Number of equity shares (B)                   | 80,000            | 1,00,000          |
| Earning per share (A/B)                       | 3.00              | 2.60              |
| Retained earnings (20%)                       | 48,000            | 52,000            |
| Dividend declared (80%) (C)                   | 1,92,000          | 2,08,000          |
| Dividend per share (C/B)                      | 2.40              | 2.08              |

- (b) Valuation of Goodwill

|                                                                              | P Ltd.<br>Rs.   | Q Ltd.<br>Rs.   | R Ltd.<br>Rs.   |
|------------------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Average annual profit after charging debenture interest                      | 3,20,000        | 2,88,000        | 1,36,000        |
| Less/Add : Depreciation on increased/decreased portion of revaluation        | (-)40,000       | +20,000         | (-) 20,000      |
|                                                                              | <u>2,80,000</u> | <u>3,08,000</u> | <u>1,16,000</u> |
| Less: Normal profit at 10% on capital employed as calculated in working note | 1,90,000        | 98,000          | 96,000          |
| Super Profit                                                                 | <u>90,000</u>   | <u>2,10,000</u> | <u>20,000</u>   |
| Goodwill valued at four years' purchase of super profits                     | <u>3,60,000</u> | <u>8,40,000</u> | <u>80,000</u>   |

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Working Note:

Calculation of Capital Employed

|                                | P Ltd.<br>Rs. | Q Ltd.<br>Rs. | R Ltd.<br>Rs. |
|--------------------------------|---------------|---------------|---------------|
| Tangible fixed assets          | 20,00,000     | 10,00,000     | 12,00,000     |
| Current assets                 | 7,00,000      | 2,80,000      | 1,60,000      |
|                                | 27,00,000     | 12,80,000     | 13,60,000     |
| Less: Debentures and Creditors | 8,00,000      | 3,00,000      | 4,00,000      |
|                                | 19,00,000     | 9,80,000      | 9,60,000      |

**Question 2**

Agni Ltd. and Bayu Ltd. both engaged in similar merchandising activities since 2006, decide to amalgamate their businesses. A holding company, Chandrama Ltd. would be formed on 1<sup>st</sup> January, 2008 to acquire the entire shares in both the companies.

From the information given below you are required to prepare:

- (a) A statement of purchase consideration, supported by requisite working notes.
- (b) Balance Sheet of Chandrama Ltd. after the transactions have been completed.
  - (i) The terms of the offer were:
    - Rs.100, 15 per cent debentures for every Rs.100 of net assets owned by each company on 31<sup>st</sup> December, 2007.
    - Rs.100 equity shares based on two years purchase of profit before taxation. The profit is to be determined by taking weighted average profits of 2006 and 2007, weights being 1 and 2 respectively.
  - (ii) It was agreed that the accounts of Bayu Ltd. for the two years ended 31<sup>st</sup> December, 2007 be adjusted, where necessary, to conform to the accounting policies followed by Agni Ltd.
  - (iii) The Pre-tax profits, including investment income, of the two companies were as follows:

|           | 2006<br>Rs. | 2007<br>Rs. |
|-----------|-------------|-------------|
| Agni Ltd. | 16,38,000   | 18,36,000   |
| Bayu Ltd. | 17,88,300   | 25,74,000   |

- (iv) Agni Ltd. values its stock on FIFO basis while Bayu Ltd. used a different basis. To bring Bayu Ltd.'s values in line with those of Agni Ltd, value of its stock will require to be reduced by Rs.36,000 at the end of 2006 and Rs.1,02,000 at the end of 2007.
  - (v) Both the companies use straight line method of depreciation.

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- (vi) Bayu Ltd. deducts 1 per cent from trade debtors as a general provision against doubtful debts.
- (vii) Prepaid expenses in Bayu Ltd. include advertisement expenditure carried forward of Rs.1,80,000 in 2006 and Rs.90,000 in 2007, being part of initial advertising in 2006, which is being written off over three years. Similar expenditure in Agni Ltd. has been fully written off in 2006.
- (viii) To bring Director's remuneration on to a comparative basis, the profits of Bayu Ltd. are to be reduced by Rs.1,20,000 in 2006 and Rs.1,80,000 in 2007 and the net assets are also to be adjusted accordingly.

Balance Sheets as at 31<sup>st</sup> December, 2006 and 2007 were as follows:

| Agni Ltd.                                                                                  |                  |                  |                                                     |                  |                  |
|--------------------------------------------------------------------------------------------|------------------|------------------|-----------------------------------------------------|------------------|------------------|
| Liabilities                                                                                | 2006             | 2007             | Assets                                              | 2006             | 2007             |
|                                                                                            | Rs.              | Rs.              |                                                     | Rs.              | Rs.              |
| Share capital issued and subscribed:<br>12,000 shares of Rs.100 each, fully paid           | 12,00,000        | 12,00,000        | Fixed assets:<br>Furniture and Fixtures:<br>at cost | 6,90,000         | 6,90,000         |
| Reserves and Surplus:                                                                      |                  |                  | Less: depreciation                                  | (69,000)         | (1,38,000)       |
| Capital reserve                                                                            | -                | 2,10,000         | Investments:                                        |                  |                  |
| Revenue reserve                                                                            | 7,98,300         | 16,74,000        | Quoted investments at market value                  | -                | 7,80,000         |
| Current Liabilities and provisions:                                                        |                  |                  | Current assets:                                     |                  |                  |
| Sundry creditors                                                                           | 15,02,700        | 18,21,000        | Stock at cost                                       | 18,30,000        | 21,75,000        |
| Provision for taxation                                                                     | 8,40,000         | 9,60,000         | Sundry debtors                                      | 18,00,000        | 22,20,000        |
|                                                                                            |                  |                  | Prepaid expenses                                    | 30,000           | 42,000           |
|                                                                                            |                  |                  | Cash at bank                                        | 60,000           | 96,000           |
|                                                                                            | <u>43,41,000</u> | <u>58,65,000</u> |                                                     | <u>43,41,000</u> | <u>58,65,000</u> |
| Bayu Ltd.                                                                                  |                  |                  |                                                     |                  |                  |
| Liabilities                                                                                | 2006             | 2007             | Assets                                              | 2006             | 2007             |
|                                                                                            | Rs.              | Rs.              |                                                     | Rs.              | Rs.              |
| Share capital:<br>Issued and subscribed<br>15,000 Equity shares of Rs.100 each, fully paid | 15,00,000        | 15,00,000        | Fixed assets:<br>Furniture and fixture at cost      | 9,60,000         | 9,60,000         |
| Reserves and surplus:                                                                      |                  |                  | Less: Depreciation                                  | (1,44,000)       | (2,88,000)       |

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|                                     |                  |                  |                              |                  |                  |
|-------------------------------------|------------------|------------------|------------------------------|------------------|------------------|
| Revenue reserve                     | 8,58,000         | 21,42,000        | Investments:                 |                  |                  |
| Current liabilities and provisions: |                  |                  | Quoted investments           |                  |                  |
| Sundry creditors                    | 14,70,000        | 14,82,000        | (Market value Rs.14,70,000 ) | -                | 12,00,000        |
| Bank overdraft                      | -                | 5,10,000         | Current assets:              |                  |                  |
| Provision for taxation              | 9,30,000         | 12,90,000        | Stock at cost                | 17,91,000        | 22,26,000        |
|                                     |                  |                  | Sundry debtors               |                  |                  |
|                                     |                  |                  | Less: provision              | 17,82,000        | 26,73,000        |
|                                     |                  |                  | Prepaid expenses             | 2,16,000         | 1,44,000         |
|                                     |                  |                  | Cash at bank                 | 1,53,000         | 9,000            |
|                                     |                  |                  |                              |                  |                  |
|                                     | <u>47,58,000</u> | <u>69,24,000</u> |                              | <u>47,58,000</u> | <u>69,24,000</u> |

(16 Marks)

Answer

(a) Statement of Purchase Consideration

|                                                  | Agni Ltd. |        |                  | Bayu Ltd.  |        |                  |
|--------------------------------------------------|-----------|--------|------------------|------------|--------|------------------|
| Year                                             | PBT (Rs.) | Weight | Rs.              | PBT (Rs.)  | Weight | Rs.              |
| 2006                                             | 16,38,000 | 1      | 16,38,000        | 15,18,300* | 1      | 15,18,300        |
| 2007                                             | 18,36,000 | 2      | 36,72,000        | 27,63,000* | 2      | 55,26,000        |
| Total Profit                                     |           |        | <u>53,10,000</u> |            |        | <u>70,44,300</u> |
| Weighted average profit (Divided by 3)           |           |        | 17,70,000        |            |        | 23,48,100        |
| (i) Two years' purchase of average profits       |           |        | 35,40,000        |            |        | 46,96,200        |
| (ii) Net assets<br>(Refer working notes 2 and 3) |           |        | <u>30,84,000</u> |            |        | <u>35,43,000</u> |
|                                                  |           |        | <u>66,24,000</u> |            |        | <u>82,39,200</u> |

(iii) Discharge of purchase consideration

82,362 Shares will be issued for goodwill amounting Rs. 82,36,200  
(Rs.35,40,000 + Rs. 46,96,200)

66,270 15% Debentures will be issued for net assets amounting Rs. 66,27,000  
(30,84,000 +35,43,000)

Total purchase consideration will amount to Rs.1,48,63,200.

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\* (Refer W.N. 1)

## PAPER – 1 : ADVANCED ACCOUNTING

(b) Balance Sheet of Chandrama Ltd. as on 1<sup>st</sup> January, 2008

| Liabilities                                        | Rs.         | Assets              | Rs.         |
|----------------------------------------------------|-------------|---------------------|-------------|
| Share Capital- issued and subscribed               |             | Investments         |             |
| 82,362 Equity shares of Rs.100 each, fully paid up | 82,36,200   | Shares in Agni Ltd. | 66,24,000   |
| (Issued for consideration other than cash)         |             | Shares in Bayu Ltd. | 82,39,200   |
| Secured Loans                                      |             |                     |             |
| 66,270 15% Debentures of Rs.100 each, fully paid   | 66,27,000   |                     |             |
|                                                    | 1,48,63,200 |                     | 1,48,63,200 |

Working Notes:

1. Statement of adjusted Net Profits of Bayu Ltd.

|                                         | Year 2006 |           | Year 2007 |           |
|-----------------------------------------|-----------|-----------|-----------|-----------|
|                                         | Rs.       | Rs.       | Rs.       | Rs.       |
| Net Profit as given                     |           | 17,88,300 | -         | 25,74,000 |
| Add: Provision for Bad Debts - Note (a) | 18,000    |           | 27,000    |           |
| Advertising                             | -         |           | 90,000    |           |
| Depreciation- Note (b)                  | 48,000    |           | 48,000    |           |
| Appreciation in Investment              | -         |           | 2,70,000  |           |
| Value of Opening Stock                  | -         | 66,000    | 36,000    | 4,71,000  |
|                                         |           | 18,54,300 |           | 30,45,000 |
| Less: Value of Closing Stock            | 36,000    |           | 1,02,000  |           |
| Advertising                             | 1,80,000  |           | -         |           |
| Directors' Remuneration                 | 1,20,000  | 3,36,000  | 1,80,000  | 2,82,000  |
|                                         |           | 15,18,300 |           | 27,63,000 |

Note:

|                                         | Rs.       | Rs.       |
|-----------------------------------------|-----------|-----------|
|                                         | Year 2006 | Year 2007 |
| (a) Sundry Debtors as per Balance sheet | 17,82,000 | 26,73,000 |
| Provision created                       |           |           |
| 1% of (Rs. 17,82,000 / .99)             | 18,000    |           |
| 1% of (Rs. 26,73,000 / .99)             |           | 27,000    |

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- (b) Rate of depreciation under straight line method for Agni Ltd. and Bayu Ltd. can be computed as follows:  
 Agni Ltd. = Rs.(69,000 / 6,90,000) × 100= 10%.  
 Bayu Ltd. = Rs.(1,44,000 / 9,60,000) × 100= 15%  
 Difference of 5% in depreciation amount i.e. (5% of Rs.9,60,000 = Rs. 48,000) has been added back to ensure uniform accounting policies.

2. Statement of Net Assets of Agni Ltd.

|                        | Rs.             | Rs.              |
|------------------------|-----------------|------------------|
| Total Assets           |                 | 58,65,000        |
| Less: Sundry Creditors | 18,21,000       |                  |
| Provision for Taxation | <u>9,60,000</u> | 27,81,000        |
|                        |                 | <u>30,84,000</u> |

3. Statement of Adjusted Net Assets of Bayu Ltd.

|                                                                          | Rs.              | Rs.              |
|--------------------------------------------------------------------------|------------------|------------------|
| Furniture and Fixtures                                                   | 9,60,000         |                  |
| Less: Depreciation at 10% p.a. for two years                             | <u>1,92,000</u>  | 7,68,000         |
| Quoted investments at market value                                       |                  | 14,70,000        |
| Stock (Rs.22,26,000 – Rs.1,02,000)                                       |                  | 21,24,000        |
| Sundry Debtors after Reversal of Provision<br>(Rs.26,73,000 + Rs.27,000) |                  | 27,00,000        |
| Prepaid Expenses (Rs.1,44,000 – 90,000)                                  |                  | 54,000           |
| Cash at Bank                                                             |                  | <u>9,000</u>     |
|                                                                          |                  | 71,25,000        |
| Less: Sundry Creditors                                                   | 14,82,000        |                  |
| Bank Overdraft                                                           | 5,10,000         |                  |
| Liability for Directors' Remuneration<br>(1,20,000 + 1,80,000)           | 3,00,000         |                  |
| Provision for Taxation                                                   | <u>12,90,000</u> | 35,82,000        |
|                                                                          |                  | <u>35,43,000</u> |

Question 3

- (a) Parikshit Ltd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

## PAPER – 1 : ADVANCED ACCOUNTING

The company securitises the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs.1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. The remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

- (b) The Annuity fund of Patiala University accepts an annuity – based gift from an alumnus who specifies that he receives a monthly payment of Rs.25,000 for the remainder of his life. The gift consists of cash of Rs.20 lakh and securities having a market value of Rs.15 lakh at the time of the gift. The investment income of annuity fund for a particular month comes to Rs.38,500.

Draft journal entries in the University's books.

- (c) From the following information taken from the books of Sunagarik Ltd. relating to staff and community benefits, you are required to prepare a statement classifying the various items under the appropriate heads, required under corporate social reporting:

| Particulars                                                            | Rs. in lakhs |
|------------------------------------------------------------------------|--------------|
| Environmental improvements                                             | 36.18        |
| Medical facilities                                                     | 9.00         |
| Training programmes                                                    | 18.45        |
| Generation of job opportunities                                        | 109.35       |
| Municipal taxes                                                        | 19.26        |
| Increase in cost of living in the vicinity due to company's operations | 29.79        |
| Concessional transport, water-supply etc.                              | 20.25        |
| Generation of business                                                 | 45.00        |
| Leave encashment and leave travel benefits                             | 93.60        |
| Education facilities for children of staff members                     | 38.88        |
| Subsidised canteen facilities                                          | 25.92        |
| Extra work put in by staff and officers for drought relief             | 33.30        |

(6+5+5= 16 Marks)

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Answer

(a)

**Journal Entries in the Books of Originator**

| S.No. | Particulars                                                                                   |     | Debit<br>Rs. | Credit<br>Rs. |
|-------|-----------------------------------------------------------------------------------------------|-----|--------------|---------------|
| 1.    | Bank A/c                                                                                      | Dr. | 1,00,000     |               |
|       | To Loans (Cost of Securitised Component)                                                      |     |              | 90,910        |
|       | To Profit on Securitisation                                                                   |     |              | 9,090         |
|       | (Being securitization of principal amount and right to receive interest at 14% interest rate) |     |              |               |
| 2.    | Servicing Asset A/c                                                                           | Dr. | 3,180        |               |
|       | Interest Strip A/c                                                                            | Dr. | 5,910        |               |
|       | To Loans                                                                                      |     |              | 9,090         |
|       | (Being creation of servicing asset and interest strip receivable)                             |     |              |               |

Working Notes:

|    |                                             |              |                 |
|----|---------------------------------------------|--------------|-----------------|
| 1. | Fair value of securitized component of loan |              | Rs.             |
|    | Fair value of Loan                          |              | 1,10,000        |
|    | Less: Fair value of servicing asset         | 3,500        |                 |
|    | Fair value of interest strip                | <u>6,500</u> | <u>10,000</u>   |
|    |                                             |              | <u>1,00,000</u> |

2. Apportionment of carrying amount based on relative Fair Values

| Particulars                       | Fair<br>Value<br>Rs. | % based on<br>Total Fair Value<br>Rs. | Carrying<br>Amount/Cost<br>Rs. |
|-----------------------------------|----------------------|---------------------------------------|--------------------------------|
| Securitised component of the loan | 1,00,000             | 90.91%                                | 90,910                         |
| Servicing Asset                   | 3,500                | 3.18%                                 | 3,180                          |
| Interest Strip Receivable         | 6,500                | 5.91%                                 | 5,910                          |
|                                   | <u>1,10,000</u>      | <u>100.00%</u>                        | <u>1,00,000</u>                |

|    |                                                                           |  |               |
|----|---------------------------------------------------------------------------|--|---------------|
| 3. | Profit on Securitisation                                                  |  | Rs.           |
|    | Net proceeds from securitisation                                          |  | 1,00,000      |
|    | Less: Cost (apportioned carrying amount) of securitized component of loan |  | <u>90,910</u> |
|    |                                                                           |  | <u>9,090</u>  |



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(b)

Books of Patiala University  
Journal Entries

| S.No. | Particulars                                                                                                                              |     | Debit<br>Rs. | Credit<br>Rs. |
|-------|------------------------------------------------------------------------------------------------------------------------------------------|-----|--------------|---------------|
| 1.    | Bank A/c                                                                                                                                 | Dr. | 20,00,000    |               |
|       | Investments A/c                                                                                                                          | Dr. | 15,00,000    |               |
|       | To Annuity Fund A/c                                                                                                                      |     |              | 35,00,000     |
|       | (Being receipt of annuity based gift in the form of cash and marketable securities)                                                      |     |              |               |
| 2.    | Bank A/c                                                                                                                                 | Dr. | 38,500       |               |
|       | To Annuities Payable A/c                                                                                                                 |     |              | 25,000        |
|       | To Annuity Fund A/c                                                                                                                      |     |              | 13,500        |
|       | (Being monthly investment income received from the fund and surplus accruing after meeting the annuity payable, transferred to the fund) |     |              |               |
| 3.    | Annuities Payable A/c                                                                                                                    | Dr. | 25,000       |               |
|       | To Bank A/c                                                                                                                              |     |              | 25,000        |
|       | (Being monthly annuity payment made)                                                                                                     |     |              |               |

(c)

Sunagarik Ltd.

Statement relating to Staff and Community Benefits

| I. | Social Benefits and Cost to Staff                          | Rs. in lakhs |
|----|------------------------------------------------------------|--------------|
| A. | Social Benefits to Staff                                   |              |
| 1. | Medical Facilities                                         | 9.00         |
| 2. | Training Programmes                                        | 18.45        |
| 3. | Concessional Transport and Water Supply                    | 20.25        |
| 4. | Leave Encashment and Leave Travel Benefits                 | 93.60        |
| 5. | Educational Facilities for children of staff members       | 38.88        |
| 6. | Subsidized canteen facilities                              | 25.92        |
|    | Total                                                      | 206.10       |
| B. | Social Costs to Staff                                      |              |
|    | Extra work put in by staff and officers for drought relief | 33.30        |
|    | Net Social Benefits to Staff (A-B)                         | 172.80       |

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**II. Social Benefits and Cost to Community**

**A. Social Benefits to Community**

|                                    |               |
|------------------------------------|---------------|
| 1. Environmental Improvements      | 36.18         |
| 2. Generation of Job Opportunities | 109.35        |
| 3. Municipal Taxes                 | 19.26         |
| 4. Generation of Business          | 45.00         |
| <b>Total</b>                       | <b>209.79</b> |

**B. Social Costs to Community**

|                                                                        |       |
|------------------------------------------------------------------------|-------|
| Increase in cost of living in the vicinity due to company's operations | 29.79 |
|------------------------------------------------------------------------|-------|

|                                          |        |
|------------------------------------------|--------|
| Net Social Benefits to Community (A – B) | 180.00 |
|------------------------------------------|--------|

|                                                |        |
|------------------------------------------------|--------|
| Social Benefits to staff and community (I +II) | 352.80 |
|------------------------------------------------|--------|

**Question 4**

- (a) The borrowings profile of Santra Pharmaceuticals Ltd. set up for the manufacture of antibiotics at Navi Mumbai is as under:

| Date                          | Nature of borrowings | Amount borrowed | Purpose of borrowings              | Incidental expenses |
|-------------------------------|----------------------|-----------------|------------------------------------|---------------------|
|                               |                      | Rs.             |                                    |                     |
| 1 <sup>st</sup> January, 2008 | 15% demand loan      | 60 lakhs        | Acquisition of Fixed assets        | 8.33%               |
| 1 <sup>st</sup> July, 2008    | 14.5% Term loan      | 40 lakhs        | Acquisition of plant and machinery | 5%                  |
| 1 <sup>st</sup> October, 2008 | 14% bonds            | 50 lakhs        | Acquisition of fixed assets        | 8%                  |

The incidental expenses consist of commission and service charges for arranging the loans and are paid after rounding off to the nearest lakh.

Fixed assets considered as qualifying assets are as under: Rs.

|                             |           |
|-----------------------------|-----------|
| Sterile Manufacturing shed  | 10,00,000 |
| Plant and machinery (total) | 90,00,000 |
| Other fixed assets          | 10,00,000 |

The Project is completed on 1<sup>st</sup> January, 2009 and is ready for commercial production. Show the capitalization of the borrowing costs.

- (b) A company is engaged in the business of ship building and ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently, invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and the amount.

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Customer scrutinizes the invoice and any variation is informed to the company. Negotiations take place between the company and the customer. Negotiations may result in a deduction being allowed from the invoiced amount either as a lumpsum or as a percentage of the invoiced amount. The accounting treatment followed by the company is as follows:

- (i) When the invoice is raised, the customer's account is debited and ship repair income account is credited with the invoiced amount.
- (ii) Deduction, if any, arrived after negotiation is treated as trade discount by debiting the ship repair income account.
- (iii) At the close of the year, negotiation in respect of certain invoices had not been completed. In such cases, based on past experience, a provision for anticipated loss is created by debiting the Profit and Loss account. The provision is disclosed in Balance Sheet.

Following two aspects are settled in the negotiations:

- (i) Errors in billing arising on account of variation between the quantities as per work completion certificate and invoice and other clerical errors in preparing the invoice.
- (ii) Disagreement between the company and customer about the rate/cost on which prior agreement has not been reached between them.

Comment:

- (i) Whether the accounting treatment of deduction as trade discount is correct? If not, state the correct accounting treatment.
- (ii) Whether the disclosure of the provision for anticipated loss in Balance Sheet is correct; if not, state the correct accounting treatment. (10+6 = 16 Marks)

Answer

(a) Specific Borrowings

|                                                                                                                                    |                  |
|------------------------------------------------------------------------------------------------------------------------------------|------------------|
| 14.5% Term Loan for acquisition of Plant & Machinery                                                                               | Rs.              |
| Interest from 1 <sup>st</sup> July, 2008 to 31 <sup>st</sup> December, 2008 = Rs. 40,00,000 $\times$ 14.5% $\times$ $\frac{6}{12}$ | 2,90,000         |
| Incidental Expenses                                                                                                                | <u>2,00,000</u>  |
| Total                                                                                                                              | <u>4,90,000</u>  |
| General Borrowings                                                                                                                 |                  |
| 15% Demand Loan                                                                                                                    |                  |
| Interest from 1 <sup>st</sup> January, 2008 to 31 <sup>st</sup> December, 2008 = Rs. 60,00,000 $\times$ 15%                        | 9,00,000         |
| Incidental Expenses                                                                                                                | <u>5,00,000</u>  |
| Sub Total (A)                                                                                                                      | <u>14,00,000</u> |

**FINAL EXAMINATION : JUNE, 2009**

14% Bonds

Interest from 1<sup>st</sup> October, 08 to 31<sup>st</sup> December, 08 = Rs.50,00,000 x 14% x  $\frac{3}{12}$  1,75,000

Incidental Expenses 4,00,000

Sub Total (B) 5,75,000

Total General Borrowing Cost (A+B) 19,75,000

Total Average Outstanding Borrowings will be as under:

$$\frac{(60,00,000 \times 12 + 50,00,000 \times 3)}{12}$$
 72,50,000

Weighted Average Borrowing Cost = 
$$\frac{\text{Total Borrowing Cost} \times 100}{\text{Total Average Outstanding}}$$

$$\frac{19,75,000 \times 100}{72,50,000}$$
 27.24%

**Allocation of General Borrowing Fund**

| Item                       | Cost      | Specific Borrowing | Net of specific borrowing |
|----------------------------|-----------|--------------------|---------------------------|
| Sterile Manufacturing Shed | 10,00,000 | Nil                | 10,00,000                 |
| Plant & Machinery          | 90,00,000 | 40,00,000          | 50,00,000                 |
| Other Fixed Assets         | 10,00,000 | Nil                | 10,00,000                 |

| Item                       | Expenditure on qualifying asset out of general borrowing fund | Capitalization Rate | Cost eligible for capitalization |
|----------------------------|---------------------------------------------------------------|---------------------|----------------------------------|
| Sterile Manufacturing Shed | 10,00,000                                                     | 27.24               | 2,72,400                         |
| Plant & Machinery          | 50,00,000                                                     | 27.24               | 13,62,000                        |
| Other Fixed Assets         | 10,00,000                                                     | 27.24               | 2,72,400                         |

**Borrowing Costs to be Capitalized**

| Assets                     | Specific Borrowing Cost | General Borrowing Cost | Total     |
|----------------------------|-------------------------|------------------------|-----------|
| Sterile Manufacturing shed | Nil                     | 2,72,400               | 2,72,400  |
| Plant & Machinery          | 4,90,000                | 13,62,000              | 18,52,000 |
| Other Fixed Assets         | Nil                     | 2,72,400               | 2,72,400  |
| Total                      | 4,90,000                | 19,06,800*             | 23,96,800 |

\* Borrowing cost capitalized on general borrowings is Rs.19,06,800 which is less than the actual borrowing cost.

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- (b) (i) As per AS 9 “Revenue Recognition”, revenue is recognized at the time when the invoice is raised to the customers; however the treatment of deduction as trade discount is not in accordance with AS 9. Considering the treatment prescribed by AS 4 “Contingencies and Events occurring after the Balance Sheet Date”, adjustment of the difference between the invoice amount and the amount finally settled against ‘Ship Repair Income’ account is in order. Events occurring up to the date of approval of the accounts by the Board of Directors should be taken into consideration in determining the amount of adjustment to be made in this regard. The description of the difference as ‘trade discount’ is not appropriate.
- (ii) In respect of ship repair jobs for which negotiations between the ship owners and the company are not over, the accounting treatment is not appropriate. Instead, the amount of difference between the invoiced amount and the amount likely to be finally settled (as estimated on the basis of past experience) should be adjusted in the “Ship Repair Income” by a corresponding credit to the accounts of the respective ship owners. Consequently, the figure of sundry debtors included in the balance sheet would be net of adjustment for such difference. In other words, the amount of the difference would be neither shown under the head provisions nor shown as a deduction from the sundry debtors in the balance sheet.

### Question 5

- (a) Santhosh Ltd. granted 500 options to each of its 2,500 employees in 2003 at an exercise price of Rs.50 when the market price was the same. The contractual life (vesting and exercise period) of the options granted is 6 years with the vesting period and exercise period being 3 years each. The expected life is 5 years and the expected annual forfeitures are estimated at 3 per cent. The fair value per option is arrived at Rs.15. Actual forfeitures in 2003 were 5 per cent. However at the end of 2003 the management of Santhosh Ltd. still expects that the actual forfeitures would average only 3 per cent over the entire vesting period. During 2004 the management revises its estimated forfeiture rate to 10 per cent per annum. Of the 2,500 employees, 1,900 employees have completed the 3 year vesting period. 1,000 employees exercise their right to obtain shares vested in them in pursuance of ESOP at the end of 2007 and 500 employees exercise their right at the end of 2008. The rights of the remaining employees expire unexercised at the end of 2008. The face value per share is Rs.10. Show the necessary journal entries with suitable narrations. Workings should form part of the answer.
- (b) On 1<sup>st</sup> February, 2008, an Indian Company sold goods to an American Company at an invoice price of US \$20,000 when the spot market rate was Rs.48.10 to a U.S. dollar. Payment was to be made in three months time, namely, by 1<sup>st</sup> May, 2008.
- To avoid the risk of foreign exchange fluctuations the Indian exporter acquired a forward contract to sell U.S. \$20,000 at Rs.47.90 per U.S. dollar on 1<sup>st</sup> May, 2008.
- The Indian company's accounting year ended on 31<sup>st</sup> March, 2008 and the spot rate on this date was Rs.47.20 per U.S. dollar. The spot rate on 1<sup>st</sup> May, 2008, the date by which the money was due from the American buyer, was Rs.50 per dollar.
- Show what accounting entries will have to be made in the books of the Indian exporter at the relevant period of time.
- (10+10 = 20 Marks)

**FINAL EXAMINATION : JUNE, 2009**

Answer

| (a) Journal Entries                                                 |     |             |             |
|---------------------------------------------------------------------|-----|-------------|-------------|
| Year 2003                                                           |     | Rs.         | Rs.         |
| Employee Compensation Expense A/c                                   | Dr. | 57,04,205   |             |
| To Employee Stock Options Outstanding A/c                           |     |             | 57,04,205   |
| (Being the compensation expenses recognized in respect of the ESOP) |     |             |             |
| Profit and Loss A/c                                                 | Dr. | 57,04,205   |             |
| To Employee Compensation Expense A/c                                |     |             | 57,04,205   |
| (Being expenses of the year transferred to P & L A/c)               |     |             |             |
| Year 2004                                                           |     |             |             |
| Employee Compensation Expense A/c                                   | Dr. | 34,08,295   |             |
| To Employee Stock Options Outstanding A/c                           |     |             | 34,08,295   |
| (Being the compensation expenses recognized in respect of the ESOP) |     |             |             |
| Profit and Loss A/c                                                 | Dr. | 34,08,295   |             |
| To Employee Compensation Expense A/c                                |     |             | 34,08,295   |
| (Being expenses of the year transferred to P & L A/c)               |     |             |             |
| Year 2005                                                           |     |             |             |
| Employee Compensation Expense A/c                                   | Dr. | 51,37,500   |             |
| To Employee Stock Options Outstanding A/c                           |     |             | 51,37,500   |
| (Being the compensation expenses recognized in respect of the ESOP) |     |             |             |
| Profit and Loss A/c                                                 | Dr. | 51,37,500   |             |
| To Employee Compensation Expense A/c                                |     |             | 51,37,500   |
| (Being expenses of the year transferred to P & L A/c)               |     |             |             |
| Year 2007                                                           |     |             |             |
| Bank A/c                                                            | Dr. | 2,50,00,000 |             |
| Employee Stock Options Outstanding A/c                              | Dr. | 75,00,000   |             |
| To Share Capital A/c                                                |     |             | 50,00,000   |
| To Securities Premium                                               |     |             | 2,75,00,000 |

## PAPER – 1 : ADVANCED ACCOUNTING

(Being shares issued to employees against options vested in them in pursuance of the ESOP)

---

Year 2008

|                                        |     |             |             |
|----------------------------------------|-----|-------------|-------------|
| Bank A/c                               | Dr. | 1,25,00,000 |             |
| Employee Stock Options Outstanding A/c | Dr. | 37,50,000   |             |
| To Share Capital A/c                   |     |             | 25,00,000   |
| To Securities Premium A/c              |     |             | 1,37,50,000 |

(Being shares issued to employees against options vested in them in pursuance of the ESOP)

---

|                                        |     |           |           |
|----------------------------------------|-----|-----------|-----------|
| Employee Stock Options Outstanding A/c | Dr. | 30,00,000 |           |
| To General Reserve A/c                 |     |           | 30,00,000 |

(Being the balance standing to the credit of stock options outstanding account, in respect of vested options expired unexercised, transferred to general reserve account)

---

Working Notes:

1. Fair value of options recognized as expense

Year 2003

Number of options expected to vest =  $500 \times 2,500 \times .97 \times .97 \times .97 = 11,40,841$  options

Fair value of options expected to vest =  $11,40,841 \times \text{Rs.}15 = \text{Rs.}1,71,12,615$

One third of fair value recognized as expense =  $\text{Rs.}1,71,12,615 / 3 = \text{Rs.}57,04,205$

Year 2004

Fair Value of options revised in the year =  $500 \times 2500 \times 0.90 \times 0.90 \times 0.90 \times \text{Rs.}15 = \text{Rs.}1,36,68,750$

Revised cumulative expenses in year 2004 =  $1,36,68,750 \times \frac{2}{3}$  91,12,500

Less: Already recognized in year 2003 57,04,205

Expenses to be recognized in year 2004 34,08,295

Year 2005

Number of options actually vested =  $1900 \times 500 = 9,50,000$

Fair Value of options actually vested =  $9,50,000 \times 15$  1,42,50,000

Less: Expense recognized till year 2005 91,12,500

Balance amount to be recognized 51,37,500

**FINAL EXAMINATION : JUNE, 2009**

2. Amount recorded in share capital account and securities premium account upon issue of shares

| Particulars                                                                                        | Year 2007          | Year 2008          |
|----------------------------------------------------------------------------------------------------|--------------------|--------------------|
| Number of employees exercising option                                                              | 1,000              | 500                |
| Number of shares issued upon exercise of option @ 500 per employee                                 | <u>5,00,000</u>    | <u>2,50,000</u>    |
| Exercise price received @ Rs.50 per share                                                          | 2,50,00,000        | 1,25,00,000        |
| Corresponding amount recognized in the 'Employee stock options outstanding A/c' @ Rs.15 per option | <u>75,00,000</u>   | <u>37,50,000</u>   |
| Total consideration                                                                                | <u>3,25,00,000</u> | <u>1,62,50,000</u> |
| Amount to be recorded in 'Share capital A/c' @ Rs.10 per share                                     | 50,00,000          | 25,00,000          |
| Amount to be recorded in 'Securities premium A/c' @ Rs.55 (i.e.65 –10) per share                   | <u>2,75,00,000</u> | <u>1,37,50,000</u> |
|                                                                                                    | <u>3,25,00,000</u> | <u>1,62,50,000</u> |

- (b) Journal Entries in the books of Indian Exporter

|                                                                                                                                                               | Dr.          | Cr.      |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|----------|
|                                                                                                                                                               | Rs.          | Rs.      |
| 1 <sup>st</sup> February, 2008                                                                                                                                |              |          |
| Sundry Debtors (American Company)A/c                                                                                                                          | Dr. 9,62,000 |          |
| To Sales A/c                                                                                                                                                  |              | 9,62,000 |
| (Being sales recorded at Rs. 9,62,000 [US\$ 20,000 x Rs.48.10])                                                                                               |              |          |
| Forward (Rs.) Contract Receivables A/c (20,000 US \$ x Rs.47.9)                                                                                               | Dr. 9,58,000 |          |
| Deferred Discount A/c (20,000 US \$ x Rs. .20)                                                                                                                | Dr. 4,000    |          |
| To Forward (\$) Contract Payable A/c (20,000 US \$ x Rs.48.10)                                                                                                |              | 9,62,000 |
| (Being forward exchange cover purchased and deferred discount amounting Rs.4,000 recorded)                                                                    |              |          |
| 31 <sup>st</sup> March, 2008                                                                                                                                  |              |          |
| Profit and Loss A/c                                                                                                                                           | Dr. 18,000   |          |
| To Sundry Debtors (American Company) A/c                                                                                                                      |              | 18,000   |
| (Being transaction loss recorded {20,000 US \$ x [Rs.48.10 less Rs. 47.2]} that occurred between the date of transaction and the date of closing of accounts) |              |          |



**PAPER – 1 : ADVANCED ACCOUNTING**

|                                                                                                                                                                                      |     |           |           |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|-----------|-----------|
| Forward (\$) Contract Payable A/c                                                                                                                                                    | Dr. | 18,000    |           |
| To Profit and Loss A/c                                                                                                                                                               |     |           | 18,000    |
| (Being exchange gain recorded {20,000 US \$ x [Rs.48.10 less Rs. 47.2]} as less rupees becoming payable to the exchange dealer on the basis of the spot rate at the end of the year) |     |           |           |
| Discount A/c                                                                                                                                                                         | Dr. | 2,666     |           |
| To Deferred Discount A/c                                                                                                                                                             |     |           | 2,666     |
| (Being proportionate discount [two-third of Rs.4,000] charged as discount expenses)                                                                                                  |     |           |           |
| 1 <sup>st</sup> May, 2008                                                                                                                                                            |     |           |           |
| Bank A/c (20,000 US\$ x Rs. 50)                                                                                                                                                      | Dr. | 10,00,000 |           |
| To Sundry Debtors A/c (20,000 US \$ x Rs. 47.2)                                                                                                                                      |     |           | 9,44,000  |
| To Profit and Loss A/c (20,000 US \$ x Rs. 2.8)                                                                                                                                      |     |           | 56,000    |
| (Being actual receipt of money from the buyer recorded )                                                                                                                             |     |           |           |
| Forward (\$) Contract Payable (20,000 US \$ x Rs. 47.2)                                                                                                                              | Dr. | 9,44,000  |           |
| Profit and Loss A/c (20,000 US \$ x Rs. 2.8)                                                                                                                                         | Dr. | 56,000    |           |
| To Bank A/c (20,000 US \$ x Rs. 50)                                                                                                                                                  |     |           | 10,00,000 |
| (Being delivery of 20,000 Dollars against forward contract at spot rate on 1 <sup>st</sup> May)                                                                                      |     |           |           |
| Bank A/c                                                                                                                                                                             | Dr. | 9,58,000  |           |
| To Forward (Rs.) Contract Receivable A/c                                                                                                                                             |     |           | 9,58,000  |
| (Being forward contract settled)                                                                                                                                                     |     |           |           |
| Discount A/c (4,000- 2,666)                                                                                                                                                          | Dr. | 1,334     |           |
| To Deferred Discount A/c                                                                                                                                                             |     |           | 1,334     |
| (Being balance amount of discount recognized)                                                                                                                                        |     |           |           |

### Question 6

- (a) Pilot Ltd. supplies the following information using which you are required to calculate the economic value added.
- Financial Leverage 1.4 times
  - Capital (equity and debt)
 

|                                     |                   |
|-------------------------------------|-------------------|
| Equity shares of Rs.1,000 each      | 34,000 (number)   |
| Accumulated profit                  | Rs. 260 lakhs     |
| 10 percent Debentures of Rs.10 each | 80 lakhs (number) |

**FINAL EXAMINATION : JUNE, 2009**

- Dividend expectations of equity shareholders 17.50%
  - Prevailing Corporate Tax rate 30%
- (b) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on “mark to market basis”. For the financial year ended March, 2009 the investments which were acquired at a cost of Rs.109 crores were reflected in the Balance Sheet at Rs.89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.
- (c) Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1<sup>st</sup> April, 2007 for Rs.60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs.41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs.36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs.54 crore per annum and has a carrying amount of Rs.3.46 crore. All such machines put together could fetch a sum of Rs.4.44 crore if disposed. Discuss the applicability of Impairment loss.
- (d) EXOX Ltd. is in the process of finalizing its accounts for the year ended 31<sup>st</sup> March, 2008. The company seeks your advice on the following:
- (i) The Company's sales tax assessment for assessment year 2005-06 has been completed on 14<sup>th</sup> February, 2008 with a demand of Rs.2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.
  - (ii) The Company has entered into a wage agreement in May, 2008 whereby the labour union has accepted a revision in wage from June, 2007. The agreement provided that the hike till May, 2008 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2008. (6+4+3+3= 16 Marks)

**Answer**

|                                                                           |              |
|---------------------------------------------------------------------------|--------------|
| (a) Computation of EVA                                                    | Rs. in lakhs |
| Net Profit after Tax (Refer Working Note 1)                               | 140          |
| Add: Interest [adjusted for tax effect ( $800 \times 10\% \times 0.70$ )] | <u>56</u>    |
|                                                                           | 196          |
| Less: Cost of Capital (Refer Working Note 2)                              | <u>161</u>   |
| Economic Value Added (EVA)                                                | <u>35</u>    |

## PAPER – 1 : ADVANCED ACCOUNTING

Working Notes:

### 1. Interest and Net Profit

$$\text{Financial Leverage} = \frac{\text{Profit before Interest \& Taxes (PBIT)}}{\text{Profit before Tax (PBT)}}$$

Interest on Borrowings = Rs. 800 lakhs × 10% = Rs.80 lakhs

|            |                       |   |                 |
|------------|-----------------------|---|-----------------|
| Therefore, | 1.40                  | = | PBIT            |
|            |                       |   | PBIT – Interest |
|            | 1.40                  | = | PBIT            |
|            |                       |   | PBIT – 80       |
|            | 1.40 (PBIT- 80)       | = | PBIT            |
|            | 1.40 PBIT- 112        | = | PBIT            |
|            | 1.40 (PBIT- PBIT)     | = | 112             |
|            | 0.40 PBIT             | = | 112             |
|            | PBIT                  | = | 112/0.40        |
|            | PBIT                  | = | Rs. 280 lakhs   |
|            | PBT = PBIT- I =280-80 | = | Rs. 200 lakhs   |
|            | Tax (30%)             | = | Rs. 60 lakhs    |
|            | Net profit after tax  | = | Rs. 140 lakhs   |

### 2. Cost of Capital

|                              |               |
|------------------------------|---------------|
|                              | Rs.(in lakhs) |
| Equity Shareholders' funds   | 600           |
| 10% Debenture holders' funds | <u>800</u>    |
| Total                        | <u>1400</u>   |

$$\text{Weights assigned to Equity shareholders fund} = \frac{600}{1400} = 0.4286$$

$$\text{Weights assigned to Debenture holders fund} = \frac{800}{1400} = 0.5714$$

| Source of Funds             | Amount (Rs.in lakhs) | Weight        | Cost %       | WACC %       |
|-----------------------------|----------------------|---------------|--------------|--------------|
| (1)                         | (2)                  | (3)           | (4)          | (5)=(3 × 4)% |
| Equity share holders' funds | 600                  | 0.4286        | 17.50        | 7.50         |
| Debenture holders' funds    | <u>800</u>           | <u>0.5714</u> | <u>7.00*</u> | <u>4.00</u>  |
| Total                       | <u>1400</u>          | <u>1.0000</u> | <u>----</u>  | <u>11.50</u> |

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\* Rate of interest net of corporate tax of 30%.

**FINAL EXAMINATION : JUNE, 2009**

Cost of Capital = Average Capital Employed × Weighted Average cost of Capital (WACC)  
= Rs.1400 lakhs × 11.50% = Rs.161 lakhs

- (b) The Guidance note on “Accounting for Investments in Financial Statements of Mutual Funds” provides that Investments should be marked to market on balance sheet date with provision for depreciation, if any, in the value of investments debited to revenue account. The provision so created should be shown as a deduction from the value of investments in the Balance Sheet. The Guidance notes further states that the depreciation or appreciation should be worked out on individual basis or by category of investment basis but not on an overall basis. Keeping in view ‘prudence’ as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the Guidance Note states that the gross value of depreciation on investments should be reflected in the revenue account rather than the same being netted off with the appreciation in the value of other investments. Thus the claim of Amigo Mutual Fund Ltd. is not correct.
- (c) As per provisions of Para 91(b) of AS 28 “Impairment of Assets”, impairment loss is not to be recognized for a given asset if the related cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit, which is group of asset to which the damaged machine belongs, is not impaired; as the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.
- (d) (i) Since the company is not appealing against the addition of Rs. 0.66 crore, the same should be provided for, in its accounts for the year ended on 31<sup>st</sup> March, 2008. The amount paid under protest can be kept under the heading ‘Loans & Advances’ and disclosed along with the contingent liability of Rs.2.10 crore.
- (ii) The arrears for the period from June, 2007 to March, 2008 are required to be provided for in the accounts of the company for the year ended on 31<sup>st</sup> March, 2008.

PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.

Working Notes should form part of the answer.

Wherever necessary, suitable assumption(s) should be made by the candidates.

Question 1

The Balance Sheets of Aqua Ltd. and Baqa Ltd. as on the dates of last closing of accounts are as under:

|                                             | Aqua Ltd.<br>as on 31.03.2009<br>Rs. | Baqa Ltd.<br>as on 31.12.2008<br>Rs. |
|---------------------------------------------|--------------------------------------|--------------------------------------|
| Liabilities                                 |                                      |                                      |
| Share capital (equity shares of Rs.10 each) | 11,00,000                            | 5,00,000                             |
| Accumulated Profits & Reserves              | 4,50,000                             | 2,05,000                             |
| 15% Rs.100 non-convertible debentures       | -                                    | 3,00,000                             |
| Accounts Payable                            | 4,80,000                             | 2,80,000                             |
| Other liabilities                           | 1,00,000                             | 40,000                               |
| Tax Provision                               | 1,50,000                             | 2,50,000                             |
| Total                                       | 22,80,000                            | 15,75,000                            |
| Assets                                      |                                      |                                      |
| Fixed Assets at Cost                        | 8,45,000                             | 5,26,500                             |
| Less: Depreciation                          | 1,95,000                             | 1,21,500                             |
|                                             | 6,50,000                             | 4,05,000                             |
| Investments:                                |                                      |                                      |
| 40,000 shares in Baqa Ltd.                  | 8,00,000                             | —                                    |
| 1,000 debentures in Baqa Ltd.               | 1,50,000                             | —                                    |
| Current Assets:                             |                                      |                                      |
| Inventories                                 | 2,00,000                             | 3,50,000                             |
| Accounts Receivable                         | 2,50,000                             | 4,65,000                             |
| Cash & Bank                                 | 2,30,000                             | 3,55,000                             |
| Total                                       | 22,80,000                            | 15,75,000                            |

The following information is also available:

1. On 8<sup>th</sup> February, 2009 there was a fire at the factory of Baqa Ltd., resulting in inventory worth Rs.20,000 being destroyed. Baqa received 75 per cent of the loss as insurance.

**FINAL EXAMINATION: NOVEMBER, 2009**

2. The same fire resulted in destruction of a machine having a written down value of Rs.1,00,000. The Insurance company admitted the Company's claim to the extent of 80 per cent. The machine was insured at its fair value of Rs.1,50,000.
3. On 13<sup>th</sup> March, 2009, Aqua sold goods costing Rs.1,50,000 to Baqa at a mark-up of 20 per cent. Half of these goods were resold to Aqua who in turn was able to liquidate the entire stock of such goods before closure of accounts on 31<sup>st</sup> March, 2009. As on 31<sup>st</sup> March, 2009 Baqa's accounts payable show Rs.60,000 due to Aqua on the two transactions.
4. Aqua acquired the holdings in Baqa on 1<sup>st</sup> January, 2007 when the reserves and accumulated profits of Baqa Ltd. stood at Rs.75,000.
5. Both Companies have not provided for tax on current year profits. The current year taxable profits are Rs.33,000 and Rs.66,000 for Aqua Ltd. and Baqa Ltd. respectively. The tax rate is 33%.
6. The incremental profits earned by Baqa Ltd. for the period January, 2009 to March 2009 over that earned in the corresponding period in 2008 was Rs.56,000. Except for the profits that resulted from the transactions with Aqua in the aforesaid period, the entire profits have been realised in cash before 31<sup>st</sup> March, 2009.

You are requested to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Aqua Limited and its subsidiary as at 31<sup>st</sup> March, 2009.

(20 Marks)

Answer

Consolidated Balance Sheet of Aqua Ltd. and its Subsidiary Baqa Ltd. as on 31.03.2009

| Liabilities                                                       | Rs.              |
|-------------------------------------------------------------------|------------------|
| Share Capital (equity shares of Rs.10 each)                       | 11,00,000        |
| Minority Interest (W.N. 4)                                        | 1,50,844         |
| Accumulated Profits & Reserves (W.N. 5)                           | 5,67,486         |
| 15% Rs.100 Non-Convertible Debentures (Rs.3,00,000 – Rs.1,00,000) | 2,00,000         |
| Accounts Payable (W.N. 6)                                         | 7,60,000         |
| Other Liabilities (Rs.1,00,000 + Rs.40,000)                       | 1,40,000         |
| Tax Provision (1,50,000 + 2,50,000+21,780+10,890)                 | <u>4,32,670</u>  |
| Total                                                             | <u>33,51,000</u> |
| Assets                                                            |                  |
| Fixed Assets at Cost (W.N. 7)                                     | 12,41,500        |
| Less: Depreciation (W.N. 7)                                       | <u>2,86,500</u>  |

## PAPER – 1 : ADVANCED ACCOUNTING

|                                   |                  |
|-----------------------------------|------------------|
|                                   | 9,55,000         |
| Goodwill (W.N. 3)                 | 3,90,000         |
| Current Assets:                   |                  |
| Inventories (W.N. 8)              | 6,05,000         |
| Accounts Receivable (W.N. 6)      | 6,55,000         |
| Insurance claim Receivable        | 1,20,000         |
| Cash & Bank (2,30,000 + 3,96,000) | <u>6,26,000</u>  |
| Total                             | <u>33,51,000</u> |

### Working Notes:

#### 1. Adjustments to Balance sheet of Baqa Ltd. and its Adjusted balance Sheet

|                                                                                                   | Rs.             |
|---------------------------------------------------------------------------------------------------|-----------------|
| (i) Inventories as on 31.12.2008                                                                  | 3,50,000        |
| Add: Unsold Stock = $\frac{(\text{Rs.}1,50,000 \times 120\%)}{2}$                                 | <u>90,000</u>   |
|                                                                                                   | 4,40,000        |
| Less: Cost of inventory destroyed in fire                                                         | <u>20,000</u>   |
| Inventories as on 31.3.2009                                                                       | <u>4,20,000</u> |
| (ii) Incremental profits earned in January, 2009 to March, 2009 over corresponding period in 2008 |                 |
| Total incremental profit earned in January 2009 – March, 2009                                     | 56,000*         |
| Less: Earned on transaction with Aqua Ltd. [W.N(viii)]                                            | <u>30,000</u>   |
| Balance profits realised in cash                                                                  | <u>26,000</u>   |
| (iii) Cash and Bank Balance as on 31.12.2008                                                      | 3,55,000        |
| Add: Insurance Claim received                                                                     | 15,000          |
| Incremental profits realised [W.N(ii)]                                                            | <u>26,000</u>   |
| Cash and Bank Balance as on 31.3.2009                                                             | <u>3,96,000</u> |
| (iv) Fixed assets as on 31.12.2008                                                                | 4,05,000        |
| Less: Written down value of machine destroyed                                                     | <u>1,00,000</u> |
| Fixed assets as on 31.3.2009                                                                      | <u>3,05,000</u> |
| (v) Insurance Claim Receivable = 80% of Rs.1,50,000                                               | 1,20,000        |

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\* Before adjustments of profit/loss on destruction by fire but after including profit on sale of goods to Aqua Ltd.

**FINAL EXAMINATION: NOVEMBER, 2009**

|        |                                                                                                                         |                 |
|--------|-------------------------------------------------------------------------------------------------------------------------|-----------------|
| (vi)   | Accounts Payable as on 31.12.2008                                                                                       | 2,80,000        |
|        | Add: Amount payable to Aqua Ltd.                                                                                        | <u>60,000</u>   |
|        | Accounts Payable as on 31.3.2009                                                                                        | <u>3,40,000</u> |
| (vii)  | Accumulated profits and Reserves as on 31.12.2008                                                                       | 2,05,000        |
|        | Less: Tax Provision = 33% of Rs.66,000                                                                                  | 21,780          |
|        | Less: Goods destroyed in Fire after adjusting claim received                                                            | 5,000           |
|        | Add: Profit on sale of goods [W.N.(viii)]                                                                               | 30,000          |
|        | Incremental profits realised in cash in Jan-March 2009 over prior period                                                | 26,000          |
|        | Additional amount receivable from Insurance Company over written down value for machine destroyed [1,20,000 – 1,00,000] | <u>20,000</u>   |
|        | Accumulated profits and Reserves as on 31.3.2009                                                                        | <u>2,54,220</u> |
| (viii) | Profit made by Baqa Ltd. on transaction with Aqua Ltd.                                                                  |                 |
|        | Cost of goods sold from Aqua to Baqa Ltd.                                                                               | 1,50,000        |
|        | Add: Mark up of 20% (profit of Aqua Ltd.)                                                                               | <u>30,000</u>   |
|        | Purchases by Baqa payable to Aqua Ltd. (A)                                                                              | 1,80,000        |
|        | Less: 50% unsold                                                                                                        | <u>90,000</u>   |
|        | Cost of goods sold back to Aqua Ltd.                                                                                    | <u>90,000</u>   |
|        | Balance payable to Aqua Ltd. after 50% goods were sold back (B)                                                         | 60,000          |
|        | Sales price charged by Baqa Ltd. for selling 50% of the goods (A-B)                                                     | 1,20,000        |
|        | Less: Cost of these goods to Baqa Ltd.                                                                                  | <u>90,000</u>   |
|        | Profit on sale of 50% goods to Aqua Ltd.                                                                                | <u>30,000</u>   |
| (ix)   | Balance Sheet of Baqa Ltd.                                                                                              |                 |
|        | as at 31.3.2009                                                                                                         |                 |

Rs.

|                                              |                  |
|----------------------------------------------|------------------|
| Liabilities                                  |                  |
| Share Capital (equity shares of Rs. 10 each) | 5,00,000         |
| Accumulated Profits and Reserves             | 2,54,220         |
| 15% Non-convertible debentures               | 3,00,000         |
| Accounts Payable                             | 3,40,000         |
| Other Liabilities                            | 40,000           |
| Tax provision (Rs.2,50,000 + Rs.21,780)      | <u>2,71,780</u>  |
|                                              | <u>17,06,000</u> |



## PAPER – 1 : ADVANCED ACCOUNTING

|                                                                               |                  |
|-------------------------------------------------------------------------------|------------------|
| Assets                                                                        |                  |
| Fixed assets at cost                                                          | 3,96,500         |
| Less: Depreciation $\left( \frac{1,21,500}{4,05,000} \times 3,05,000 \right)$ | <u>91,500</u>    |
|                                                                               | 3,05,000         |
| Inventories                                                                   | 4,20,000         |
| Accounts Receivable                                                           | 4,65,000         |
| Insurance Claim receivable                                                    | 1,20,000         |
| Cash and Bank                                                                 | <u>3,96,000</u>  |
|                                                                               | <u>17,06,000</u> |

### 2. Analysis of Accumulated Profits and Reserves of Baqa Ltd.

|                          | Pre-<br>acquisition<br>Rs. | Post<br>acquisition<br>Rs. |
|--------------------------|----------------------------|----------------------------|
| Profits and Reserves     | <u>75,000</u>              | <u>1,79,220</u>            |
| Share of Aqua Ltd. (80%) | 60,000                     | 1,43,376                   |
| Minority Interest (20%)  | 15,000                     | 35,844                     |

### 3. Calculation of Goodwill/ Cost of Control

|                                        | Rs.             |
|----------------------------------------|-----------------|
| Amount paid for shares in Baqa Ltd.    | 8,00,000        |
| Amount paid for 1,000 debentures       | <u>1,50,000</u> |
|                                        | 9,50,000        |
| Less: Nominal Value of shares acquired | 4,00,000        |
| Nominal Value of debentures acquired   | 1,00,000        |
| 80% share in pre-acquisition profits   | <u>60,000</u>   |
| Goodwill                               | <u>3,90,000</u> |

### 4. Minority Interest

|                                                            |                 |
|------------------------------------------------------------|-----------------|
| Share Capital (20%)                                        | 1,00,000        |
| 20% of Profits and Reserves of Baqa Ltd. (15,000 + 35,844) | <u>50,844</u>   |
|                                                            | <u>1,50,844</u> |

**FINAL EXAMINATION: NOVEMBER, 2009**

|                                                                                                  |                  |
|--------------------------------------------------------------------------------------------------|------------------|
| 5. Accumulated Profits and Reserves in the Consolidated Balance Sheet                            |                  |
| Balance as on 31.03.2009                                                                         | 4,50,000         |
| Add: 80% Share in revenue reserves(2,54,220-75,000) of Baqa Ltd.                                 | 1,43,376         |
| Less: Unrealised profits on inventory Rs. $\left(1,50,000 \times 20\% \times \frac{1}{2}\right)$ | 15,000           |
| Less: Provision for taxation 33% on Rs.33,000                                                    | <u>10,890</u>    |
|                                                                                                  | <u>5,67,486</u>  |
| 6. Accounts Payable and Accounts Receivable in Consolidated Balance Sheet                        |                  |
| Accounts payable as per Balance Sheet of Aqua Ltd.                                               | 4,80,000         |
| Accounts payable as per Balance Sheet of Baqa Ltd [W.N. 1(vi)]                                   | <u>3,40,000</u>  |
|                                                                                                  | 8,20,000         |
| Less: Inter company dues set off                                                                 | <u>60,000</u>    |
| Balance of Accounts Payable for Consolidated Balance Sheet                                       | <u>7,60,000</u>  |
| Accounts Receivable as per Balance Sheet of Aqua Ltd.                                            | 2,50,000         |
| Accounts Receivable as per Balance Sheet of Baqa Ltd. [W.N. 1(ix)]                               | <u>4,65,000</u>  |
|                                                                                                  | 7,15,000         |
| Less: Inter company dues                                                                         | <u>60,000</u>    |
| Balance of Accounts Receivable for Consolidated Balance Sheet                                    | <u>6,55,000</u>  |
| 7. Fixed Assets and accumulated Depreciation in Consolidated Balance Sheet                       |                  |
| WDV of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)                        | 4,05,000         |
| Accumulated depreciation                                                                         | 1,21,500         |
| % of Depreciation (1,21,500/ 4,05,000)                                                           | 30               |
| Original Cost of Destroyed Asset (W.D.V. of Rs.1,00,000)                                         | 1,30,000         |
| Original Cost of Fixed Assets of Aqua Ltd. as per Balance sheet (given in question)              | 8,45,000         |
| Original Cost of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)              | <u>5,26,500</u>  |
|                                                                                                  | 13,71,500        |
| Less: Original Cost of Destroyed Asset of Baqa Ltd.                                              | <u>1,30,000</u>  |
| Original Cost of Fixed Assets for Consolidated Balance Sheet                                     | <u>12,41,500</u> |

## PAPER – 1 : ADVANCED ACCOUNTING

|                                                         |                 |
|---------------------------------------------------------|-----------------|
| Accumulated Depreciation                                |                 |
| As per Balance Sheet of Aqua Ltd. (given in question)   | 1,95,000        |
| As per Balance Sheet of Baqa Ltd. (given in question)   | <u>1,21,500</u> |
|                                                         | 3,16,500        |
| Less: Accumulated Depreciation on Destroyed asset       | <u>30,000</u>   |
| Accumulated Depreciation for Consolidated Balance Sheet | <u>2,86,500</u> |
| 8. Inventories                                          |                 |
| As per Balance Sheet of Aqua Ltd.                       | 2,00,000        |
| Balance in Baqa Ltd. Balance Sheet [W.N. 1(i)]          | <u>4,20,000</u> |
|                                                         | 6,20,000        |
| Less: Unrealised Profits on closing inventory           | <u>15,000</u>   |
| Balance in Consolidated Balance Sheet                   | <u>6,05,000</u> |

### Question 2

Small Ltd. and Little Ltd., two Companies in the field of speciality chemicals, decided to go in for a follow on Public Offer after completion of an amalgamation of their businesses. As per agreed terms initially a new company Big Ltd. will be incorporated on 1<sup>st</sup> January, 2010 with an authorized capital of Rs.2 crore comprised of 20 lakh equity shares of Rs.10 each. The holding company would acquire the entire shareholding of Small Ltd. & Little Ltd. and in turn would issue its shares to the outside holders of these shares. It is also agreed that the consideration would be a multiple of the average P/E ratio for the period 1<sup>st</sup> January, 2009 to 31<sup>st</sup> March, 2009 times the rectified profits of each company, subject to necessary adjustments for complying with the terms of the share issue.

The following information is supplied to you:

|                                                                                                          | Small Ltd.  | Little Ltd. |
|----------------------------------------------------------------------------------------------------------|-------------|-------------|
| Ordinary Shares of Rs.10 each (Nos.)                                                                     | 40 lakhs    | 20 lakhs    |
| 10% Preference shares of Rs.100 each (Nos.)                                                              | 2 lakh      | Nil         |
| 10% Preference shares of Rs.10 each (Nos.)                                                               | Nil         | 2 lakh      |
| 5% debentures of Rs.10 each (Nos.)                                                                       | 4 lakh      | 4 lakh      |
| Investments Held                                                                                         |             |             |
| (a) 4 lakh ordinary shares in Small Ltd.                                                                 | -           | Rs.40 lakhs |
| (b) 2 lakh ordinary shares in Little Ltd.                                                                | Rs.20 lakhs | -           |
| Profit before Interest & Tax (PBIT) after considering impact of Inter-company Transactions and Holdings. | Rs.50 lakhs | Rs.25 lakhs |
| Average P/E ratio January, 2009 to March, 2009                                                           | 10          | 8           |

### **FINAL EXAMINATION: NOVEMBER, 2009**

The following additional information is also furnished to you in respect of adjustments required to the profit figure as given above:

1. The profits of the respective companies would be adjusted for half the value of contingent liabilities as on 31<sup>st</sup> March, 2009.
2. Debtors of Small Ltd. include an irrecoverable amount of Rs.2 lakh against which Rs.1 lakh was recovered but kept in Advance account.
3. Little Ltd. had omitted to provide for increased FOREX liability of US\$10,000 on loan availed in financial year 2005-06 for purchase of Machinery. The machinery was acquired on 1<sup>st</sup> January, 2006 and put to use in Financial year 2006-07. The additional liability arose due to change in exchange rates and is arrived at in conformity with prevailing provisions of AS 11. The exchange rate is US \$ 1 = INR 50.
4. Small Ltd. has omitted to invoice a sale that took place on 31<sup>st</sup> March, 2009 of goods costing Rs.2,50,000 at a mark up of 15 per cent instead the goods were considered as part of closing inventory.
5. Closing Inventory of Rs.45 lakhs of Little Ltd. as on 31<sup>st</sup> March, 2009 stands undervalued by 10 per cent.
6. Contingent liabilities of Small Ltd. and Little Ltd. as on 31<sup>st</sup> March, 2009 stands at Rs.5 lakhs and Rs.10 lakhs respectively.

The terms of the share issue are as under:

- (i) Shares in Big Ltd. will be issued at a premium of Rs.13 per share for all external shareholders of Small Ltd. The Premium will be Rs.15 per share for shares in Big Ltd. issued to all external shareholders of Little Ltd.
- (ii) No shares in Big Ltd. will be issued in lieu of the investments (intercompany holdings) of both companies. Instead the shares so held shall be transferred to Big Ltd. at the close of the financial year ended 31<sup>st</sup> March, 2010 at Par Value consideration payable on date of transfer.
- (iii) Big Ltd. would in addition to the issue of shares to outside shareholders of Small Ltd. and Little Ltd. make a preferential allotment on 31<sup>st</sup> March, 2010 of 2 lakhs ordinary shares at a premium of Rs.28 per share to Virgin Capital Ltd. (VCL). These shares will not be eligible for any dividends declared or paid till that date.
- (iv) Big Ltd. will go in for a 18 per cent unsecured Bank overdraft facility to meet incorporation costs of Rs.16 lakhs and towards management expenses till 31<sup>st</sup> March, 2010 estimated at Rs.14 lakhs. The overdraft is expected to be availed on 1<sup>st</sup> February, 2010 and closed on 31<sup>st</sup> March, 2010 out of the proceeds of the preferential allotment.
- (v) It is agreed that interim dividends will be paid on 31.03.2010 for the period January, 2010 to March, 2010 by Big Ltd. at 2 per cent; Small Ltd. at 3 per cent and Little Ltd. at 2.5 per cent. Ignore Dividend Distribution tax.

## PAPER – 1 : ADVANCED ACCOUNTING

(vi) The prevailing Income Tax Rate is 25 per cent.

You are required to compute the number of shares to be issued to the shareholders of each of the companies and prepare the projected Profit and Loss Account for the period from 1<sup>st</sup> January, 2010 to 31.03.2010 of Big Ltd. and its Balance Sheet as on 31<sup>st</sup> March, 2010. (20 Marks)

Answer

Computation of number of shares issued

Calculation of Rectified Profits and Purchase consideration

|                                                                                | Rs.             | Rs.               |
|--------------------------------------------------------------------------------|-----------------|-------------------|
| Small Ltd.                                                                     |                 |                   |
| Given profits                                                                  |                 | 50,00,000         |
| Less: Irrecoverable Debtors                                                    | 1,00,000        |                   |
| 50% Contingent Liability                                                       | <u>2,50,000</u> | <u>3,50,000</u>   |
|                                                                                |                 | 46,50,000         |
| Add: Profit on omitted sale (15% of Rs.2,50,000)                               |                 | <u>37,500</u>     |
|                                                                                |                 | 46,87,500         |
| Less: Debenture interest                                                       |                 | <u>2,00,000</u>   |
|                                                                                |                 | 44,87,500         |
| Less: Income Tax @ 25%                                                         |                 | <u>11,21,875</u>  |
| Profits after Tax (PAT)                                                        |                 | 33,65,625         |
| Less: Preference Dividend (10% of Rs.2,00,00,000)                              |                 | <u>20,00,000</u>  |
| Rectified Profits                                                              |                 | <u>13,65,625</u>  |
| Average PE ratio = 10                                                          |                 |                   |
| Total consideration for all equity shareholders<br>(Average PE ratio × Profit) |                 | 136,56,250        |
| Less: 10% thereof for shareholders of Little Ltd.                              |                 | <u>13,65,625</u>  |
| Balance available for other shareholders of Small Ltd.                         |                 | <u>122,90,625</u> |
| Little Ltd.                                                                    |                 |                   |
| Given profits                                                                  |                 | 25,00,000         |
| Less: Increase in FOREX liability (US\$10,000 × 50)                            | 5,00,000        |                   |
| 50% Contingent Liability                                                       | <u>5,00,000</u> | <u>10,00,000</u>  |
|                                                                                |                 | 15,00,000         |
| Add: Undervaluation of inventory (45,00,000 × 10/90)                           |                 | <u>5,00,000</u>   |
|                                                                                |                 | 20,00,000         |

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|                                                                                |                  |
|--------------------------------------------------------------------------------|------------------|
| Less:Debenture interest                                                        | <u>2,00,000</u>  |
|                                                                                | 18,00,000        |
| Less:Income Tax @ 25%                                                          | <u>4,50,000</u>  |
| Profits after Tax (PAT)                                                        | 13,50,000        |
| Less:Preference Dividend (10% of Rs.20,00,000)                                 | <u>2,00,000</u>  |
| Rectified Profis                                                               | <u>11,50,000</u> |
| Average PE ratio = 8                                                           |                  |
| Total consideration for all equity shareholders<br>(Average PE ratio × Profit) | 92,00,000        |
| Less:10% thereof for shareholders of Small Ltd.                                | <u>9,20,000</u>  |
| Balance available for other shareholders of Little Ltd.                        | <u>82,80,000</u> |

Statement showing Disposal of Purchase Consideration

|                                                                              | Small Ltd.<br>Rs. | Little Ltd.<br>Rs. | Total<br>Rs.       |
|------------------------------------------------------------------------------|-------------------|--------------------|--------------------|
| Number of shares [Purchase consideration/(Face Value + Securities Premium) ] | <u>5,34,375</u>   | <u>3,31,200</u>    | <u>8,65,575</u>    |
| Share Capital                                                                | 53,43,750         | 33,12,000          | 86,55,750          |
| Securities Premium                                                           | <u>69,46,875</u>  | <u>49,68,000</u>   | <u>1,19,14,875</u> |
| Purchase Consideration                                                       | <u>122,90,625</u> | <u>82,80,000</u>   | <u>2,05,70,625</u> |

Projected Profit and Loss Account of Big Ltd.  
for the period 1<sup>st</sup> January, 2010 to 31<sup>st</sup> March, 2010

|                                                             | Rs.              |
|-------------------------------------------------------------|------------------|
| Dividends received from Subsidiaries (12,00,000 + 5,00,000) | 17,00,000        |
| Less:Management expenses                                    | 14,00,000        |
| Interest on Bank O/D                                        | <u>90,000</u>    |
| Net profit for the period                                   | <u>14,90,000</u> |
| Less:Proposed Dividend (2% of Rs.86,55,750)                 | <u>1,73,115</u>  |
| Balance of Profit and Loss Account carried forward          | <u>36,885</u>    |

## PAPER – 1 : ADVANCED ACCOUNTING

### Projected Balance Sheet of Big Ltd. as on 31<sup>st</sup> March, 2010

| Liabilities                                                                           | Rs.                | Assets                          | Rs.               |
|---------------------------------------------------------------------------------------|--------------------|---------------------------------|-------------------|
| Equity Share Capital                                                                  |                    | Investments                     |                   |
| Authorised                                                                            |                    | Shares in Subsidiaries (W.N. 4) | 2,65,70,625       |
| 20 lakhs shares of Rs.10 each                                                         | <u>2,00,00,000</u> | Current Assets                  |                   |
| Issued & Paid up                                                                      |                    | Cash at Bank (W.N. 3)           | 36,885            |
| 10,65,575 shares of Rs.10 each                                                        | 1,06,55,750        | Miscellaneous Expenditure       |                   |
| (out of the above 8,65,575 shares have been issued for consideration other than cash) |                    | Preliminary expenses            | 16,00,000         |
| Reserves & Surplus                                                                    |                    |                                 |                   |
| Securities Premium                                                                    | 1,75,14,875        |                                 |                   |
| (1,19,14,875 + 56,00,000)                                                             |                    |                                 |                   |
| Profit and loss Account                                                               | <u>36,885</u>      |                                 |                   |
|                                                                                       | <u>2,82,07,510</u> |                                 | <u>282,07,510</u> |

#### Working Notes:

1. Shares issued by Big Ltd. to Virgin capital Ltd. (VCL)
 

|                                          |                  |
|------------------------------------------|------------------|
| Number of shares issued                  | 2,00,000         |
|                                          | Rs.              |
| Face Value of Share Capital @ Rs.10 each | 20,00,000        |
| Securities Premium @ Rs.28 each          | <u>56,00,000</u> |
| Total cash received from VCL             | <u>76,00,000</u> |
2. Overdraft of Big Ltd. as on 31.3.2010
 

|                                                          |                  |
|----------------------------------------------------------|------------------|
|                                                          | Rs.              |
| Towards Incorporation expenses i.e. preliminary expenses | 16,00,000        |
| Towards Management expenses                              | <u>14,00,000</u> |
| Total Bank Overdraft availed                             | <u>30,00,000</u> |
| Interest @ 18% p.a. for 2 months                         | <u>90,000</u>    |

3. Bank balance of Big Ltd. as on 31.3.2010  
Bank Account of Big Ltd.
 

|                         |           |                                      |           |
|-------------------------|-----------|--------------------------------------|-----------|
|                         | Rs.       |                                      | Rs.       |
| 01.02.2010 To Overdraft | 30,00,000 | 01.02.2010 By Incorporation expenses | 16,00,000 |
| 31.03.2010 To VCL       | 76,00,000 | 31.03.2010 By Management expenses    | 14,00,000 |

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|            |    |          |                        |            |    |                                              |                       |
|------------|----|----------|------------------------|------------|----|----------------------------------------------|-----------------------|
| 31.03.2010 | To | Dividend |                        | 31.03.2010 | By | Interest on Overdraft                        | 90,000                |
|            |    | Small    | 12,00,000 <sup>1</sup> | 31.03.2010 | By | Overdraft                                    | 30,00,000             |
|            |    | Little   | 5,00,000 <sup>2</sup>  | 31.03.2010 | By | Dividend paid                                | 1,73,115 <sup>3</sup> |
|            |    |          |                        | 31.03.2010 | By | Shares in Small Ltd. bought from Little Ltd. | 40,00,000             |
|            |    |          |                        | 31.03.2010 | By | Shares in Little Ltd. bought from Small Ltd. | 20,00,000             |
|            |    |          |                        |            | By | Balance c/d (Balancing figure)               |                       |
|            |    |          |                        |            |    |                                              | <u>36,885</u>         |
|            |    |          | <u>123,00,000</u>      |            |    |                                              | <u>123,00,000</u>     |

|    |                                                                          |                    |
|----|--------------------------------------------------------------------------|--------------------|
| 4. | Investments of Big Ltd. in Projected Balance Sheet                       | Rs.                |
|    | Purchase consideration paid for acquiring shares of outside holders of - |                    |
|    | Small Ltd                                                                | 122,90,625         |
|    | Little Ltd.                                                              | 82,80,000          |
|    | Consideration paid in cash for acquiring cross holdings                  |                    |
|    | From Small Ltd. (shares of Little Ltd.)                                  | 20,00,000          |
|    | From Little Ltd. (shares of Small Ltd.)                                  | <u>40,00,000</u>   |
|    |                                                                          | <u>2,65,70,625</u> |

**Question 3**

- (a) Timby Ltd. is in the business of making sports equipment. The Company operates from Thailand. To globalise its operations Timby has identified Fine Toys Ltd. an Indian Company, as a potential take over candidate. After due diligence of Fine Toys Ltd. the following information is available:

- (a) Cash Flow Forecasts (Rs. in crore):

|                |     |    |    |    |    |    |    |    |    |    |
|----------------|-----|----|----|----|----|----|----|----|----|----|
| Year           | 10  | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  |
| Fine Toys Ltd. | 24  | 21 | 15 | 16 | 15 | 12 | 10 | 8  | 6  | 3  |
| Timby Ltd.     | 108 | 70 | 55 | 60 | 52 | 44 | 32 | 30 | 20 | 16 |

<sup>1</sup>  $(40,00,000 \times 10) \times 3\% = 12,00,000$ .

<sup>2</sup>  $(20,00,000 \times 10) \times 2.5\% = 5,00,000$ .

<sup>3</sup>  $[(5,34,375 + 3,31,200) \times 10] \times 2\% = 1,73,115$ .



## PAPER – 1 : ADVANCED ACCOUNTING

- (b) The net worth of Fine Toys Ltd. (in lakh Rs.) after considering certain adjustments suggested by the due diligence team reads as under:

|                                               |            |              |
|-----------------------------------------------|------------|--------------|
| Tangible                                      |            | 750          |
| Inventories                                   |            | 145          |
| Receivables                                   |            | <u>75</u>    |
|                                               |            | 970          |
| Less:                                         |            |              |
| Creditors                                     | 165        |              |
| Bank Loans                                    | <u>250</u> | <u>(415)</u> |
| Represented by equity shares of Rs. 1000 each |            | <u>555</u>   |

Talks for take over have crystalized on the following:

1. Timby Ltd. will not be able to use Machinery worth Rs.75 lakhs which will be disposed of by them subsequent to take over. The expected realization will be Rs.50 lakhs.
2. The inventories and receivables are agreed for takeover at values of Rs.100 and Rs.50 lakhs respectively which is the price they will realize on disposal.
3. The liabilities of Fine Toys Ltd. will be discharged in full on take over alongwith an employee settlement of Rs.90 lakhs for the employees who are not interested in continuing under the new management.
4. Timby Ltd. will invest a sum of Rs.150 lakhs for upgrading the Plant of Fine Toys Ltd. on takeover. A further sum of Rs.50 lakhs will also be incurred in the second year to revamp the machine shop floor of Fine Toys Ltd.
5. The Anticipated Cash Flows (in Rs. crore) post takeover are as follows:

|      |    |    |    |    |    |    |    |     |     |     |
|------|----|----|----|----|----|----|----|-----|-----|-----|
| Year | 1  | 2  | 3  | 4  | 5  | 6  | 7  | 8   | 9   | 10  |
|      | 18 | 24 | 36 | 44 | 60 | 80 | 96 | 100 | 140 | 200 |

You are required to advise the management the maximum price which they can pay per share of Fine Toys Ltd. if a discount factor of 20 per cent is considered appropriate.

- (b) Investors Mutual Fund is registered with SEBI and having its registered office at Pune. The fund is in the process of finalising the annual statement of accounts of one of its open ended mutual fund schemes. From the information furnished below you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31<sup>st</sup> March, 2009.

|                                   |           |
|-----------------------------------|-----------|
|                                   | Rs.'000   |
| Opening Balance of net assets     | 12,00,000 |
| Net Income for the year (Audited) | 85,000    |

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|                                        |        |
|----------------------------------------|--------|
| 8,50,200 units issued during 2008-09   | 96,500 |
| 7,52,300 units redeemed during 2008-09 | 71,320 |
| The par value per unit is Rs100        |        |

(10+4 = 14 Marks)

Answer

(a) Calculation of Maximum Price that can be quoted for take over of Fine Toys Ltd.

|                                                                                                | Rs. in lakhs | Rs. in lakhs    |
|------------------------------------------------------------------------------------------------|--------------|-----------------|
| Present (Discounted) value of incremental cash flows<br>(Refer Working Note)                   |              | 7,845.02        |
| Add: Proceeds from disposal of fixed assets                                                    | 50.00        |                 |
| Proceeds from disposal of inventories                                                          | 100.00       |                 |
| Receipts from debtors                                                                          | <u>50.00</u> | <u>200.00</u>   |
|                                                                                                |              | 8,045.02        |
| Less: Settlement of creditors                                                                  | 165.00       |                 |
| Bank Loans                                                                                     | 250.00       |                 |
| Employee settlement                                                                            | 90.00        |                 |
| Renovation of Plant                                                                            | 150.00       |                 |
| Revamp of machine shop floor (Rs. 50 lakhs × 0.6944)*                                          | <u>34.72</u> | <u>689.72</u>   |
| Maximum value that can be offered                                                              |              | <u>7,355.30</u> |
| Maximum price per share of Fine Toys Ltd. (Rs. 7,355.30 lakhs / 55,500 shares) = Rs. 13,252.79 |              |                 |

Working Note:

| Present Value of Incremental Cash Flows |                          |                            |                        | (Rs. in lakhs)      |                       |
|-----------------------------------------|--------------------------|----------------------------|------------------------|---------------------|-----------------------|
| Year                                    | Cash flow after takeover | Cash flows before takeover | Incremental Cash flows | Discount factor@20% | Discounted Cash flows |
| 1                                       | 1,800                    | 1600                       | 200                    | 0.8333              | 166.66                |
| 2                                       | 2,400                    | 2000                       | 400                    | 0.6944              | 277.76                |
| 3                                       | 3,600                    | 3000                       | 600                    | 0.5787              | 347.22                |
| 4                                       | 4,400                    | 3200                       | 1200                   | 0.4823              | 578.76                |
| 5                                       | 6,000                    | 4400                       | 1600                   | 0.4019              | 643.04                |
| 6                                       | 8,000                    | 5200                       | 2800                   | 0.3349              | 937.72                |
| 7                                       | 9,600                    | 6000                       | 3600                   | 0.2791              | 1,004.76              |

---

\* Discount factor of year 2 @20% .

**PAPER – 1 : ADVANCED ACCOUNTING**

|    |        |       |      |        |                 |
|----|--------|-------|------|--------|-----------------|
| 8  | 10,000 | 5500  | 4500 | 0.2326 | 1,046.70        |
| 9  | 14,000 | 7000  | 7000 | 0.1938 | 1,356.60        |
| 10 | 20,000 | 10800 | 9200 | 0.1615 | <u>1,485.80</u> |
|    |        |       |      |        | <u>7,845.02</u> |

- (b) Statement showing the Movement of Unit Holders' Funds for the year ended 31<sup>st</sup> March, 2009

|                                                                    |                  |
|--------------------------------------------------------------------|------------------|
|                                                                    | (Rs.'000)        |
| Opening balance of net assets                                      | 12,00,000        |
| Add: Par value of units issued (8,50,200 × Rs.100)                 | 85,020           |
| Net Income for the year                                            | 85,000           |
| Transfer from Reserve/Equalisation fund<br>(Refer working Note)    | <u>15,390</u>    |
|                                                                    | 13,85,410        |
| Less: Par value of units redeemed (7,52,300 × Rs.100)              | <u>75,230</u>    |
| Closing balance of net assets (as on 31 <sup>st</sup> March, 2009) | <u>13,10,180</u> |

Working Note:

| Particulars                                      | Issued   | Redeemed |
|--------------------------------------------------|----------|----------|
| Units                                            | 8,50,200 | 7,52,300 |
|                                                  | Rs.'000  | Rs.'000  |
| Par value                                        | 85,020   | 75,230   |
| Sale proceeds/Redemption value                   | 96,500   | 71,320   |
| Profit transferred to Reserve /Equalisation Fund | 11,480   | 3,910    |
| Balance in Reserve/Equalisation Fund             |          | 15,390   |

**Question 4**

- (a) Pankaj Ltd. is a company engaged in manufacture of Nuclear Power Stations. The Company usually resorts to long term Foreign Currency borrowings for its fund requirements. The Company had on 1<sup>st</sup> April, 2005 borrowed U.S. \$100 million from Global Fund Consortium based in Washington, USA. The funds were used by Pankaj Ltd. for purposes OTHER THAN acquiring 'Depreciable Capital Assets'. The loan carries an interest rate of 3 per cent on reducing balance and is repayable in two instalments, the first one due on 1<sup>st</sup> April, 2010 and the next on 1<sup>st</sup> April, 2012. The interest due on the loan has been paid in full on 31<sup>st</sup> March of each year. The exchange rate on the date of borrowing was 1 U.S. \$ = INR 40.

The accounting treatment followed by the Company for the subsequent three years with exchange rates prevailing on those dates were as under:

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| Year ended                   | Exchange Rate | Accounting Treatment                                             |
|------------------------------|---------------|------------------------------------------------------------------|
| 31 <sup>st</sup> March, 2006 | 1 US \$ = 41  | Forex Loss of Rs.10 crore charged to Profit and Loss account;    |
| 31 <sup>st</sup> March, 2007 | 1 US \$ = 39  | Forex gain of Rs.20 crore recognised in Profit and Loss Account; |
| 31 <sup>st</sup> March, 2008 | 1 US \$ = 48  | Forex Loss of Rs.90 crore charged to Profit and Loss account;    |

Note: Interest payment were charged to Profit and Loss account of each year at transaction value on payment dates.

Pankaj Ltd. is in the process of finalising its accounts for the year ended 31<sup>st</sup> March, 2009 and understands that AS 11 has been amended and opts to follow the Companies (Accounting Standards) Amendment Rules, 2009.

- (i) You are required to show treatment of the Forex Losses/gains in the light of the above amendment to AS 11 for the years 2005-06; 06-07; 07-08 & 08-09. The exchange rate to 1 US Dollar on 31<sup>st</sup> March, 2009 is Rs.50. Assuming that the rates of Exchange on 31<sup>st</sup> March, 2010 and 31<sup>st</sup> March, 2011 will be Rs.51 and Rs.52 respectively the accounting for the Forex Losses/gains may also be shown for these years also.
  - (ii) What are the disclosure requirements to be complied with by Pankaj Ltd. as a result of having opted to follow the amendment in the Companies (Accounting Standard) Rules, 2006.
  - (iii) Would your answer to (i) above be different if Pankaj Ltd. was not a Company and were a Co-operative Society.
- (b) As on 1<sup>st</sup> April, 2008 the fair value of plan assets was Rs.1,00,000 in respect of a pension plan of Zeleous Ltd. On 30<sup>th</sup> September, 2008 the plan paid out benefits of Rs.19,000 and received inward contributions of Rs.49,000. On 31<sup>st</sup> March, 2009 the fair value of plan assets was Rs.1,50,000 and present value of the defined benefit obligation was Rs.1,47,920. Acturial losses on the obligations for the year 2008-09 were Rs.600.

On 1<sup>st</sup> April, 2008 the company made the following estimates, based on its market studies, understanding and prevailing prices.

|                                                           | %             |
|-----------------------------------------------------------|---------------|
| Interest & dividend income, after tax payable by the fund | 9.25          |
| Realised and unrealised gains on plan assets (after tax)  | 2.00          |
| Fund administrative costs                                 | <u>(1.00)</u> |
| Expected Rate of Return                                   | <u>10.25</u>  |

You are required to find the expected and actual returns on plan assets. (10+4= 14 Marks)

## PAPER – 1 : ADVANCED ACCOUNTING

Answer

- (a) Central Govt. in consultation with National advisory Committee on Accounting Standards made an amendment to AS 11 "The Effects of Changes in Foreign Exchange Rates" vide Notification No. G.S.R.225(E), dated 31<sup>st</sup> March, 09 in the form of Companies (Accounting Standards) Amendment Rules, 2009. According to the Notification, any exchange gain or loss resulting from the translation of foreign currency monetary items not attributable to a depreciable asset should be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) Account and should be written off over the useful life of the assets but not beyond 31<sup>st</sup> March, 2011. The treatment availed at the option of the company shall be irrevocable and shall be exercised till 31<sup>st</sup> March, 2011. Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, previously, recognised in the profit and loss account before the exercise of the option shall be reversed in case of non-depreciable asset by transfer to Foreign Currency Monetary Item Translation Difference (FCMITD) Account, and by debit or credit, as the case may be, to the general reserve.

- (i) Table showing the Treatment of Forex Losses/gains as per amendment to AS 11

| Year ended                 | Opening<br>Balance in<br>FCMITD A/c<br>(Rs. in<br>crores) | Exchange<br>Gain/ (Loss)<br>(Rs. in<br>crores) | Total<br>(Rs. in<br>crores) | Amount<br>Recognised in<br>P&L A/c<br>(Rs. in crores) | Closing<br>Balance in<br>FCMITD A/c<br>(Rs. in crores) |
|----------------------------|-----------------------------------------------------------|------------------------------------------------|-----------------------------|-------------------------------------------------------|--------------------------------------------------------|
| 31 <sup>st</sup> March, 06 | Nil                                                       | (10)                                           | (10)                        | (10)                                                  | NIL                                                    |
| 31 <sup>st</sup> March, 07 | NIL                                                       | 20                                             |                             | 20                                                    | NIL                                                    |
| 31 <sup>st</sup> March, 08 | NIL                                                       | (90)                                           |                             | (22.50) <sup>1</sup>                                  | (67.50)                                                |
| 31 <sup>st</sup> March, 09 | (67.50)                                                   | (20)                                           | (87.50)                     | (29.17) <sup>2</sup>                                  | (58.33)                                                |
| 31 <sup>st</sup> March, 10 | (58.33)                                                   | (10)                                           | (68.33)                     | (34.17) <sup>3</sup>                                  | (34.16)                                                |
| 31 <sup>st</sup> March, 11 | (34.16)                                                   | (10)                                           | (44.16)                     | (44.16) <sup>4</sup>                                  | NIL                                                    |

- (ii) Disclosure Requirements:

- The company has chosen to avail the option provided by way of amendment in the Companies (AS) Amendment Rules, 2009.
- According to AS 1 "Disclosure of Accounting Policies", Exercise of option due to amendment in AS 11 is a change in accounting policy.
- The amount amortized to profit and loss account and the amount carried forwarded in each year till 31<sup>st</sup> March, 2011 should be disclosed.

<sup>1</sup> Total loss of Rs.90 crores will be amortised over 4 years till 2011. The amount of Rs.67.50 crores would be credited to General reserve and debited to FCMITD Account in the year 2008-09.

<sup>2</sup> Amount written off in 2008-09 is 29.17 crores [1/4 of Rs. 90 crores + 1/3 of Rs. 20 crores]

<sup>3</sup> Amount written off in 2009-10 is 34.17 crores [1/4 of Rs. 90 crores + 1/3 of Rs. 20 crores + 1/2 of Rs. 10 crores]

<sup>4</sup> Entire balance including exchange loss of current year is fully amortized.

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- (iii) Notification No. G.S.R.225(E) is relevant only for companies. If Pankaj Ltd., is a co-operative society, then the said notification would not be applicable. In that case, option to amortise FOREX losses over the period till 31.03.2011 will not be available to it. The amounts charged to Profit and loss account would be same as shown in the column carrying the heading "Exchange gain/Loss" in the table given under (i).

(b) Computation of Expected and Actual Returns on Plan Assets

|                                                                                                                                | Rs.             |
|--------------------------------------------------------------------------------------------------------------------------------|-----------------|
| Return on Rs. 1,00,000 held for 12 months at 10.25%                                                                            | 10,250          |
| Return on Rs. 30,000 (49,000-19,000) held for six months at 5%<br>(equivalent to 10.25% annually, compounded every six months) | <u>1,500</u>    |
| Expected return on plan assets for 2008-09                                                                                     | <u>11,750</u>   |
| Fair value of plan assets as on 31 March, 2009                                                                                 | 1,50,000        |
| Less: Fair value of plan assets as on 1 April, 2008                                                                            | 1,00,000        |
| Contributions received                                                                                                         | <u>49,000</u>   |
|                                                                                                                                | <u>1,49,000</u> |
|                                                                                                                                | 1,000           |
| Add: Benefits paid                                                                                                             | <u>19,000</u>   |
| Actual return on plan assets                                                                                                   | <u>20,000</u>   |

Question 5

- (a) Global Health Foundation furnishes the following information with regard to its Development Fund for the year 2009:

|                                                                                                                                    | Rs.       |
|------------------------------------------------------------------------------------------------------------------------------------|-----------|
| UN Grant received for building construction in Afganisthan                                                                         | 50,00,000 |
| Development Grant from Prize Foundation                                                                                            | 40,00,000 |
| Grants from private charities for acquiring land at Afganisthan                                                                    | 30,00,000 |
| Interest received on Fixed Deposits invested in Trust Bank @ 10 per cent per annum on 1 <sup>st</sup> July, 2009                   | 2,00,000  |
| Cost of land purchased for setting up Rehabilitation Centre at Afganisthan                                                         | 12,25,000 |
| Transfers from unrestricted fund for purchasing moveable assets                                                                    | 45,00,000 |
| Advance payment for acquiring balance land at Afganisthan                                                                          | 7,00,000  |
| Furniture purchased for Rehabilitation Project                                                                                     | 3,00,000  |
| Cost of 5 Desert Deuller Jeeps                                                                                                     | 35,00,000 |
| Amount settled to builders for construction of Rehabilitation Centre Building at Afganisthan based on percentage of work completed | 12,50,000 |
| Prepare a statement of Changes in Development Fund and a Balance Sheet of the Fund at the year end.                                |           |

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- (b) AS Ltd. Leased a machine to SB Ltd. on the following terms:

|                           | (Rs. In lakhs) |
|---------------------------|----------------|
| Fair value of the machine | 4.00           |
| Lease term                | 5 years        |
| Lease Rental Per annum    | 1.00           |
| Guaranteed Residual value | 0.20           |
| Expected Residual value   | 0.40           |
| Internal Rate of Return   | 15%            |

Depreciation is provided on straight line method at 10 per cent per annum. Ascertain Unearned Financial Income. Necessary Journal entries in the books of the Lessee in first year may be shown. (8+8= 16 Marks)

Answer

- (a) Statement of Changes in Development Fund for the year 2009

| Particulars                      | Rs.              | Rs.                |
|----------------------------------|------------------|--------------------|
| Receipts/Transfers               |                  |                    |
| UN Grant                         | 50,00,000        |                    |
| Grant - Prize Foundation         | 40,00,000        |                    |
| Private grants                   | 30,00,000        |                    |
| Fixed deposit Interest           | 2,00,000         |                    |
| Transfer from unrestricted funds | <u>45,00,000</u> | 1,67,00,000        |
| Payments/Transfers               |                  |                    |
| Land purchase- Afganisthan       | 12,25,000        |                    |
| Furniture purchased              | 3,00,000         |                    |
| Vehicles purchased               | <u>35,00,000</u> | <u>50,25,000</u>   |
| Balance as on 31.12.09           |                  | <u>1,16,75,000</u> |

Balance sheet of the Development Fund of Global Heath Foundation

as on 31st December, 2009

| Liabilities  | Amount<br>Rs. | Assets                      | Amount<br>Rs. |
|--------------|---------------|-----------------------------|---------------|
| Fund balance | 116,75,000    | Capital work in progress    | 12,50,000     |
|              |               | Land advance- Afghanistan   | 7,00,000      |
|              |               | Fixed deposit at Trust Bank |               |

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|                   |                        |                   |
|-------------------|------------------------|-------------------|
|                   | (2,00,000 x 100/10x 2) | 40,00,000         |
|                   | Bank balance           |                   |
|                   | (Refer working note)   | <u>57,25,000</u>  |
| <u>116,75,000</u> |                        | <u>116,75,000</u> |

Working Note:

| Bank Account                 |                   |                        |                   |
|------------------------------|-------------------|------------------------|-------------------|
|                              | Rs.               |                        | Rs.               |
| To UN Grants                 | 50,00,000         | By Fixed deposits      | 40,00,000         |
| To Grant - Prize Foundation  | 40,00,000         | By Land purchased      | 12,25,000         |
| To Private grants            | 30,00,000         | By Land advance        | 7,00,000          |
| To Interest on fixed deposit | 2,00,000          | By Furniture purchased | 3,00,000          |
| To Transfers from            |                   | By Vehicles purchased  | 35,00,000         |
| unrestricted funds           | 45,00,000         | By Payment to builders | 12,50,000         |
|                              |                   | By Balance c/d         | <u>57,25,000</u>  |
|                              | <u>167,00,000</u> |                        | <u>167,00,000</u> |

Note: Land costing Rs.12.25 lakhs, Furniture Rs.3 lakhs and Vehicles Rs.35 lakhs will be shown in the General balance sheet of Global Heath Foundation.

- (b) As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where :

- (a) Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

$$\begin{aligned}
 \text{Gross investment} &= \text{Minimum lease payments} + \text{Unguaranteed residual value} \\
 &= [\text{Total lease rent} + \text{Guaranteed residual value (GRV)}] + \text{Unguaranteed residual value (URV)} \\
 &= [(\text{Rs. } 1,00,000 \times 5 \text{ years}) + \text{Rs. } 20,000] + \text{Rs. } 20,000 \\
 &= \text{Rs. } 5,40,000 \text{ (a)}
 \end{aligned}$$



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- (b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

| Year | M.L.P. inclusive of URV<br>Rs. | Internal rate of return<br>( Discount factor @ 15%) | Present Value<br>Rs. |
|------|--------------------------------|-----------------------------------------------------|----------------------|
| 1    | 1,00,000                       | 0.8696                                              | 86,960               |
| 2    | 1,00,000                       | 0.7561                                              | 75,610               |
| 3    | 1,00,000                       | 0.6575                                              | 65,750               |
| 4    | 1,00,000                       | 0.5718                                              | 57,180               |
| 5    | 1,00,000                       | 0.4972                                              | 49,720               |
|      | <u>20,000</u> (GRV)            | 0.4972                                              | <u>9,944</u>         |
|      | 5,20,000                       |                                                     | 3,45,164 (i)         |
|      | <u>20,000</u> (URV)            | 0.4972                                              | <u>9,944</u> (ii)    |
|      | <u>5,40,000</u>                | (i) + (ii)                                          | <u>3,55,108</u> (b)  |

Unearned Finance Income = (a) – (b)  
= Rs. 5,40,000 – Rs. 3,55,108  
= Rs. 1,84,892

Journal Entries in the books of SB Ltd.

|                                                                                | Rs.           | Rs.       |
|--------------------------------------------------------------------------------|---------------|-----------|
| At the inception of lease                                                      |               |           |
| Machinery account                                                              | Dr. 3,45,164* |           |
| To AS Ltd.'s account                                                           |               | 3,45,164* |
| (Being lease of machinery recorded at present value of minimum lease payments) |               |           |
| At the end of the first year of lease                                          |               |           |
| Finance charges account                                                        | Dr. 51,775    |           |
| (Refer Working Note)                                                           |               |           |

---

\* As per para 11 of AS 19, the lessee should recognize the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 4,00,000 is more than the present value amounting Rs. 3,45,164, the machinery has been recorded at Rs. 3,45,164 in the books of SB Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

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|                                                                                                                               |     |          |          |
|-------------------------------------------------------------------------------------------------------------------------------|-----|----------|----------|
| To AS Ltd.'s account                                                                                                          |     |          | 51,775   |
| (Being the finance charges for first year due)                                                                                |     |          |          |
| AS Ltd.'s account                                                                                                             | Dr. | 1,00,000 |          |
| To Bank account                                                                                                               |     |          | 1,00,000 |
| (Being the lease rent paid to the lessor which includes outstanding liability of Rs. 48,225 and finance charge of Rs. 51,775) |     |          |          |
| Depreciation account <sup>£</sup>                                                                                             | Dr. | 34,516   |          |
| To Machinery account                                                                                                          |     |          | 34,516   |
| (Being the depreciation provided @ 10% p.a. on straight line method)                                                          |     |          |          |
| Profit and loss account                                                                                                       | Dr. | 86,291   |          |
| To Depreciation account                                                                                                       |     |          | 34,516   |
| To Finance charges account                                                                                                    |     |          | 51,775   |
| (Being the depreciation and finance charges transferred to profit and loss account)                                           |     |          |          |

**Working Note:**

Table showing apportionment of lease payments by SB Ltd. between the finance charges and the reduction of outstanding liability

| Year | Outstanding liability (opening balance) | Minimum lease payments | Finance charges | Reduction in principal amount | Outstanding liability (closing balance) |
|------|-----------------------------------------|------------------------|-----------------|-------------------------------|-----------------------------------------|
|      | Rs.                                     | Rs.                    | Rs.             | Rs.                           | Rs.                                     |
| 1    | 3,45,164                                | 1,00,000               | 51,775          | 48,225                        | 2,96,939                                |
| 2    | 2,96,939                                | 1,00,000               | 44,541          | 55,459                        | 2,41,480                                |
| 3    | 2,41,480                                | 1,00,000               | 36,222          | 63,778                        | 1,77,702                                |
| 4    | 1,77,702                                | 1,00,000               | 26,655          | 73,345                        | 1,04,357                                |
| 5    | 1,04,357                                | 1,00,000               | 15,654          | 84,346                        | 20,011*                                 |

<sup>£</sup> Depreciation has been provided on the basis that the machine has been leased at the beginning of the year.

\* The difference between this figure and guaranteed residual value (Rs. 20,000) is due to approximation in computing the interest rate implicit in the lease.

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### Question 6

In preparing the Financial Statements of Santhanam Ltd. for the year ended 31<sup>st</sup> March, 2009, you come across the following features. State with reasons, how you would deal with them in the Financial Statements:

- (i) An unquoted long term investment is carried in the books at its cost of Rs.5 lakhs. The Published Accounts of the unlisted company received in May, 2009 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs.80,000.
- (ii) The Company invested Rs.560 lakhs in April, 2009 in the acquisition of another company doing similar business, the negotiations for which had started during the current financial year.
- (iii) There was a major theft of stores valued at Rs.46 lakhs in the preceding year which was detected only during the current financial year. (5+5+6= 16 Marks)

### Answer

As it is stated in the question that financial statements for the year ended 31.3.2009 are under preparation, the views given are on the basis that the financial statements are yet to be approved by the Board of Directors. Para 3.2 of AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date" defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company.

- (i) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On this basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 80,000 in the financial statements for the year ended 31<sup>st</sup> March, 2009.
- (ii) The acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31<sup>st</sup> March, 2009. Applying Para 15 of AS 4 (Revised), which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 560

### **FINAL EXAMINATION: NOVEMBER, 2009**

lakhs in April, 2009 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

- (iii) Due to major theft of stores in the preceding year (2007-08) which was detected only during the current financial year (2008-09), there was overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". Accordingly, the adjustments relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. The disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2009.

## PAPER – 1 : ADVANCED ACCOUNTING

Answer **all** questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidates.

### Question 1

The summarized Balance Sheets of Kush Ltd. and Shuk Ltd. as at 31<sup>st</sup> March, 2010 are as follows:

(Figures in lakhs)

| Liabilities                  | Kush Ltd.    | Shuk Ltd.    | Assets                                 | Kush Ltd.    | Shuk Ltd.    |
|------------------------------|--------------|--------------|----------------------------------------|--------------|--------------|
|                              | Rs.          | Rs.          |                                        | Rs.          | Rs.          |
| Share capital:               |              |              | Plant at cost less depreciation        | 86.4         | 72.9         |
| Equity shares of Rs. 10 each | 216.0        | 108.0        | Furniture, Fixtures & Fittings         | 23.4         | 7.2          |
| Securities premium           | 32.4         | -            | Stock at cost                          | 18.0         | 13.5         |
| Capital reserve on 1.04.09   | -            | 7.2          | Debtors                                | 73.8         | 47.6         |
| General reserve on 1.04.09   | 13.5         | 9.0          | Trade investment                       | -            | 2.7          |
| Profit & Loss A/c            | 70.2         | 21.6         | Goodwill at cost                       | 45.0         | 13.6         |
| Creditors                    | 29.7         | 19.7         | Investment:                            |              |              |
|                              |              |              | 8.64 lakhs shares of Shuk Ltd. at cost | 97.2         | -            |
|                              |              |              | Balance at bank                        | 18.0         | 8.0          |
|                              | <u>361.8</u> | <u>165.5</u> |                                        | <u>361.8</u> | <u>165.5</u> |

Additional information:

- (1) On 1<sup>st</sup> April, 2009 Kush Ltd. acquired from the shareholders of Shuk Ltd. 8.64 lakhs shares of Rs. 10 each in Shuk Ltd. and allotted in consideration thereof 6.48 lakhs of its own shares of Rs. 10 each at a premium of Rs. 5 per share.
- (2) The consideration for the shares of Shuk Ltd. was arrived at inter-alia by valuing certain assets of Shuk Ltd. on 1<sup>st</sup> April, 2009 as under:
  - (i) Plant at Rs. 90 lakhs
  - (ii) Furniture, Fixtures & Fittings at Rs. 8 lakhs
  - (iii) No value on Trade Investment and Goodwill.

No adjustments were made in the books of accounts of Shuk Ltd. in respect of the above valuation.

During 2009-10 there was no purchase or sale of these assets. It is desired that such adjustments should however be made in the Consolidated Accounts.

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- (3) The figures for Plant and Furniture, Fixtures and Fittings at 31.3.2010 shown in the Balance Sheet are after providing depreciation for 2009-10 at the rates of 10 per cent per annum and 20 per cent per annum respectively, on the book values as at 1.04.09.
- (4) The Profit and Loss Account of Shuk Ltd. showed a Credit balance of Rs. 27 lakhs on 1.04.09. A dividend of 10% was paid in January, 2010 for the year 2008-09. This dividend was credited to Profit and Loss Account of Kush Ltd.
- (5) The following point was not considered in making out the accounts:  
During the year, expenses of Rs. 4,500 per month were incurred by Kush Ltd. on behalf of Shuk Ltd. It was by mistake debited to Profit and Loss Account of Kush Ltd. and nothing has been done in the accounts of Shuk Ltd.
- (6) The stock of Shuk Ltd included Rs. 4.5 lakhs of goods received from Kush Ltd. invoiced at cost plus 25 per cent.
- (7) Debtors of Shuk Ltd. include Rs. 3.5 lakhs due from Kush Ltd. whereas Creditors of Kush Ltd. include Rs. 3.1 lakhs due to Shuk Ltd., the difference being represented by a cheque in transit.

You are required to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Kush Ltd. and its subsidiary as at 31<sup>st</sup> March, 2010.

(20 Marks)

**Answer**

**Consolidated Balance Sheet of Kush Ltd. and its subsidiary Shuk Ltd.**

**As on 31<sup>st</sup> March, 2010**

| (Rs. in lakhs)                  |                |                                        |                |
|---------------------------------|----------------|----------------------------------------|----------------|
| Liabilities                     | Rs.            | Assets                                 | Rs.            |
| Share Capital                   |                | Fixed Assets                           |                |
| Equity shares of Rs. 10 each    | 216.000        | Goodwill (W.N.2)                       | 27.880         |
| Minority Interest (W.N.3)       | 27.252         | Plant (W.N.8)                          | 167.400        |
| Reserves & Surplus              |                | Furniture, fixtures & fittings (W.N.9) | 29.800         |
| Securities premium              | 32.400         | Current Assets                         |                |
| General reserve                 | 13.500         | Stock (W.N.10)                         | 30.600         |
| Profit and loss account (W.N.4) | 64.528         | Debtors (W.N.11)                       | 117.900        |
| Current Liabilities             |                | Balance at bank                        |                |
| Creditors (W.N.12)              | 46.300         | (Rs.18 lakhs + Rs.8 lakhs)             | 26.000         |
|                                 |                | Cash in transit                        |                |
|                                 |                | (Rs.3.5 lakhs – Rs.3.1 lakhs)          | <u>0.400</u>   |
|                                 | <u>399.980</u> |                                        | <u>399.980</u> |

**PAPER – 1 : ADVANCED ACCOUNTING**

**Working Notes:**

**1. Analysis of Profits & Reserves of Shuk Ltd.**

| (Rs. in lakhs)                                                        |                |                     |                 |                     |
|-----------------------------------------------------------------------|----------------|---------------------|-----------------|---------------------|
|                                                                       |                | Pre-<br>Acquisition |                 | Post<br>Acquisition |
| [Profit and loss account balance as on 31.3.2010 is Rs.21.60 lakhs]   |                |                     |                 |                     |
| Profit and loss account balance on 1.4.2009                           | 27.00          |                     |                 |                     |
| Less: Dividend for 2008-09                                            | <u>(10.80)</u> | 16.20               | (21.60 – 16.20) | 5.40                |
| Capital reserve on 1.4.2009                                           |                | 7.20                |                 |                     |
| General reserve on 1.4.2009                                           |                | 9.00                |                 |                     |
| Upward revaluation of plant (W.N.6)                                   |                | 9.00                |                 |                     |
| Downward revaluation of furniture, fixtures and fittings (W.N.7)      |                | (1.00)              |                 |                     |
| Trade Investment written off                                          |                | (2.70)              |                 |                     |
| Goodwill written off                                                  |                | (13.60)             |                 |                     |
| Additional depreciation on plant                                      |                |                     |                 | (0.90)              |
| Overcharged depreciation on furniture, fixtures and fittings          |                |                     |                 | 0.20                |
| Expenses paid by Kush Ltd. on behalf of Shuk Ltd.<br>(Rs. 4,500 x 12) |                |                     |                 | <u>(0.54)</u>       |
|                                                                       |                | <u>24.10</u>        |                 | <u>4.16</u>         |
| Share of Kush Ltd. (80%)                                              |                | 19.28               |                 | 3.328               |
| Minority interest (20%)                                               |                | 4.82                |                 | 0.832               |

**2. Cost of Control**

|                                                                                                  |              | (Rs. in lakhs)  |
|--------------------------------------------------------------------------------------------------|--------------|-----------------|
| Amount paid for investment in Shuk Ltd.                                                          |              | 97.20           |
| Less: Dividend for the year 2008-09                                                              |              | <u>(8.64)</u>   |
|                                                                                                  |              | 88.56           |
| Less: Nominal value of shares acquired                                                           | 86.40        |                 |
| Share in pre-acquisition profit (80%)                                                            | <u>19.28</u> | <u>(105.68)</u> |
| Capital reserve                                                                                  |              | <u>17.12</u>    |
| Goodwill to be shown in the consolidated balance sheet =<br>(Rs. 45.00 lakhs – Rs. 17.12 lakhs ) |              | Rs. 27.88 lakhs |

**FINAL (OLD) EXAMINATION : MAY, 2010**

**3. Minority Interest**

|                                        | (Rs. in lakhs) |
|----------------------------------------|----------------|
| Share Capital (20%)                    | 21.600         |
| Share in pre-acquisition profit (20%)  | 4.820          |
| Share in post-acquisition profit (20%) | <u>0.832</u>   |
|                                        | <u>27.252</u>  |

**4. Consolidated Profit and Loss Account of Kush Ltd. as on 31.3.2010**

|                                                           | (Rs. in lakhs) |
|-----------------------------------------------------------|----------------|
| Profit and loss account balance of Kush Ltd. on 31.3.2010 | 70.200         |
| Less: Dividend for the year 2008-09                       | <u>(8.640)</u> |
|                                                           | 61.560         |
| Add: Expenses met by Kush on behalf of Shuk Ltd.          | <u>0.540</u>   |
|                                                           | 62.100         |
| Add: Share in post acquisition profit of Shuk Ltd.        | <u>3.328</u>   |
|                                                           | 65.428         |
| Less: Unrealized profit on stock (W.N.5)                  | <u>(0.900)</u> |
|                                                           | <u>64.528</u>  |

5. Unrealized profit on stock =  $\frac{\text{Rs. 4.5 lakhs} \times 25}{125} = \text{Rs. 0.9 lakhs}$

**6. Upward revaluation of Plant of Shuk Ltd.**

$$\left[ \text{Rs. 90 lakhs} - \left( \text{Rs. 72.9 lakhs} \times \frac{100}{90} \right) \right] = \text{Rs. 9 lakhs}$$

**7. Downward revaluation of Furniture, Fixtures & Fittings of Shuk Ltd.**

$$[\text{Rs. 8 lakhs} - (\text{Rs. 7.2 lakhs} \times \frac{100}{80})] = \text{Rs. 1 lakh}$$

**8. Value of Plant in the consolidated balance sheet**

*Rs. in lakhs*

|                                             | <i>Kush Ltd.</i> | <i>Shuk Ltd.</i> | <i>Total</i> |
|---------------------------------------------|------------------|------------------|--------------|
| Balance as on 31.3.2010                     | 72.9             | 86.4             |              |
| Add: Upward revaluation                     | <u>9.0</u>       |                  |              |
|                                             | 81.9             |                  |              |
| Less: Additional depreciation to be charged | <u>(0.9)</u>     |                  |              |
|                                             | <u>81.0</u>      | <u>86.4</u>      | <u>167.4</u> |



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**9. Value of Furniture, Fixtures & Fittings in the consolidated balance sheet**

| <i>Rs. in lakhs</i>          |                  |                  |               |
|------------------------------|------------------|------------------|---------------|
|                              | <i>Kush Ltd.</i> | <i>Shuk Ltd.</i> | <i>Total</i>  |
|                              | 7.2              | 23.4             |               |
| Less: Downward revaluation   | <u>(1.0)</u>     |                  |               |
|                              | 6.2              |                  |               |
| Add: Additional depreciation | <u>0.2</u>       | <u>      </u>    | <u>      </u> |
|                              | <u>6.4</u>       | <u>23.4</u>      | <u>29.8</u>   |

**10. Value of Stock in the consolidated balance sheet**

|                         | <i>Rs. in lakhs</i> |
|-------------------------|---------------------|
| Kush Ltd.               | 18.0                |
| Shuk Ltd.               | <u>13.5</u>         |
|                         | 31.5                |
| Less: Unrealized profit | <u>(0.9)</u>        |
|                         | <u>30.6</u>         |

**11. Sundry Debtors in the consolidated balance sheet**

|                           | <i>Rs. in lakhs</i> |
|---------------------------|---------------------|
| Kush Ltd.                 | 73.8                |
| Shuk Ltd.                 | <u>47.6</u>         |
|                           | 121.4               |
| Less: Inter-company debts | <u>(3.5)</u>        |
|                           | <u>117.9</u>        |

**12. Sundry Creditors in the consolidated balance sheet**

|                           | <i>Rs. in lakhs</i> |
|---------------------------|---------------------|
| Kush Ltd.                 | 29.7                |
| Shuk Ltd.                 | <u>19.7</u>         |
|                           | 49.4                |
| Less: Inter-company debts | <u>(3.1)</u>        |
|                           | <u>46.3</u>         |

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**Question 2**

(a) The summarized Balance Sheet of 'Janmejaya' Private Ltd. as on 31.03.2010 is as under:

| Liabilities               | Amount<br>Rs.    | Assets             |               | Amount<br>Rs.    |
|---------------------------|------------------|--------------------|---------------|------------------|
| Share Capital:            |                  | Fixed Assets:      |               |                  |
| Equity Shares of          |                  | Goodwill           |               | 1,75,000         |
| Rs. 10 each               | 5,00,000         | Leasehold Property | 1,60,000      |                  |
| 8% Preference Shares      |                  | (-) Depreciation   | <u>70,000</u> | 90,000           |
| of Rs. 10 each fully paid | 2,00,000         | Plant & Machinery  | 2,50,000      |                  |
| Reserve & Surplus:        |                  | (-) Depreciation   | <u>25,000</u> | 2,25,000         |
| General Reserve           | 1,00,000         | Investment at cost |               | 4,00,000         |
| Profit & Loss Account     | 2,20,250         | Current Assets:    |               |                  |
| Current Liabilities:      |                  | Stock at cost      |               | 82,500           |
| Bank Loan                 | 1,00,000         | Sundry Debtors     |               | 40,500           |
| Sundry Creditors          | <u>49,750</u>    | Balance at Bank    |               | <u>1,57,000</u>  |
|                           | <u>11,70,000</u> |                    |               | <u>11,70,000</u> |

A holder of 10,000 equity shares in the company has agreed to sell these shares at a value based on the above Balance Sheet, but subject to adjustment of the valuation of the following:

- (1) The leasehold property was acquired on 1.4.2000 and at the Balance Sheet date the lease has a further six years to run. The cost should be written off over the term of the lease by equal annual charges. Till date, Rs. 7,000 per annum had been written off.
- (2) In 2007-08, goods costing Rs. 6,000 were purchased and have been included since that date at cost in the Stock lists. The goods were valueless on the Balance Sheet date.
- (3) An expense Creditor Rs. 3,750 of the current year has been omitted from being recorded in the books.
- (4) A General Reserve of 10 per cent on total Debtors, after specific provision for Doubtful Debts, has been made for the first time in the current year accounts.
- (5) Goodwill is to be valued at two years' purchase of the average profits, after the above adjustments, of three years 2007-08; 2008-09; and 2009-10, such profits being those available for dividend for Equity shareholders.

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- (6) The profits of the company as shown by the accounts before appropriations and before providing for preference dividends were as follows:

| Year    | Rupees |
|---------|--------|
| 2007-08 | 80,400 |
| 2008-09 | 92,900 |
| 2009-10 | 89,650 |

You are required to compute the total consideration due to the Vending Shareholder.

- (b) From the following data compute the Economic Value Added:

|                                |                  |
|--------------------------------|------------------|
| Share Capital                  | Rs. 1,600 crores |
| Long-term Debt                 | Rs. 320 crores   |
| Interest                       | Rs. 32 crores    |
| Reserve and Surplus            | Rs. 3,200 crores |
| Profit before Interest and Tax | Rs. 1,432 crores |
| Tax Rate                       | 30%              |
| Beta Factor                    | 1.05             |
| Market Rate of Return          | 14%              |
| Risk Free Rate                 | 10%              |

(10+6= 16 Marks)

**Answer**

- (a) Calculation of Adjusted Profits of Janmejy Ltd.

|                                                                                    | Year 2007-08<br>Rs. |                 | Year 2008-09<br>Rs. |                 | Year 2009-10<br>Rs. |                 |
|------------------------------------------------------------------------------------|---------------------|-----------------|---------------------|-----------------|---------------------|-----------------|
| Profit before appropriation and preference dividend                                |                     | 80,400          |                     | 92,900          |                     | 89,650          |
| Less: Under provision of writing off of lease                                      | 3,000               |                 | 3,000               |                 | 3,000               |                 |
| Stock written off                                                                  | -                   |                 | -                   |                 | 6,000               |                 |
| Expenses omitted                                                                   | -                   |                 | -                   |                 | 3,750               |                 |
| Dividend on preference shares                                                      | <u>16,000</u>       | <u>(19,000)</u> | <u>16,000</u>       | <u>(19,000)</u> | <u>16,000</u>       | <u>(28,750)</u> |
|                                                                                    |                     | 61,400          |                     | 73,900          |                     | 60,900          |
| Add: General reserve created on 31.3.10 on debtors in excess of specific provision |                     | <u>-</u>        |                     | <u>-</u>        |                     | <u>4,500</u>    |
| Adjusted profits                                                                   |                     | <u>61,400</u>   |                     | <u>73,900</u>   |                     | <u>65,400</u>   |

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$$\text{Adjusted average profits} = \frac{\text{Rs. 61,400} + \text{Rs. 73,900} + \text{Rs. 65,400}}{3} = \text{Rs. 66,900}$$

$$\text{Goodwill} = \text{Rs. 66,900} \times 2 = \text{Rs. 1,33,800}$$

**Net Assets owned by Equity Shareholders**

|                                                                             | Rs.               |
|-----------------------------------------------------------------------------|-------------------|
| Goodwill                                                                    | 1,33,800          |
| Leasehold property $\left( \frac{\text{Rs. 1,60,000}}{16} \times 6 \right)$ | 60,000            |
| Plant and machinery                                                         | 2,25,000          |
| Investments                                                                 | 4,00,000          |
| Stock (Rs. 82,500 – Rs. 6,000)                                              | 76,500            |
| Sundry debtors (Rs. 40,500 + Rs. 4,500)                                     | 45,000            |
| Bank balance                                                                | <u>1,57,000</u>   |
|                                                                             | 10,97,300         |
| Less: Current liabilities:                                                  |                   |
| Bank loan                                                                   | 1,00,000          |
| Sundry creditors (Rs. 49,750 + Rs. 3750)                                    | <u>53,500</u>     |
|                                                                             | (1,53,500)        |
|                                                                             | 9,43,800          |
| Less: Preference share capital                                              | <u>(2,00,000)</u> |
| Net assets owned by equity shareholders                                     | <u>7,43,800</u>   |

$$\text{Value per equity share} = \frac{\text{Rs. 7,43,800}}{50,000} = \text{Rs. 14.876}$$

$$\begin{aligned} \text{Total consideration due to vending shareholder} &= 10,000 \text{ Equity shares @ Rs. 14.876} \\ &= \text{Rs. 1,48,760} \end{aligned}$$

**(b) Computation of Economic Value Added**

|                                                       | Rs. in crores |
|-------------------------------------------------------|---------------|
| Net operating profit after tax (Refer working note 5) | 980.0         |
| Add: Cost of debt (7% of Rs. 320 crores)              | <u>22.4</u>   |
|                                                       | 1002.4        |
| Less: Cost of capital (13.75% of Rs. 5,120 crores)    | <u>704.0</u>  |
| Economic Value Added                                  | <u>298.4</u>  |

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### Working Notes:

#### 1. Cost of Equity

$$\begin{aligned}\text{Cost of equity} &= \text{Risk Free Rate} + \text{Beta factor} \times (\text{Market Rate} - \text{Risk Free Rate}) \\ &= 10 + 1.05 (14 - 10) \\ &= 14.20\%\end{aligned}$$

#### 2. Cost of Debt

|                                                    | <i>Rs. in crores</i> |
|----------------------------------------------------|----------------------|
| Interest                                           | 32.0                 |
| Less: Tax @ 30%                                    | <u>9.6</u>           |
|                                                    | <u>22.4</u>          |
| Cost of Debt = $\frac{22.4}{320} \times 100 = 7\%$ |                      |

#### 3. Capital Employed

|                      | <i>Rs. in crores</i> |
|----------------------|----------------------|
| Share capital        | 1,600                |
| Reserves and surplus | 3,200                |
| Long term debt       | <u>320</u>           |
|                      | <u>5,120</u>         |

#### 4. Weighted Average Cost of Capital (WACC)

|                                                   | <i>Rs. in crores</i> |
|---------------------------------------------------|----------------------|
| Cost of Equity (14.20% of Rs. 4,800 crores)       | 681.6                |
| Cost of Debt [7% (Refer W.N.2) of Rs. 320 crores] | <u>22.4</u>          |
|                                                   | <u>704.0</u>         |
| WACC = $\frac{704}{5,120} \times 100 = 13.75\%$   |                      |

#### 5. Calculation of Net Operating Profit after Tax

|                                  | <i>Rs. in crores</i> |
|----------------------------------|----------------------|
| Profit before interest and tax   | 1,432                |
| Less: Interest on long term debt | <u>(32)</u>          |
|                                  | 1,400                |
| Less: Tax (30% of Rs. 1,400)     | <u>(420)</u>         |
| Net operating profit after tax   | <u>980</u>           |

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**Question 3**

- (a) Modern Cars Ltd. is engaged in the business of manufacture of electric passenger cars. The Company requires you to determine the value of its goodwill also showing the leverage effect on goodwill. Its Balance Sheet as on 31.03.2010 is as under:

*Balance Sheet of Modern Cars Ltd. as at 31<sup>st</sup> March, 2010*

| Liabilities                                         | Rs.<br>(Lakh) | Assets                        | Rs.<br>(Lakh) | Rs.<br>(Lakh) |
|-----------------------------------------------------|---------------|-------------------------------|---------------|---------------|
| Share Capital:<br>(Equity Shares of<br>Rs. 10 each) | 1,500         | Gross Fixed Assets            | 1,500         |               |
| General Reserve                                     | 500           | Less: Depreciation till date  | <u>500</u>    | 1,000         |
| 12% Term Loan from bank                             | 500           | Investments:                  |               |               |
| Creditors                                           | 210           | Non-trade                     | 300           |               |
| Provision for Tax                                   | 10            | Trade                         | <u>90</u>     | 390           |
| Proposed Dividend                                   | 140           | Current Assets:               |               |               |
|                                                     |               | Overseas Debtors (1\$=INR 42) | 420           |               |
|                                                     |               | Indian Debtors                | <u>400</u>    | 820           |
|                                                     |               | Stock in Trade                |               | 350           |
|                                                     |               | Cash and Bank Balances        |               | <u>300</u>    |
|                                                     | <u>2,860</u>  |                               |               | <u>2,860</u>  |

Additional information:

The closing exchange rate for the U.S. dollar was INR 48. There was a loss for the year ended 31.03.2010 owing to write down of cost of acquisition of non trade investments by 4%. There was no other transaction under non-trade investments during the year.

Current year depreciation charged on historical cost was Rs. 100 lakhs. Current cost of Fixed assets is determined at Rs. 2,000 lakhs.

While current cost of closing stock is Rs.367, that of the opening stock was Rs. 200 lakhs against its historical cost of Rs. 148 lakhs. The market value of non-trade Investments at the year end was Rs. 300 lakhs. The overseas debtors made settlements in U.S. \$ only.

The industry average rate of return on current cost of capital employed is 12% on long-term debt, and 15% on equity. The opening balance in general reserve was Rs. 150 lakhs. While prevailing tax rate is 30% such rate is expected to decline by 5%.

Using the above information you are required to arrive at value of the goodwill of the company under equity and long-term fund approaches and also show the leverage effect on Goodwill

- (b) Aakshaya Ltd. has given a 12.50% fixed rate loan to its subsidiary Shaya Ltd. Aakshaya Ltd. measures this loan at an amortised cost of Rs. 2,50,000. Aakshaya Ltd. has plans to

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hive off the receivable at a later stage and as a measure to safeguard against fall in value of its dues enters into a pay-fixed, receive floating interest rate swap to convert the fixed interest receipts into floating interest receipts. Aakshaya Ltd. designates the swap as a Hedging instrument in a fair value hedge of the Loan Asset.

Over the following months, market interest rates increase and Aakshaya Ltd. earns interest income of Rs. 25,000 on the loan and Rs. 1,000 as net interest payments on the swap. The Fair value of the Loan Asset decreases by Rs. 5,000 while that of the interest rate swap increases by 5,000. You are informed that all conditions required for the Hedge Accounting are satisfied. You are required to pass Journal Entries, with suitable narrations, in the books of Aakshaya Ltd. to record the above transactions.

(10+6= 16 Marks)

**Answer**

**(a) Future Maintainable Profit**

| Rs. in Lakhs                                                                   |               |                 |
|--------------------------------------------------------------------------------|---------------|-----------------|
| Profit made in the year 2009-10                                                |               |                 |
| Increase in reserve (Rs. 500 lakhs – Rs.150 lakhs)                             | 350.00        |                 |
| Add: Proposed dividend                                                         | <u>140.00</u> |                 |
| Profit after tax                                                               | 490.00        |                 |
| Add back: Income tax $\left( \frac{490 \times 30\%}{70\%} \right)$             | <u>210.00</u> | 700.00          |
| Less: Additional depreciation required(W.N.1)                                  | 81.82         |                 |
| Adjustment for change in revaluation of stock (opening and closing)(W.N.2)     | <u>35.00</u>  | <u>116.82</u>   |
|                                                                                |               | 583.18          |
| Add: Debtors' adjustment- exchange gain (W.N. 3)                               |               | 60.00           |
| Add: Loss on non trade investment [Rs. lakhs (300 x 100/96) – 300]             |               | <u>12.50</u>    |
|                                                                                |               | 655.68          |
| Less: Tax @ 25%                                                                |               | <u>(163.92)</u> |
| Profit after tax under equity approach                                         |               | 491.76          |
| Add Back: Interest on term loans (net of taxes)<br>[Rs. 500 lakhs x 12% x 75%] |               | <u>45.00</u>    |
| Profit after tax under long term fund approach                                 |               | <u>536.76</u>   |

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**Capital Employed**

| <i>Rs. in lakhs</i>                            |                 |
|------------------------------------------------|-----------------|
| Assets as per Balance Sheet                    | 2,860.00        |
| Less: Non trade investments                    | <u>300.00</u>   |
|                                                | 2,560.00        |
| Add: Current cost adjustments:                 |                 |
| Net increase in fixed assets costs             | 818.18          |
| [Rs. (2000*-1100) lakhs – Rs. 81.82 lakhs]     |                 |
| Increase in the value of closing stock         |                 |
| (Rs. 367 lakhs – Rs. 350 lakhs)                | 17.00           |
| Increase in the value of debtors               | <u>60.00</u>    |
|                                                | <u>895.18</u>   |
|                                                | 3,455.18        |
| Less: External liabilities:                    |                 |
| Sundry creditors                               | 210.00          |
| Provision for tax                              | 10.00           |
| 12% Term loan                                  | <u>500.00</u>   |
|                                                | <u>720.00</u>   |
| Capital employed under equity approach         | 2,735.18        |
| Add: 12% Term loan                             | <u>500.00</u>   |
| Capital employed under long term fund approach | <u>3,235.18</u> |

**Valuation of Goodwill\***

| <b>Equity approach</b>                                                        | <i>Rs. in lakhs</i> |
|-------------------------------------------------------------------------------|---------------------|
| Capitalized value of future maintainable profit @ 15% = $\frac{491.76}{15\%}$ | 3,278.40            |
| Less: Capital employed under equity approach                                  | <u>2,735.18</u>     |
| Goodwill under equity approach                                                | <u>543.22</u>       |

\* It is assumed that current cost of fixed assets amounting Rs. 2,000 lakhs is determined on 1.4.2009.

\* Goodwill has been computed on the basis of closing capital employed.



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| Long term fund approach                                                       | Rs. in lakhs    |
|-------------------------------------------------------------------------------|-----------------|
| Capitalised value of future maintainable profit @ 12% = $\frac{536.76}{12\%}$ | 4,473.00        |
| Less: Capital employed under long term fund approach                          | <u>3,235.18</u> |
| Goodwill under long term fund approach                                        | <u>1,237.82</u> |

### Leverage effect on goodwill

The adverse leverage effect on goodwill is Rs. 694.60 lakhs (Rs.1,237.82 lakhs – Rs. 543.22 lakhs). Modern Cars Ltd. has a low leverage ratio and its goodwill value is lower under equity approach as compared to that under the long term fund approach.

### Working Notes:

#### 1. Shortfall in depreciation

|                                                             | Rs. in lakhs |
|-------------------------------------------------------------|--------------|
| Current cost of fixed assets as on 1.4.2009                 | <u>2,000</u> |
| Value of fixed assets as per balance sheet on 31.3.10 1,000 |              |
| Add back: Depreciation for 2009-10 <u>100</u>               |              |
| Cost of fixed assets on 1.4.2009 <u>1,100</u>               |              |
| Depreciation rate $(100/1,100) \times 100 = 9.091\%$        |              |
| Revised amount of depreciation (Rs. 2,000 lakhs x 9.091%)   | 181.82       |
| Less: Depreciation already charged <u>100.00</u>            |              |
| Additional depreciation to be provided                      | <u>81.82</u> |

#### 2. Stock adjustment

|                                                              | Rs. in lakhs |
|--------------------------------------------------------------|--------------|
| Increase in current cost of opening stock Rs.(200-148) lakhs | 52           |
| Increase in current cost of closing stock Rs.(367-350) lakhs | <u>17</u>    |
| Stock adjustment                                             | <u>35</u>    |

#### 3. Debtors' adjustment

|                                                               | Rs. in lakhs |
|---------------------------------------------------------------|--------------|
| Overseas Debtors in US\$ = $420/42 = \$10$ lakhs              |              |
| Overseas Debtors in INR at the end of the year( \$ 10x Rs.48) | 480          |
| Less: Balance Sheet value of overseas debtors                 | <u>420</u>   |
| Gain due to change in exchange rate                           | <u>60</u>    |

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**(b) Journal Entries in the books of Aakashya Ltd.**

|                                                                                                                                                               | Rs.    | Rs.    |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|--------|
| Cash account Dr.<br>To Interest account<br>(Being the receipt of interest income on the loan asset)                                                           | 25,000 | 25,000 |
| Derivative account Dr.<br>To Hedging gain account<br>(Being increase in the fair value of the interest rate swap)                                             | 5,000  | 5,000  |
| Hedging loss account Dr.<br>To Loan to Shaya Ltd. account<br>(Being decrease in the fair value of loan to Shaya Ltd attributable to the hedged risk recorded) | 5,000  | 5,000  |
| Cash Account Dr.<br>To Interest account<br>(Being the entry to record the interest settlement of the swap as increase in interest income)                     | 1,000  | 1,000  |

**Question 4**

(a) Perrotte Ltd. has the following Capital Structure as on 31.03.2009:

|     | Particulars                                             | (Rs. in crores) |       |
|-----|---------------------------------------------------------|-----------------|-------|
| (1) | Equity Share Capital (Shares of Rs. 10 each fully paid) | -               | 330   |
| (2) | Reserves and Surplus                                    |                 |       |
|     | General Reserve                                         | 240             | -     |
|     | Securities Premium Account                              | 90              | -     |
|     | Profit & Loss Account                                   | 90              | -     |
|     | Infrastructure Development Reserve                      | 180             | 600   |
| (3) | Loan Funds                                              |                 | 1,800 |

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.2009 a proposal to buy back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs. 25 per share and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs. 1,200 crores or Rs. 1,500 crores.

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Assuming that the entire buy back is completed by 09.12.2009, show the accounting entries in the company's books in each situation. Narrations should form part of your answer.

- (b) Friendly Ltd granted Rs. 100 lakhs as loan to its employees on 1<sup>st</sup> January, 2009 at a concessional rate of interest of 4 per cent per annum on the condition that the loan is to be repaid in five equal annual instalments along with interest thereon. You are informed that the prevailing lending rate for such risk profiles is 10% p.a. You are required to find out at what value the loan should be recognized initially and the amount of annual amortization till closure thereof. Show Journal Entries with appropriate narrations that will be recorded in the company's Books in the year 2009.

[Present value of an Indian Rupee at a discount rate of 10 per cent per annum will be .9090, .8263, .7512, .6829 and .6208 which is to be adopted for purposes of calculation].  
(8 + 8 =16 Marks)

### Answer

#### (a) Statement determining the maximum number of shares to be bought back

Number of shares

| Particulars *                                                         | Situation 1 | Situation 2 | Situation 3 |
|-----------------------------------------------------------------------|-------------|-------------|-------------|
| Shares Outstanding Test (W.N.1)                                       | 8.25        | 8.25        | 8.25        |
| Resources Test (W.N.2)                                                | 6.25        | 6.25        | 6.25        |
| Debt Equity Ratio Test (W.N.3)                                        | Nil         | 5.00        | Nil         |
| Maximum number of shares that can be bought back [least of the above] | Nil         | 5.00        | Nil         |

#### Journal Entries for the Buy Back (applicable only for situation 2)

|     |                                                                                                                                                                                             | Rs. in crores              |        |
|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|--------|
|     |                                                                                                                                                                                             | Debit                      | Credit |
| (a) | Equity share buy back account<br>To Bank account<br>(Being buy back of five crores equity shares of Rs. 10 each @ Rs. 30 per share)                                                         | Dr. 150                    | 150    |
| (b) | Equity share capital account<br>Securities premium account<br>General reserve account (Balancing figure.)<br>To Equity share buy back account<br>(Being cancellation of shares bought back) | Dr. 50<br>Dr. 90<br>Dr. 10 | 150    |

\* Situation 1: When loan funds are Rs. 1,800 crores.

Situation 2: When loan funds are Rs. 1,200 crores.

Situation 3: When loan funds are Rs. 1,500 crores.

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|     |                                                                                                                                                                                                              |     |    |    |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----|----|
| (c) | General reserve account<br>To Capital redemption reserve account<br>(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital redeemed through free reserves) | Dr. | 50 | 50 |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|----|----|

**Note :** Under Situations 1 & 3 the company does not qualify for buy back of shares as per the provisions of Section 77A of the Companies Act, 1956.

**Working Notes:**

**1. Shares Outstanding Test**

| Particulars                   | (Shares in crores) |
|-------------------------------|--------------------|
| Number of shares outstanding  | 33                 |
| 25% of the shares outstanding | 8.25               |

**2. Resources Test**

| Particulars                                                 |            |
|-------------------------------------------------------------|------------|
| Paid up capital (Rs. in crores)                             | 330        |
| Free reserves (Rs. in crores)                               | <u>420</u> |
| Shareholders' funds (Rs. in crores)                         | <u>750</u> |
| 25% of Shareholders fund (Rs. in crores)                    | 187.5      |
| Buy back price per share                                    | Rs.30      |
| Number of shares that can be bought back (shares in crores) | 6.25       |

**3. Debt Equity Ratio Test**

|     | Particulars                                                                            | Situation<br>1 | Situation<br>2 | Situation<br>3 |
|-----|----------------------------------------------------------------------------------------|----------------|----------------|----------------|
| (a) | Loan funds (Rs. in crores)                                                             | 1,800          | 1,200          | 1,500          |
| (b) | Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs. in crores)     | 900            | 600            | 750            |
| (c) | Present equity shareholders fund (Rs. in crores)                                       | 750            | 750            | 750            |
| (d) | Maximum permitted buy back of Equity (Rs. in crores) [(b) – (c)]                       | Nil            | 150            | Nil            |
| (e) | Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores) | Nil            | 5              | Nil            |

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**(b) (i) Calculation of initial recognition amount of loan to employees**

| Year end                    | Cash Inflow      |                      | Total<br>Rs. | P.V. factor<br>@10% | Present<br>value<br>Rs. |
|-----------------------------|------------------|----------------------|--------------|---------------------|-------------------------|
|                             | Principal<br>Rs. | Interest @ 4%<br>Rs. |              |                     |                         |
| 2009                        | 20,00,000        | 4,00,000             | 24,00,000    | 0.9090              | 21,81,600               |
| 2010                        | 20,00,000        | 3,20,000             | 23,20,000    | 0.8263              | 19,17,016               |
| 2011                        | 20,00,000        | 2,40,000             | 22,40,000    | 0.7512              | 16,82,688               |
| 2012                        | 20,00,000        | 1,60,000             | 21,60,000    | 0.6829              | 14,75,064               |
| 2013                        | 20,00,000        | 80,000               | 20,80,000    | 0.6208              | <u>12,91,264</u>        |
| Present value or Fair value |                  |                      |              |                     | <u>85,47,632</u>        |

**(ii) Calculation of amortised cost of loan to employees**

| Year | Amortised cost<br>(Opening<br>balance)<br>[1]<br>Rs. | Interest to be<br>recognised@10%<br>[2]<br>Rs. | Repayment<br>(including<br>interest)<br>[3]<br>Rs. | Amortised Cost<br>(Closing<br>balance)<br>[4]=[1]+ [2] – [3]<br>Rs. |
|------|------------------------------------------------------|------------------------------------------------|----------------------------------------------------|---------------------------------------------------------------------|
| 2009 | 85,47,632                                            | 8,54,763                                       | 24,00,000                                          | 70,02,395                                                           |
| 2010 | 70,02,395                                            | 7,00,240                                       | 23,20,000                                          | 53,82,635                                                           |
| 2011 | 53,82,635                                            | 5,38,264                                       | 22,40,000                                          | 36,80,899                                                           |
| 2012 | 36,80,899                                            | 3,68,090                                       | 21,60,000                                          | 18,88,989                                                           |
| 2013 | 18,88,989                                            | 1,91,011*                                      | 20,80,000                                          | Nil                                                                 |

**(iii) Journal Entries in the books of Friendly Ltd.**

**for the year ended 31<sup>st</sup> December, 2009 (regarding loan to employees)**

|                                            |     | Dr.<br>Amount (Rs.) | Cr.<br>Amount (Rs.) |
|--------------------------------------------|-----|---------------------|---------------------|
| Staff loan A/c                             | Dr. | 1,00,00,000         |                     |
| To Bank A/c                                |     |                     | 1,00,00,000         |
| (Being the disbursement of loans to staff) |     |                     |                     |
| Staff cost A/c (1,00,00,000 – 85,47,632)   | Dr. | 14,52,368           |                     |
| [Refer part (ii)]                          |     |                     |                     |

\* The difference of Rs. 2,112 (Rs.1,91,011 - Rs. 1,88,899) is due to approximation in computations.

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|                                                                                                                                                                     |           |           |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| To Staff loan A/c*<br>(Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of Rs. 85,47,632) |           | 14,52,368 |
| Staff loan A/c Dr.<br>To Interest on staff loan A/c<br>(Being the charge of interest @ market rate of 10% on the loan)                                              | 8,54,763  | 8,54,763  |
| Bank A/c Dr.<br>To Staff loan A/c<br>(Being the repayment of first instalment with interest for the year)                                                           | 24,00,000 | 24,00,000 |
| Interest on staff loan A/c Dr.<br>To Profit and loss A/c<br>(Being transfer of balance of staff loan interest account to profit and loss account)                   | 8,54,763  | 8,54,763  |
| Profit and loss A/c Dr.<br>To Staff cost A/c<br>(Being transfer of balance of staff cost account to profit and loss account)                                        | 14,52,368 | 14,52,368 |

**Question 5**

- (a) A plant was acquired 15 years ago at a cost of Rs. 5 crores. Its accumulated depreciation as at 31<sup>st</sup> March, 2009 was Rs. 4.15 crores. Depreciation estimated for the Financial year 2009-10 is Rs. 25 lakhs. Estimated Net Selling Price as on 31<sup>st</sup> March, 2009 was Rs. 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

*Its value in use has been computed at Rs. 35 lakhs as on 1<sup>st</sup> April, 2009, which is expected to decrease by 30 per cent by the end of the Financial year.*

- Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31<sup>st</sup> March, 2010?
- How much will be the amount of write off for the financial year ended 31<sup>st</sup> March, 2010?

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\* Loans and receivables should be Measured at amortized cost using the effective interest method as per AS 30 'Financial Instruments : Recognition and Measurement'.

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- (iii) *If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be Rs. 12 lakhs, how would you answer to questions (i) and (ii) above?*
- (iv) *If the value in use was zero and the enterprise were required to incur a cost of Rs. 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?*
- (b) *'Suram' Ltd. wants to re-classify its Investment in accordance with AS 13. Decide on the treatment to be given in each of the following cases:*
- (1) *A portion of Current Investments purchased for Rs. 20 lakhs to be reclassified as long-term Investments, as the company has decided to retain them. The market value as on the date of Balance Sheet was Rs. 25 lakhs.*
  - (2) *Another portion of Current Investments purchased for Rs. 15 lakhs has to be re classified as Long-term Investments. The market value of these investments as on the date of Balance Sheet was Rs. 6.5 lakhs.*
  - (3) *Certain Long-term Investments no longer considered for holding purposes have to be re-classified as Current Investments. The original cost of these was Rs. 18 lakhs but they had been written down to Rs. 12 lakhs to recognize permanent decline as per AS 13.*
- (c) *On 1<sup>st</sup> December, 2009, "Sampath" Construction Company Limited undertook a contract to construct a building for Rs. 108 lakhs. On 31<sup>st</sup> March, 2010 the company found that it had already spent Rs. 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was Rs. 36.01 lakhs.*

*What is the provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31<sup>st</sup> March, 2010 based on AS 7 "Accounting for Construction Contracts."*

*(8+4+4= 16 Marks)*

**Answer**

- (a) As per AS 28 "Impairment of Assets", if the recoverable amount\* of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be Rs. 24.5 lakhs on 31.3.2010 according to the provisions of AS 28 [Refer working note].

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\* Recoverable amount is the higher of an asset's net selling price and its value in use.

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| (Rs. in lakhs)                                                                                                                       |         |
|--------------------------------------------------------------------------------------------------------------------------------------|---------|
| (i) Carrying amount of plant (after impairment) as on 31 <sup>st</sup> March, 2010                                                   | 24.50   |
| (ii) Amount of write off (impairment loss) for the financial year ended 31 <sup>st</sup> March, 2010 [Rs. 60 lakhs – Rs. 24.5 lakhs] | 35.50   |
| (iii) <i>If the plant had been revalued ten years ago</i>                                                                            |         |
| Debit to revaluation reserve                                                                                                         | 12.00   |
| Amount charged to profit and loss account (Rs. 35.50 lakhs–Rs. 12 lakhs)                                                             | 23.50   |
| (iv) <i>If Value in use is zero</i>                                                                                                  |         |
| Value in use (a)                                                                                                                     | Nil     |
| Net selling price (b)                                                                                                                | (-)2.00 |
| Recoverable amount [higher of (a) and (b)]                                                                                           | Nil     |
| Carrying amount (closing book value)                                                                                                 | Nil     |
| Amount of write off (impairment loss)(Rs. 60 lakhs – Nil)                                                                            | 60.00   |
| Entire book value of plant will be written off and charged to profit and loss account.                                               |         |

**Working Note:**

**Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31<sup>st</sup> March, 2010.**

| Rs. in lakhs)                                                    |               |
|------------------------------------------------------------------|---------------|
| Opening book value as on 1.4.2009 (Rs. 500 lakhs –Rs. 415 lakhs) | 85            |
| Less: Depreciation for financial year 2009 – 10                  | <u>(25)</u>   |
| Closing book value as on 31.3.2010                               | <u>60</u>     |
| Estimated net selling price as on 1.4.2009                       | 30            |
| Less: Estimated decrease during the year (20% of Rs. 30 lakhs)   | <u>(6)</u>    |
| Estimated net selling price as on 31.3.2010                      | <u>24</u>     |
| Estimated value in use as on 1.4.2009                            | 35.0          |
| Less: Estimated decrease during the year (30% of Rs. 35 lakhs)   | <u>(10.5)</u> |
| Estimated value in use as on 31.3.2010                           | <u>24.5</u>   |

- (b) As per Para 24 of AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

In the first case, the market value\* of the investment is Rs. 25 lakhs, which is higher than its cost i.e. Rs. 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. Rs. 20 lakhs.

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\* It is assumed that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller.



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In the second case, the market value\* of the investment is Rs. 6.5 lakhs, which is lower than its cost i.e. Rs. 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. Rs. 6.5 lakhs. The loss of Rs.8.5 lakhs should be charged to profit and loss account.

As per para 23 of AS 13, where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

In the third case, the book value of the investment is Rs. 12 lakhs, which is lower than its cost i.e. Rs. 18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at Rs. 12 lakhs.

**(c) Calculation of foreseeable loss for the year ended 31<sup>st</sup> March, 2010**  
(as per AS 7 “Construction Contracts”)

|                                                    | <i>Rs. in lakhs</i> |
|----------------------------------------------------|---------------------|
| Cost incurred till 31 <sup>st</sup> March, 2010    | 83.99               |
| Prudent estimate of additional cost for completion | <u>36.01</u>        |
| Total cost of construction                         | 120.00              |
| Less: Contract price                               | <u>108.00</u>       |
| Foreseeable loss                                   | <u>12.00</u>        |

According to para 35 of AS 7 (Revised 2002) “Construction Contracts”, when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of Rs.12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31<sup>st</sup> March, 2010.

### Question 6

- (a) From the following data in respect of an employer kindly calculate the total value of human Capital under ‘Lev and Schwartz’ Model:

| Age Group | Distribution of Employees |                               |              |                               |         |                               |
|-----------|---------------------------|-------------------------------|--------------|-------------------------------|---------|-------------------------------|
|           | Unskilled                 |                               | Semi-skilled |                               | Skilled |                               |
|           | No.                       | Average Annual earning<br>Rs. | No.          | Average Annual earning<br>Rs. | No.     | Average Annual earning<br>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 20%. In calculation of total value of

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human factor the lowest age of each class should be taken. Annuity factor @ 20 per cent are:

|              |       |
|--------------|-------|
| for 5 years  | 2.991 |
| for 10 years | 4.192 |
| for 15 years | 4.675 |
| for 20 years | 4.870 |
| for 25 years | 4.948 |

- (b) *Refiners and Projects Limited is a company in the oil and gas sector. It undertakes extensive research and development work as part of its operations. It has till the end of the financial year 31 March, 2008 spent Rs. 592.23 crores on research expenses.*

*The development of a new process was completed in the accounting year 2008-2009 after incurring an expenditure of Rs. 322.26 crores. In the accounting year 2009-2010, the company implemented the new process resulting in a post tax saving of Rs. 100 crores in the first year of operation and savings of Rs. 80 crores per annum thereafter for the next four years.*

*The cost of capital to the company is 12 per cent.*

*Kindly indicate how you will, in the background of accounting standards prescribed, proceed to record the transactions in the books of accounts of the company.*

*You are given to understand that the research expenses shown above do not include any general or selling and administrative expenses.*

*The present value discounted at 12 per cent of a Rupee can be adopted at .893, .797, .712, .636 and .567 for the purposes of calculation.*

*(12+4=16 Marks)*

**Answer**

- (a) Statement showing the total value of human capital under Lev and Schwartz Model**

| Particulars                   | Age Group   |             |             | Value in Rupees           |
|-------------------------------|-------------|-------------|-------------|---------------------------|
|                               | 30-39 Years | 40-49 Years | 50-55 Years |                           |
| Unskilled Employees           | 98,60,400   | 71,57,400   | 32,30,280   | 2,02,48,080               |
| Semi-Skilled Employees        | 1,12,88,160 | 69,05,880   | 35,89,200   | 2,17,83,240               |
| Skilled Employees             | 1,79,01,120 | 1,17,99,600 | 53,83,800   | <u>3,50,84,520</u>        |
| <b>Value of human capital</b> |             |             |             | <u><b>7,71,15,840</b></u> |

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**Working Note:**

The Present value\* of earnings of each category of employees is ascertained as follows:

| Particulars                   | No. | Annual Salary (Rs.) | Total Salary (Rs.) | P.V. Factor | Present Value (Rs.) |
|-------------------------------|-----|---------------------|--------------------|-------------|---------------------|
| <b>Unskilled Employees</b>    |     |                     |                    |             |                     |
| <i>Age Group 30–39 years</i>  |     |                     |                    |             |                     |
| For next 10 years             | 100 | 18,000              | 18,00,000          | 4.192       | 75,45,600           |
| For 11 – 20 years             | 100 | 30,000              | 30,00,000          | 0.678       | 20,34,000           |
| For 21 – 25 years             | 100 | 36,000              | 36,00,000          | 0.078       | <u>2,80,800</u>     |
| Total                         |     |                     |                    |             | <u>98,60,400</u>    |
| <i>Age Group 40–49 years</i>  |     |                     |                    |             |                     |
| For next 10 years             | 50  | 30,000              | 15,00,000          | 4.192       | 62,88,000           |
| For 11 – 15 years             | 50  | 36,000              | 18,00,000          | 0.483       | <u>8,69,400</u>     |
| Total                         |     |                     |                    |             | <u>71,57,400</u>    |
| <i>Age Group 50–55 years</i>  |     |                     |                    |             |                     |
| For next 5 years              | 30  | 36,000              | 10,80,000          | 2.991       | <u>32,30,280</u>    |
| <b>Semi-skilled Employees</b> |     |                     |                    |             |                     |
| <i>Age Group 30-39 years</i>  |     |                     |                    |             |                     |
| For next 10 years             | 60  | 36,000              | 21,60,000          | 4.192       | 90,54,720           |
| For 11 – 20 years             | 60  | 48,000              | 28,80,000          | 0.678       | 19,52,640           |
| For 21 – 25 years             | 60  | 60,000              | 36,00,000          | 0.078       | <u>2,80,800</u>     |
| Total                         |     |                     |                    |             | <u>1,12,88,160</u>  |
| <i>Age Group 40–49 years</i>  |     |                     |                    |             |                     |
| For next 10 years             | 30  | 48,000              | 14,40,000          | 4.192       | 60,36,480           |
| For 11 – 15 years             | 30  | 60,000              | 18,00,000          | 0.483       | <u>8,69,400</u>     |
| Total                         |     |                     |                    |             | <u>69,05,880</u>    |

**\* Present value factors (PV Factor)**

PV Factor for 11 – 20 years =  $4.870 - 4.192 = 0.678$

for 21 – 25 years =  $4.948 - 4.870 = 0.078$

for 11 – 15 years =  $4.675 - 4.192 = 0.483$

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|                              |    |          |           |       |                    |
|------------------------------|----|----------|-----------|-------|--------------------|
| <i>Age Group 50–55 years</i> |    |          |           |       |                    |
| For next 5 years             | 20 | 60,000   | 12,00,000 | 2.991 | <u>35,89,200</u>   |
| <b>Skilled Employees</b>     |    |          |           |       |                    |
| <i>Age Group 30–39 years</i> |    |          |           |       |                    |
| For next 10 years            | 40 | 84,000   | 33,60,000 | 4.192 | 1,40,85,120        |
| For 11 – 20 years            | 40 | 1,20,000 | 48,00,000 | 0.678 | 32,54,400          |
| For 21 – 25 years            | 40 | 1,80,000 | 72,00,000 | 0.078 | <u>5,61,600</u>    |
| Total                        |    |          |           |       | <u>1,79,01,120</u> |
| <i>Age Group 40–49 years</i> |    |          |           |       |                    |
| For next 10 years            | 20 | 1,20,000 | 24,00,000 | 4.192 | 1,00,60,800        |
| For 11 – 15 years            | 20 | 1,80,000 | 36,00,000 | 0.483 | <u>17,38,800</u>   |
| Total                        |    |          |           |       | <u>1,17,99,600</u> |
| <i>Age Group 50–55 Yrs</i>   |    |          |           |       |                    |
| For next 5 years             | 10 | 1,80,000 | 18,00,000 | 2.991 | <u>53,83,800</u>   |

- (b) As per para 41 of AS 26 “Intangible Assets”, no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Therefore, the amount of Rs. 592.23 crores incurred on research till the end of financial year ended 31<sup>st</sup> March, 2008 cannot be capitalised and hence has to be expensed in the year in which it is incurred. In case the same is still unexpensed it will have to be written off under ‘Prior period Expenditure’. As per para 44 of the standard, an intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions specified in the standard.

From the facts given in the question, it can be reasonably assumed that the criteria specified in the standard for recognition of an internally generated intangible asset arising in the development phase are met and the Refiners and Projects Ltd. can demonstrate that future economic benefits from the intangible asset are probable. Hence, development cost of Rs. 322.26 crores is eligible for capitalization.

As per para 62 of AS 26, after initial recognition, an intangible asset should be carried at its cost less any accumulated amortization and any accumulated impairment losses. In the given case, present value of future cash flows amounting Rs.306.26 crores [(Rs 100 crores x 0.893) + (Rs. 80 crores x 0.797) + (Rs.80 crores x 0.712) + (Rs. 80 crores x 0.636) + (Rs. 80 crores x 0.567)] is less than the cost incurred, it is prudent to carry the intangible asset at the discounted value of future cash flows (Rs. 306.26 crores). The excess of cost incurred over present values amounting Rs. 16 crores (322.26 – 306.26) has to be recognised as an impairment loss in the year 2008 – 09.

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According to para 63 of the standard, depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use. In the given case, the value of intangible asset should be amortized over a period of five years by following the straight line method. Therefore, an annual depreciation of Rs. 61.25 crores (Rs. 306.26 crores/5) should be charged for each year beginning with 2009-10.



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Question No.1 is compulsory

Answer any five from the remaining six questions.

Question 1

(a) Albert Finance Ltd. has made the following investments.

(i) Purchased the following equity shares from stock exchange on 1<sup>st</sup> June, 2009.

|         | Cost<br>₹       |
|---------|-----------------|
| Scrip X | 1,80,000        |
| Scrip Y | 50,000          |
| Scrip Z | <u>1,70,000</u> |
|         | <u>4,00,000</u> |

(ii) Purchased gold of ₹ 3,00,000 on 1<sup>st</sup> April, 2006.

(iii) Invested in mutual funds at a cost of ₹ 6,00,000 on 31<sup>st</sup> March, 2009.

(iv) Purchased government securities at a cost of ₹ 5,00,000 on 1<sup>st</sup> April, 2009.

How will you treat these investments as per applicable AS in the books of the company for the year ended on 31<sup>st</sup> March, 2010, if the values of these investments are as follows:

| Shares                | ₹             | ₹        |
|-----------------------|---------------|----------|
| Scrip X               | 1,90,000      |          |
| Scrip Y               | 40,000        |          |
| Scrip Z               | <u>70,000</u> | 3,00,000 |
| Gold                  |               | 5,00,000 |
| Mutual funds          |               | 4,50,000 |
| Government securities |               | 7,00,000 |

Also explain is it possible to off-set depreciation in investment in mutual funds against appreciation of the value of investment in government securities?

(b) A Ltd. purchased fixed assets costing ₹ 2,544 lakhs on 1<sup>st</sup> April, 2009 and the same was fully financed by foreign currency loan in U.S. Dollars, repayable in four equal annual instalments. Exchange rate at the time of purchase was 1 US Dollar ₹ 42.40. The first instalment was paid on 31<sup>st</sup> March, 2009 when 1 US Dollar fetched ₹ 45.40. The entire loss on exchange was included in cost of goods sold of normal business operations. A Ltd. provides depreciation on their fixed assets at 20% on WDV basis.

Show the correct accounting treatment with reference to relevant accounting standards.

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- (c) State the treatment of the following items with reference to Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS):
- (i) Impairment of assets
- (ii) Business combinations
- (d) The Chief Accountant of ANZ Ltd., gives the following data regarding its six segments:

(₹ in lakhs)

| Particulars     | M   | N    | O  | P  | Q   | R  | Total |
|-----------------|-----|------|----|----|-----|----|-------|
| Segment Assets  | 40  | 80   | 30 | 20 | 20  | 10 | 200   |
| Segment Results | 50  | -190 | 10 | 10 | -10 | 30 | -100  |
| Segment Revenue | 300 | 620  | 80 | 60 | 80  | 60 | 1200  |

The Chief Accountant is of the opinion that segments 'M' and 'N' alone should be reported. Is he justified in his view? Discuss.  
(4 x 5 = 20 Marks)

**Answer**

- (a) As per AS 13 'Accounting for Investments', current investments should be carried in the financial statements at lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis and long-term investments are carried at cost except when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognize the decline.
- (i) If the investment in shares is intended to be held for not more than one year from the date on which such investment is made: Scrip X should be valued at cost i.e. ₹1,80,000 (lower of cost and fair value); Scrip Y should be valued at fair value i.e. ₹40,000 (lower of cost and fair value) and scrip Z should be valued at fair value i.e. ₹ 70,000 (lower of cost and fair value). The total loss of ₹1,00,000 (₹4,00,000 – ₹ 3,00,000) on scrips purchased on 1<sup>st</sup> June, 2009, is to be charged to profit and loss account for the year ended 31<sup>st</sup> March, 2010.
- If investment is intended to be held for long term period: Investment will continue to be shown at cost in the balance sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually.
- (ii) Investment in gold (purchased in April, 2006) shall continue to be shown at cost of ₹ 3,00,000 in the balance sheet as on 31.3.2010.
- (iii) If mutual funds are intended to be held for short term period it will be valued at ₹ 4,50,000 as on 31<sup>st</sup> March, 2010 and if it is intended to be held for long term, then it should be valued at its cost i.e. ₹ 6,00,000.
- (iv) Value of government securities (purchased on 1<sup>st</sup> April, 2009) is to be shown at cost of ₹ 5,00,000 in the balance sheet as on 31.3.2010.

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Inter category adjustments of appreciation and depreciation in value of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation in value of investment in government securities.

- (b) As per AS 11 'The Effects of Changes in Foreign Exchange Rates', foreign currency non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction and exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expense in the period in which they arise. Foreign Currency loss will be computed as ₹ 180 lakhs { \$ 60 lakhs  $\left[ \frac{2544 \text{ lakhs}}{42.40} \right] \times (\text{₹}45.40 - \text{₹}42.40)$  }. The

entire loss on exchange difference of ₹180 lakhs should be recognized as an expense for the year ended 31<sup>st</sup> March 2010 and should not be included in the cost of goods sold. Depreciation on fixed assets amounting ₹508.80 lakhs\* (20% of ₹2,544 lakhs) should be provided for in the financial statements for the year ended 31<sup>st</sup> March 2010.

PS: In the third sentence of the question, the date 31<sup>st</sup> March, 2009 should be read as 31<sup>st</sup> March, 2010.

- (c) Treatment under Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS)

|                          | AS                                                                                                                                                                                                                                                           | IFRS                                   |
|--------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| (i) Impairment of Assets | Assets are impaired if recoverable amount is less than the carrying amount. Recoverable amount will be calculated as higher of net selling price and value in use based on discounted cashflows.<br><br>Impairment test is to be conducted every year and if | Similar to Indian Accounting Standard. |

\* Alternatively, A Ltd. may opt for capitalizing the difference of foreign exchange to fixed assets account on the basis of the notification no G.S.R.225(E) issued by the Central Government dated 31.3.2009. According to the notification, the new cost of the fixed asset will be ₹ 2,724 lakhs { ₹2,544 lakhs + Difference in foreign exchange currency translation as on 31.3.2010 ₹ 180 lakhs [ \$60 lakhs  $\times (\text{₹} 45.40 - \text{₹}42.40)$  ] }. Depreciation on fixed assets will be ₹598.80 lakhs ( ₹508.80 lakhs+ ₹90 lakhs). Difference in foreign exchange capitalised due to the said notification amounting ₹ 180 lakhs, should be amortised till 31<sup>st</sup> March 2011 i.e. in 2 years.



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there is upward increase in the value of asset, then reversal of impairment losses is required in certain circumstances.

Assets are not separately classified or disclosed as held for sale on the face of the balance sheet. However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.

- |                            |                                                                                                                                                                                     |                                                                    |
|----------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|
| (ii) Business Combinations | No particular standard has been issued by ICAI till date. However, all business acquisitions are business combinations except pooling of interest method for certain amalgamations. | All business acquisitions are business combinations as per IFRS 3. |
|----------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|

(d) As per para 27 of AS 17 "Segment Reporting", a business segment or geographical segment should be identified as a reportable segment, if

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

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

- (a) On the basis of 'Revenue' criteria, segments M and N are reportable segments.
- (b) On the basis of 'Result' criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 lakhs)
- (c) On the basis of 'Asset' criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence the opinion of chief accountant that segments 'M' and 'N' alone should be reported is wrong.

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**Question 2**

The summarised Balance Sheets of the following three companies are given below:

|                                                                 | (₹ in lakhs)                             |                   |                   |
|-----------------------------------------------------------------|------------------------------------------|-------------------|-------------------|
|                                                                 | A. Ltd.                                  | B. Ltd.           | C. Ltd            |
| <i>Liabilities:</i>                                             | <i>As on 31<sup>st</sup> March, 2009</i> |                   |                   |
| Equity shares (₹10 each fully paid up)                          | 60                                       | 48                | 40                |
| 7½ % Cumulative preference shares (₹100 each fully paid up)     | 15                                       | 12                | 10                |
| Capital reserve on revaluation of land, buildings and machinery | 120                                      | -                 | -                 |
| General reserve                                                 | 25                                       | 15                | 10                |
| 2,500, 8% Mortgage debenture bonds of ₹ 1,000 each              | 25                                       | -                 | -                 |
| Secured loans and advances from banks                           | 153                                      | 71                | 52                |
| Unsecured loans:                                                |                                          |                   |                   |
| (i) From B Ltd.                                                 | -                                        | -                 | 12                |
| (ii) From C Ltd.                                                | 15                                       | -                 | -                 |
| (iii) Deposits from public                                      | 18                                       | 12                | 3                 |
| Current liabilities and provisions                              |                                          |                   |                   |
| (i) Inter-company balances                                      | 9                                        | -                 | -                 |
| (ii) Other liabilities and provisions                           | <u>314</u>                               | <u>125</u>        | <u>72</u>         |
| <b>Total</b>                                                    | <b><u>754</u></b>                        | <b><u>283</u></b> | <b><u>199</u></b> |
| <i>Assets :</i>                                                 |                                          |                   |                   |
| Fixed assets (net)                                              | 272                                      | 104               | 42                |
| Investments (at cost)                                           |                                          |                   |                   |
| 2,50,000 Equity shares of B Ltd.                                | 25                                       | -                 | -                 |
| 80,000 Equity shares of C Ltd.                                  | 8                                        | -                 | -                 |
| 1,60,000 Equity shares of C Ltd.                                | -                                        | 20                | -                 |
| 10,000 Cumulative preference shares of A Ltd.                   | -                                        | -                 | 10                |
| 1,500 Mortgage debentures of A Ltd.                             | -                                        | -                 | 14                |
| Current assets                                                  | 353                                      | 123               | 112               |
| Profit and loss account                                         | <u>96</u>                                | <u>36</u>         | <u>21</u>         |
| <b>Total</b>                                                    | <b><u>754</u></b>                        | <b><u>283</u></b> | <b><u>199</u></b> |

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- (i) A Ltd. subscribed for the shares of B Ltd. & C Ltd. at par at the time of first issue of shares by the latter companies.
- (ii) B Ltd. subscribed for 80,000 shares of C Ltd. at par at the time of first issue and latter acquired by purchase in the market 80,000 shares of C Ltd. at ₹ 15 each when reserves and surplus of C Ltd. stood at ₹ 5 lakhs.
- (iii) Current assets of B Ltd. & C Ltd. included ₹ 4 lakhs and ₹ 6 lakhs respectively being the current accounts balance against A Ltd. These accounts remained unreconciled.
- (iv) Preference dividends were in arrears for
  - (a) 8 years in the case of A Ltd. and
  - (b) 4 years in the case of other two companies.

Prepare the Consolidated Balance Sheet for the year as on 31<sup>st</sup> March, 2009. (16 Marks)

Answer

**Consolidated Balance Sheet\* of A Ltd.**

as on 31<sup>st</sup> March, 2009

| Liabilities                                                   | (₹ in lakhs) | Assets                                   | (₹ in lakhs) |
|---------------------------------------------------------------|--------------|------------------------------------------|--------------|
| Share capital :                                               |              | Goodwill (W.N.5)                         | 1.00         |
| 6,00,000 Equity shares of ₹ 10 each fully paid                | 60.00        | Fixed assets (Net) (272+104+42)          | 418.00       |
| 5,000, 7½% Cumulative preference shares of ₹ 100 each (15-10) | 5.00         | Current assets [(353+123+112)-(12+15)-9] | 552.00       |
| Minority interest (W.N.3)                                     | 44.07        | Profit & loss account (W.N.4)            | 122.92       |
| Reserves & surplus:                                           |              |                                          |              |
| Capital reserve                                               | 120.00       |                                          |              |
| General reserve (W.N.4)                                       | 34.85        |                                          |              |
| Secured loans:                                                |              |                                          |              |
| 8% Mortgage debenture bonds of ₹1,000 each (25-15)            | 10.00        |                                          |              |
| Loans & Advances from banks (153+71+52)                       | 276.00       |                                          |              |
| Unsecured Loans:                                              |              |                                          |              |
| Public Deposits (18+12+3)                                     | 33.00        |                                          |              |

\* In accordance with para 15 of AS 21 "Consolidated Financial Statements", the balance sheet has been presented from the date on which holding subsidiary relationship comes into existence.

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Current Liabilities and Provisions:

Other Liabilities and Provisions

(314+125+72)

511.00

1,093.92

1,093.92

Note: Preference dividends are in arrears for 8 years in A Ltd. and 4 years in subsidiaries B Ltd. and C Ltd.

Working Notes:

1. Analysis of profits of C Ltd.

(₹ in lakhs)

|                                | Pre acquisition<br>(capital) profit | Post acquisition (Revenue) gains |                            |
|--------------------------------|-------------------------------------|----------------------------------|----------------------------|
|                                |                                     | General<br>Reserve               | Profit and Loss<br>Account |
|                                | (₹ in lakhs)                        | (₹ in lakhs)                     | (₹ in lakhs)               |
| General reserve                | 5                                   | 5                                |                            |
| Profit and loss account (21-1) | <u>      </u>                       | <u>      </u>                    | <u>(20)</u>                |
|                                | <u>5</u>                            | <u>5</u>                         | <u>(20)</u>                |
| A Ltd. (20%)                   | 1                                   | 1                                | (4)                        |
| B Ltd. (40%)                   | 2                                   | 2                                | (8)                        |
| Minority interest (40%)        | 2                                   | 2                                | (8)                        |

2. Analysis of Profits of B Ltd.

|                                              | Pre acquisition<br>(capital) profit | Post acquisition (revenue) gains |                            |
|----------------------------------------------|-------------------------------------|----------------------------------|----------------------------|
|                                              |                                     | General<br>Reserve               | Profit and Loss<br>Account |
|                                              | (₹ in lakhs)                        | (₹ in lakhs)                     | (₹ in lakhs)               |
| General reserve                              |                                     | 15                               |                            |
| Profit and loss account                      |                                     |                                  | (36)                       |
| Share in post acquisition<br>gains of C Ltd. |                                     | <u>2</u>                         | <u>(8)</u>                 |
|                                              |                                     | <u>17</u>                        | <u>(44)</u>                |
| A Ltd. (25/48)                               |                                     | 8.85                             | (22.92)                    |
| Minority interest (23/48)                    |                                     | 8.15                             | (21.08)                    |

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**3. Minority interest**

|                                       | B Ltd.         | C Ltd.       |
|---------------------------------------|----------------|--------------|
|                                       | (₹ in lakhs)   | (₹ in lakhs) |
| Equity share capital                  | 23             | 16           |
| Preference share capital              | 12             | 10           |
| Pre acquisition profit                |                | 2            |
| Post acquisition gains:               |                |              |
| General reserve                       | 8.15           | 2            |
| Profit and Loss Account               | <u>(21.08)</u> | <u>(8)</u>   |
|                                       | <u>22.07</u>   | <u>22.00</u> |
| Total = 22.07 + 22.00 = ₹ 44.07 lakhs |                |              |

**4. Consolidated General Reserve and Profit and Loss Account of A Ltd.**

|                                            | General Reserve | Profit and Loss Account |
|--------------------------------------------|-----------------|-------------------------|
|                                            | (₹ in lakhs)    | (₹ in lakhs)            |
| Balance as per the Balance Sheet of A Ltd. | 25              | (96.00)                 |
| B Ltd.                                     | 8.85            | (22.92)                 |
| C Ltd.                                     | <u>1</u>        | <u>(4.00)</u>           |
|                                            | <u>34.85</u>    | <u>(122.92)</u>         |

**5. Cost of Control**

|                                         |              | (₹ in lakhs)   |
|-----------------------------------------|--------------|----------------|
| Cost of investments in B Ltd. by A Ltd. |              | 25.00          |
| Add: Cost of investments in C Ltd.:     |              |                |
| By A Ltd.                               | 8            |                |
| By B Ltd.                               | <u>20</u>    | <u>28.00</u>   |
|                                         |              | 53.00          |
| Less: Paid up value of equity shares in |              |                |
| B Ltd.                                  | 25.00        |                |
| C Ltd.                                  | <u>24.00</u> | 49.00          |
| Capital Profit in C Ltd.                | <u>3.00</u>  | <u>(52.00)</u> |
| Goodwill                                |              | <u>1.00</u>    |

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### Question 3

Libra Ltd. has two divisions A and B and their respective shares of various assets and liabilities in the company's Balance Sheet as on 31<sup>st</sup> March, 2009 are given below:

|                                           | (₹ in lakhs)  |                        |
|-------------------------------------------|---------------|------------------------|
|                                           | A<br>division | B<br>division<br>Total |
| <b>Fixed assets:</b>                      |               |                        |
| Cost                                      | 650           | 340                    |
| Less: Depreciation                        | <u>225</u>    | <u>160</u>             |
| Written down value                        | <u>425</u>    | <u>180</u>             |
| Investments                               |               | 605                    |
| Current Assets                            | 350           | 430                    |
| Less: Current Liabilities                 | <u>185</u>    | <u>210</u>             |
| Net Current Assets                        | <u>165</u>    | <u>220</u>             |
|                                           |               | <u>385</u>             |
|                                           |               | <u>1,105</u>           |
| <b>Financed by:</b>                       |               |                        |
| Loan Funds                                |               | 400                    |
| Own Funds:                                |               |                        |
| Equity share capital- shares of ₹ 10 each |               | 300                    |
| Reserves and Surplus                      |               | <u>405</u>             |
|                                           |               | <u>1,105</u>           |

Division B has been invariably suffering losses. The company sold this division B along with its assets and liabilities to a newly formed company, Zee Ltd. which was incorporated with an authorized capital of ₹ 800 lakhs divided into shares of ₹10 each. Zee Ltd. allotted to Libra Ltd's shareholders its two fully paid equity shares of ₹10 each at par for every fully paid equity shares of ₹10 each held in Libra Ltd. as discharge of consideration for the division taken over.

Zee Ltd. recorded in its books the fixed assets at ₹ 280 lakhs, current assets at ₹ 320 lakhs and liabilities at the same value at which they appeared in the books of Libra Ltd.

On 1<sup>st</sup> April, 2009 Libra Ltd. sold all its investments for ₹135 lakhs and redeemed debentures liability of ₹ 150 lakhs at par, which was included in loan funds. The cash transaction being recorded in the Bank Account pertaining to A division.

You are required to:

- (i) Show Journal Entries in the books of Libra Ltd.
- (ii) Prepare Libra Ltd's Balance Sheet immediately after the Demerger and
- (iii) Initial Balance Sheet of Zee Ltd.

(16 Marks)

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Answer

(i) Journal Entries\* in the books of Libra Ltd.

|     |                                                                                                                        | (₹ in lakhs) |     |
|-----|------------------------------------------------------------------------------------------------------------------------|--------------|-----|
|     |                                                                                                                        | Dr.          | Cr. |
| (a) | Bank account (Current assets) Dr.                                                                                      | 135          |     |
|     | To Investments                                                                                                         |              | 115 |
|     | To Profit and loss account (Reserves & surplus)                                                                        |              | 20  |
|     | (Being sales of investments at a profit of ₹20 lakhs)                                                                  |              |     |
| (b) | Debentures account (Loan funds) Dr.                                                                                    | 150          |     |
|     | To Bank account (Current assets)                                                                                       |              | 150 |
|     | (Being redemption of debentures at par)                                                                                |              |     |
| (c) | Current liabilities account Dr.                                                                                        | 210          |     |
|     | Provision for depreciation account Dr.                                                                                 | 160          |     |
|     | Reserves and surplus Dr.                                                                                               | 400          |     |
|     | To Fixed assets account                                                                                                |              | 340 |
|     | To Current assets account                                                                                              |              | 430 |
|     | (Being assets and liabilities pertaining to B division taken out of the books on transfer of the division to Zee Ltd.) |              |     |

(ii) **Libra Ltd.'s Balance Sheet (After Demerger)**  
as on 1.4.2009

|                           | ₹ in lakhs | ₹ in lakhs |
|---------------------------|------------|------------|
| Fixed assets              |            |            |
| Gross block               | 650        |            |
| Less: Depreciation        | <u>225</u> | 425        |
| Net current assets        |            |            |
| Current assets (W.N.3)    | 335        |            |
| Less: Current liabilities | <u>185</u> | <u>150</u> |
|                           |            | <u>575</u> |
| Financed by               |            |            |
| Shareholders' funds       |            |            |
| Equity share capital      | 300        |            |

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

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|                             |           |            |
|-----------------------------|-----------|------------|
| Reserve and surplus (W.N.1) | <u>25</u> | 325        |
| Loan funds (W.N.2)          |           | <u>250</u> |
|                             |           | <u>575</u> |

(iii) Initial Balance Sheet of Zee Ltd.  
as on 1.4.2009

|                                                           | ₹ in lakhs | ₹ in lakhs |
|-----------------------------------------------------------|------------|------------|
| Fixed assets                                              |            | 280        |
| Goodwill (W.N.4)                                          |            | 210        |
| Net current assets:                                       |            |            |
| Current assets                                            | 320        |            |
| Less: Current liabilities                                 | <u>210</u> | <u>110</u> |
|                                                           |            | <u>600</u> |
| Financed by                                               |            |            |
| Shareholders' funds: (Authorised share capital ₹ 800)     |            |            |
| Equity share capital (issued for acquisition of business) |            | <u>600</u> |
|                                                           |            | <u>600</u> |

**Working Notes:**

|                                               |            |
|-----------------------------------------------|------------|
| 1. Reserves and surplus of Libra Ltd.         | ₹ in lakhs |
| Balance as on 31 <sup>st</sup> March, 2009    | 405        |
| Add: Profit on sale of investments            | <u>20</u>  |
|                                               | 425        |
| Less: Adjustment for difference on demerger   | <u>400</u> |
| Balance shown in balance sheet after demerger | <u>25</u>  |
| 2. Loan funds of Libra Ltd.                   |            |
| Balance as on 31 <sup>st</sup> March, 2009    | 400        |
| Less: Debentures redeemed                     | <u>150</u> |
| Balance shown in balance sheet after demerger | <u>250</u> |
| 3. Current assets of Libra Ltd.               |            |
| Balance as on 31 <sup>st</sup> March, 2009    | 350        |
| Add: Cash received from sale of investments   | <u>135</u> |
|                                               | 485        |
| Less: Cash paid for redemption of debentures  | <u>150</u> |
| Balance shown in balance sheet after demerger | <u>335</u> |



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|                                         |            |            |
|-----------------------------------------|------------|------------|
| 4. Calculation of goodwill for Zee Ltd. | ₹ in lakhs |            |
| Purchase consideration (300 x 2)        | 600        |            |
| Less: Assets sold                       |            |            |
| Fixed assets                            | 280        |            |
| Current assets                          | <u>320</u> |            |
|                                         | 600        |            |
| Less: Current liabilities               | <u>210</u> | <u>390</u> |
| Goodwill                                |            | <u>210</u> |

**Question 4**

The Balance Sheet of Bird Ltd. as on 31<sup>st</sup> March, 2009 is given below:

| Liabilities                                                | ₹                | Assets               | ₹                |
|------------------------------------------------------------|------------------|----------------------|------------------|
| Share capital:                                             |                  | Fixed assets:        |                  |
| Equity shares of ₹ 10 each 6,00,000                        |                  | Goodwill             | 40,000           |
| Less: Calls in arrear<br>(₹2 for final call) <u>20,000</u> | 5,80,000         | Machinery            | 3,00,000         |
| 7% Preference shares of ₹10 each fully paid                | 3,00,000         | Freehold properties  | 4,50,000         |
| Reserve and surplus:                                       |                  | Vehicles             | 1,00,000         |
| General reserve                                            | 3,50,000         | Furniture            | 50,000           |
| Profit and loss account                                    | 1,50,000         | Investments          | 2,00,000         |
| Current liabilities:                                       |                  | Current assets:      |                  |
| Sundry creditors                                           | 3,00,000         | Stock-in-trade       | 2,50,000         |
| Bank loan                                                  | 2,00,000         | Sundry debtors       | 4,00,000         |
|                                                            |                  | Cash at bank         | 60,000           |
|                                                            |                  | Preliminary expenses | <u>30,000</u>    |
|                                                            | <u>18,80,000</u> |                      | <u>18,80,000</u> |

Additional information:

- On 1-4-2006 a new furniture costing ₹ 20,000 was purchased and wrongly charged to revenue. No rectification has yet been made for above. Depreciation charged on furniture is @ 10% on reducing balance system.
- Fixed assets are worth 15% above their actual book value.
- Stock is overvalued by ₹ 50,000 and 10% debtors are doubtful.

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- (iv) Of the investments, 10% is in trade and the balance non-trade. Trade investments are to be valued at 10% below cost. A uniform rate of dividend of 10% is earned on all investments.
- (v) For the purpose of valuation of shares, goodwill is to be considered on the basis of 2 years' purchase of super profits based on average profit of last 3 years.

Profits are as follows:

|         | ₹        |
|---------|----------|
| 2006-07 | 2,50,000 |
| 2007-08 | 2,80,000 |
| 2008-09 | 3,30,000 |

- (vi) In a similar business normal return on capital employed is 20%.

You are required to value each fully paid and partly paid equity share, assuming tax rate of 50%.  
(16 Marks)

Answer

Valuation of shares of Bird Ltd.

|                                                                | ₹                                         |
|----------------------------------------------------------------|-------------------------------------------|
| Capital employed (net tangible assets) as on 31.3.2009 (W.N.1) | 12,07,477                                 |
| Add: Value of goodwill (W.N.3)                                 | <u>33,870</u>                             |
|                                                                | 12,41,347                                 |
| Add: Non-Trade investments                                     | 1,80,000                                  |
| Add : Calls in arrear                                          | <u>20,000</u>                             |
|                                                                | 14,41,347                                 |
| Less : Preference share capital                                | <u>3,00,000</u>                           |
| Equity available for equity shareholders                       | <u>11,41,347</u>                          |
| No. of shares                                                  | 60,000                                    |
| Value of a fully paid equity share                             | $\frac{11,41,347}{60,000 \text{ shares}}$ |
|                                                                | ₹19.02                                    |
| Values of a partly paid equity share (₹19.02- ₹ 2)             | ₹ 17.02                                   |

Workings Notes:

1. Capital employed as on 31.3.2009

|                     | ₹ | ₹        |
|---------------------|---|----------|
| Machinery           |   | 3,00,000 |
| Freehold properties |   | 4,50,000 |
| Vehicles            |   | 1,00,000 |

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|                         |                 |
|-------------------------|-----------------|
| Furniture (W.N.4)       | <u>64,580</u>   |
|                         | 9,14,580        |
| Add: 15%                | <u>1,37,187</u> |
|                         | 10,51,767       |
| Trade investment        | 18,000          |
| Stock in trade          | 2,00,000        |
| Sundry debtors          | 3,60,000        |
| Cash at bank            | 60,000          |
| Tax recoverable (W.N.5) | <u>17,710</u>   |
|                         | 17,07,477       |

Less : Outside liabilities:

|                  |                 |                  |
|------------------|-----------------|------------------|
| Sundry creditors | 3,00,000        |                  |
| Bank loan        | <u>2,00,000</u> | <u>5,00,000</u>  |
|                  |                 | <u>12,07,477</u> |

**2. Average profits for last three years**

|                                                                  | 2006-07               | 2007-08         | 2008-09         |
|------------------------------------------------------------------|-----------------------|-----------------|-----------------|
|                                                                  | ₹                     | ₹               | ₹               |
| Reported profits                                                 | 2,50,000              | 2,80,000        | 3,30,000        |
| Add: Furniture purchased wrongly charged to revenue (net of tax) | <u>10,000</u>         | <u>-</u>        | <u>-</u>        |
|                                                                  | 2,60,000              | 2,80,000        | 3,30,000        |
| Less: Depreciation on furniture purchased (net of tax)           | <u>1,000</u>          | <u>900</u>      | <u>810</u>      |
|                                                                  | 2,59,000              | 2,79,100        | 3,29,190        |
| Less: Dividend on non trading investments (net of tax)           | <u>9,000</u>          | <u>9,000</u>    | <u>9,000</u>    |
|                                                                  | 2,50,000              | 2,70,100        | 3,20,190        |
| Less: Adjustment for stock overvaluation (net of tax)            |                       |                 | (25,000)        |
| Less: Provision for doubtful debts (not tax deductible)          |                       |                 | <u>(40,000)</u> |
|                                                                  | <u>2,50,000</u>       | <u>2,70,100</u> | <u>2,55,190</u> |
| Average profit                                                   | 7,75,290/3 = 2,58,430 |                 |                 |

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### 3. Computation of goodwill

|                                         |                  |
|-----------------------------------------|------------------|
|                                         | ₹                |
| Capital employed                        | <u>12,07,477</u> |
| Average Profit (W.N.2)                  | 2,58,430         |
| Normal profit @ 20% on capital employed | <u>2,41,495</u>  |
| Super profit                            | <u>16,935</u>    |
| Goodwill at 2 years' purchase           | 33,870           |

### 4. Value of furniture as on 31.3.2009

|                                                    |               |               |
|----------------------------------------------------|---------------|---------------|
|                                                    | ₹             | ₹             |
| Furniture (Given in balance sheet) as on 31.3.2009 |               | 50,000        |
| Add: Purchased on 1.4.2006                         | 20,000        |               |
| Less: Depreciation @10% on WDV                     | <u>2,000</u>  |               |
| WDV as on 31.3.2007                                | 18,000        |               |
| Less: Depreciation @10% on WDV                     | <u>1,800</u>  |               |
| WDV as on 31.3.2008                                | 16,200        |               |
| Less: Depreciation @10% on WDV                     | <u>1,620</u>  |               |
| WDV as on 31.3.2009                                | <u>14,580</u> | <u>14,580</u> |
| Total                                              |               | <u>64,580</u> |

### 5. Tax recoverable

|                                                                                            |               |               |
|--------------------------------------------------------------------------------------------|---------------|---------------|
|                                                                                            |               | ₹             |
| Tax recoverable:                                                                           |               |               |
| Due to additional depreciation on furniture<br>[(2,000 + 1,800 + 1,620) x 50%]             | 2,710         |               |
| Due to overvaluation of stock<br>(50,000 x 50%)                                            | <u>25,000</u> | 27,710        |
| Less: Tax liability of furniture wrongly charged to profit and loss account (20,000 x 50%) |               | <u>10,000</u> |
|                                                                                            |               | <u>17,710</u> |

#### Assumptions:

1. Profit given in the question is assumed as post tax profit.

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2. Terminal capital employed has been considered for valuation of goodwill and shares. It is also possible to adjust half of the profits earned in 2008-09 for calculation of average capital employed.
3. Dividend from non-trade investment is assumed to be subject to tax.
4. Provision for doubtful debts is not allowed in the Income Tax Act. Hence, it is not tax deductible

**Question 5**

- (a) S Ltd. is considering buying the business of R Ltd.; the final accounts of which for the last 3 years were as follow:

*Profit and Loss Accounts for the 3 years ended December 31<sup>st</sup>*

(Figures in ₹)

|                   | 2007            | 2008            | 2009            |
|-------------------|-----------------|-----------------|-----------------|
| Sales             | <u>2,00,000</u> | <u>1,90,000</u> | <u>2,24,000</u> |
| Material consumed | <u>1,00,000</u> | <u>95,000</u>   | <u>1,12,000</u> |
| Business expenses | <u>80,000</u>   | <u>80,000</u>   | <u>82,000</u>   |
| Depreciation      | <u>12,000</u>   | <u>13,000</u>   | <u>14,000</u>   |
| Net profit        | <u>8,000</u>    | <u>2,000</u>    | <u>16,000</u>   |

*Balance Sheets as at 31<sup>st</sup> December*

|                             | 2006            | 2007            | 2008            | 2009            |
|-----------------------------|-----------------|-----------------|-----------------|-----------------|
| Fixes assets                | <u>1,00,000</u> | <u>1,20,000</u> | <u>1,40,000</u> | <u>1,80,000</u> |
| (at cost) less depreciation | <u>70,000</u>   | <u>82,000</u>   | <u>95,000</u>   | <u>1,09,000</u> |
|                             | <u>30,000</u>   | <u>38,000</u>   | <u>45,000</u>   | <u>71,000</u>   |
| Stock in trade              | <u>16,000</u>   | <u>17,000</u>   | <u>18,500</u>   | <u>21,000</u>   |
| Sundry debtors              | <u>21,000</u>   | <u>24,000</u>   | <u>26,000</u>   | <u>28,000</u>   |
| Cash in hand and at bank    | <u>32,000</u>   | <u>11,000</u>   | <u>28,000</u>   | <u>13,200</u>   |
| Prepaid expenses            | <u>1,000</u>    | <u>500</u>      | <u>2,000</u>    | <u>1,000</u>    |
|                             | <u>1,00,000</u> | <u>90,500</u>   | <u>1,19,500</u> | <u>1,34,200</u> |
| Equity capital              | <u>50,000</u>   | <u>50,000</u>   | <u>70,000</u>   | <u>70,000</u>   |
| Securities premium          |                 |                 | <u>5,000</u>    | <u>5,000</u>    |
| General reserve             | <u>16,000</u>   | <u>24,000</u>   | <u>26,000</u>   | <u>42,000</u>   |
| Debentures                  | <u>20,000</u>   | <u>-</u>        | <u>-</u>        | <u>-</u>        |
| Sundry creditors            | <u>11,000</u>   | <u>13,000</u>   | <u>14,000</u>   | <u>14,000</u>   |
| Accrued expenses            | <u>3,000</u>    | <u>3,500</u>    | <u>4,500</u>    | <u>3,200</u>    |
|                             | <u>1,00,000</u> | <u>90,500</u>   | <u>1,19,500</u> | <u>1,34,200</u> |

S Ltd. wishes the offer to be based upon trading cash flows rather than book profits. By trading cash flow is meant cash received from debtors less cash paid to creditors and for business expenses (excluding depreciation), together with an allowance for average annual expenditure on fixed assets of ₹15,000 per year.

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The actual expenditure on fixed assets is to be ignored, as is any cash received or paid out on the issue or redemption of shares or debentures.

S Ltd. wishes the trading cash flow to be calculated for each of the years 2007, 2008 and 2009 and for these to be combined using weighting of 20% for 2007, 30% for 2008 and 50% for 2009 to give an average annual trading cash flow.

S Ltd. considers that the average annual trading cash flow should show a return of 10% on its investment.

You are required to calculate:

- (a) the trading cash flow for each of the years 2007, 2008 & 2009.
  - (b) the weighted average annual trading cash flow.
  - (c) the price which S Ltd. should offer for the business. (10 Marks)
- (b) From the following information of Steel India Ltd. for the year ended 31<sup>st</sup> March, 2010, prepare their Social Balance Sheet as on that date.

A specialist has valued their human assets at ₹ 828 lakhs.

Their investments were classified as:

|                                                              | Residential | Hospital | School | Welfare |
|--------------------------------------------------------------|-------------|----------|--------|---------|
| Buildings                                                    | 17.00       | 1.00     | 1.40   | 0.80    |
| Equipments                                                   | 2.80        | 1.00     | 1.00   | -       |
| - Water, Electricity and gas supply systems totaled ₹1 lakh. |             |          |        |         |
| - Their net owned funds were ₹ 26 lakhs                      |             |          |        |         |

(₹ in lakhs)

(6 Marks)

Answer

- (a) Trading cash flows of R Ltd.

|                                    | 2007<br>₹     | 2008<br>₹     | 2009<br>₹     |
|------------------------------------|---------------|---------------|---------------|
| (a) Profits earned during the year | 8,000         | 2,000         | 16,000        |
| Depreciation                       | 12,000        | 13,000        | 14,000        |
| Increase in creditors              | 2,000         | 1,000         | -             |
| Increase in accrued expenses       | 500           | 1,000         |               |
| Decrease in prepaid expenses       | <u>500</u>    | <u>—</u>      | <u>1,000</u>  |
| (A)                                | <u>23,000</u> | <u>17,000</u> | <u>31,000</u> |
| Less : Increase in stock           | 1,000         | 1,500         | 2,500         |
| Increase in debtors                | 3,000         | 2,000         | 2,000         |
| Decrease in accrued expenses       |               |               | 1,300         |

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|                                                                 |               |                |               |
|-----------------------------------------------------------------|---------------|----------------|---------------|
| Increase in prepaid expenses                                    | <u>-</u>      | <u>1,500</u>   | <u>      </u> |
| (B)                                                             | <u>4,000</u>  | <u>5,000</u>   | <u>5,800</u>  |
| Gross trading cash flows (A-B)                                  | 19,000        | 12,000         | 25,200        |
| Less: Adjustment for average annual expenditure on fixed assets | <u>15,000</u> | <u>15,000</u>  | <u>15,000</u> |
|                                                                 | <u>4,000</u>  | <u>(3,000)</u> | <u>10,200</u> |

(b) Calculation of weighted average annual trading cash flows

| Year | Trading cashflow | Weight | Weighted trading cash flow |
|------|------------------|--------|----------------------------|
|      | ₹                |        | ₹                          |
| 2007 | 4,000            | 20%    | 800                        |
| 2008 | (3000)           | 30%    | (900)                      |
| 2009 | 10,200           | 50%    | <u>5,100</u>               |
|      |                  |        | <u>5,000</u>               |

Weighted average annual trading cash flows

(c) Offer price by S Ltd. for the business of R Ltd.

$$\frac{\text{Weighted average annual trading cashflow}}{\text{Return on investment}} = \frac{5,000}{0.10} = ₹50,000$$

(b) Social Balance Sheet of Steel India Ltd. as at 31<sup>st</sup> March, 2010:

(₹ in lakhs)

*Liabilities*

|                                       |               |
|---------------------------------------|---------------|
| Organisation Equity                   | 26.00         |
| Social Equity (Contribution by staff) | <u>828.00</u> |
|                                       | <u>854.00</u> |

*Assets*

|                           |             |       |
|---------------------------|-------------|-------|
| Social Capital Investment |             |       |
| Buildings                 |             |       |
| (i) Residential           | 17.00       |       |
| (ii) Hospital             | 1.00        |       |
| (iii) School              | 1.40        |       |
| (iv) Welfare              | <u>0.80</u> | 20.20 |
| Equipments                |             |       |

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|                                            |             |               |
|--------------------------------------------|-------------|---------------|
| (i) Residential                            | 2.80        |               |
| (ii) Hospital                              | 1.00        |               |
| (iii) School                               | <u>1.00</u> | 4.80          |
| Water, Gas and Electricity supply systems  |             | 1.00          |
| Human Assets (as valued by the specialist) |             | <u>828.00</u> |
|                                            |             | <u>854.00</u> |

**Question 6**

- (a) The following is the Profit and Loss Account of Murali Ltd.; for the year ended 31<sup>st</sup> March, 2010. Prepare a gross value added statement of Murali Ltd.

*Profit and Loss Account for the year ended 31<sup>st</sup> March, 2010:*

|                                         | Amount (₹ in lakhs) |            |
|-----------------------------------------|---------------------|------------|
| Income                                  |                     | 890        |
| Sale                                    |                     | <u>55</u>  |
| Other Income                            |                     | 945        |
| Expenditure                             |                     |            |
| Production and operational expenses (a) | 641                 |            |
| Administrative expenses (factory) (b)   | 33                  |            |
| Interest                                | 29                  |            |
| Depreciation                            | <u>17</u>           | <u>720</u> |
| Profit before tax                       |                     | 225        |
| Provision for taxation                  |                     | <u>30</u>  |
| Profit after tax                        |                     | 195        |
| Balance as per last Balance Sheet       |                     | <u>10</u>  |
|                                         |                     | <u>205</u> |
| Transferred to General Reserve          |                     | 45         |
| Dividend Paid                           |                     | <u>95</u>  |
|                                         |                     | 140        |
| Surplus carried to Balance Sheet        |                     | <u>65</u>  |
|                                         |                     | <u>205</u> |



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Notes:

| (a)                                                                                                                                | (₹ in lakhs) |
|------------------------------------------------------------------------------------------------------------------------------------|--------------|
| <i>Production and operational expenses</i>                                                                                         |              |
| Consumption of raw Materials                                                                                                       | 293          |
| Consumption of stores                                                                                                              | 59           |
| Salaries, wages. Gratuities etc., (Admn)                                                                                           | 82           |
| Cess and local                                                                                                                     | 98           |
| Other manufacturing expenses                                                                                                       | <u>109</u>   |
|                                                                                                                                    | <u>641</u>   |
| (b) <i>Administration expenses include salaries, commission to Directors ₹9.00 lakhs, Provision for doubtful debts ₹6.30 lakhs</i> |              |
| (c) <i>Interest on loan from bank for working capital</i>                                                                          | 9            |
| <i>Interest on fixed loan from bank</i>                                                                                            | 10           |
| <i>Interest on loan from financial institution for fixed loan</i>                                                                  | 8            |
| <i>Interest on Debentures</i>                                                                                                      | <u>2</u>     |
|                                                                                                                                    | <u>29</u>    |
| (d) <i>The charges for taxation include a transfer of ₹3.00 lakhs to the credit of Deferred tax account.</i>                       |              |
| (e) <i>Cess and local taxes include excise duty, which is equal to 10% of cost of bought-in-materials.</i>                         |              |

(10 Marks)

- (b) *From the following in respect of loan funds of M/s Cometogether Foundation for 2009-10, prepare a statement showing changes in fund balance during the year.*

|                                                    | ₹         |
|----------------------------------------------------|-----------|
| <i>Private and Government grants</i>               | 5,00,000  |
| <i>Loan fund matching grant from revenue funds</i> | 10,000    |
| <i>Other transfer from unrestricted funds</i>      | 1,00,000  |
| <i>Investment income</i>                           | 15,000    |
| <i>Interest on loans</i>                           | 25,000    |
| <i>Refunded to grantors</i>                        | 20,000    |
| <i>Loan cancellation and written off</i>           | 10,000    |
| <i>Administrative and collection costs</i>         | 15,000    |
| <i>Fund balance at the beginning of the year</i>   | 20,15,000 |

(6 Marks)

**PAPER – 1 : ADVANCED ACCOUNTING**

Answer

(a)

Murali Ltd.

Gross Valued Added Statement for the year ended 31<sup>st</sup> March, 2010

|                                                     | (₹ in lakhs) | (₹ in lakhs)  |       |
|-----------------------------------------------------|--------------|---------------|-------|
| Sales                                               |              | 890           |       |
| Less: Cost of bought in materials and services:     |              |               |       |
| Production and operational expenses*                |              |               |       |
| (293 + 59 +109)                                     | 461          |               |       |
| Administration expenses (33 – 9)                    | 24           |               |       |
| Interest on working capital loan                    | 9            |               |       |
| Excise duty (Refer W.N)                             | <u>35.20</u> | <u>529.20</u> |       |
| Value added by manufacturing and trading activities |              | 360.80        |       |
| Add: Other income                                   |              | <u>55</u>     |       |
| Total Value Added                                   |              | <u>415.80</u> |       |
| Application of Value Added                          |              |               | %     |
| To Employees                                        |              |               |       |
| Salaries, Wages, Gratuities etc.                    |              | 82            | 19.72 |
| To Directors                                        |              |               |       |
| salaries and commission                             |              | 9             | 2.16  |
| To Government                                       |              |               |       |
| Cess and local taxes (98 - 35.20)                   | 62.80        |               |       |
| Income-tax                                          | <u>27</u>    |               |       |
|                                                     |              | 89.80         | 21.60 |
| To providers of capital                             |              |               |       |
| Interest on Debentures                              | 2            |               |       |
| Interest on Fixed loan (10+8)                       | 18           |               |       |
| Dividend                                            | <u>95</u>    |               |       |
|                                                     |              | 115           | 27.66 |
| To provide for maintenance and expansion of the     |              |               |       |

\* As no increase or decrease in stock is given in the question, therefore, it is assumed that whatever raw material and stores were bought, had been consumed.

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company

|                          |           |               |              |
|--------------------------|-----------|---------------|--------------|
| Depreciation             | 17        |               |              |
| General Reserve          | 45        |               |              |
| Deferred tax             | 3         |               |              |
| Retained profits (65-10) | <u>55</u> |               |              |
|                          |           | <u>120</u>    | <u>28.86</u> |
|                          |           | <u>415.80</u> | <u>100</u>   |

Working Note:

Calculation of Excise duty

Excise duty is 10% of ₹352 lakhs (i.e. 293+59) = ₹ 35.20 lakhs

(b) Statement of Changes in Loan Fund Balances

|                                                  | ₹               | ₹                |
|--------------------------------------------------|-----------------|------------------|
| A Fund balance at the beginning of 2009-10       |                 | <u>20,15,000</u> |
| B Additions during 2009-10                       |                 |                  |
| Private and Government Grants                    | 5,00,000        |                  |
| Investment income                                | 15,000          |                  |
| Interest on loans                                | <u>25,000</u>   |                  |
|                                                  |                 | <u>5,40,000</u>  |
| C Deductions during the year 2009-10             |                 |                  |
| Refunded to grantors                             | 20,000          |                  |
| Administrative and collection costs              | 15,000          |                  |
| Loan cancellations and written offs              | <u>10,000</u>   |                  |
|                                                  |                 | <u>45,000</u>    |
| D Transfer from other funds                      |                 |                  |
| Mandatory                                        |                 |                  |
| Loan fund matching grant                         | 10,000          |                  |
| Non mandatory                                    |                 |                  |
| Others transfers from unrestricted revenue funds | <u>1,00,000</u> |                  |
|                                                  |                 | <u>1,10,000</u>  |
| E Net additions (B-C+D)                          |                 | 6,05,000         |
| F Fund balance at the end of 2009-10 (A+E)       |                 | 26,20,000        |

## PAPER – 1 : ADVANCED ACCOUNTING

### Question 7

Attempt any four:

- (a) *An airline is required by law to overhaul its aircraft once in every three years. A company which operates aircrafts does not provide any provision as required by law in its final account. Discuss with reference to relevant Accounting Standard.*
- (b) *A company purchased on April 1, 2010 a special purpose machinery for ₹ 1 crore, and received Central Government subsidy for 25% of the price. Effective life of the machinery is 8 years. Explain the accounting treatment and quote the relevant AS.*
- (c) *An intangible item is appearing in the Balance Sheet of A Ltd. at ₹ 15 lakhs on 1-4-2010. The item was acquired for ₹ 25 lakhs on 1-4-2008. The enterprise has been following a policy of amortizing the intangible item over a period of 5 years on straight line basis. Applying paragraph 63 of AS 26 the enterprise determines the amortization period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use i.e., April, 1, 2008. Comment.*
- (d) *Certain Ltd., has signed at 31<sup>st</sup> Dec, 2009, the Balance Sheet date, a contract where the total revenue is estimated at ₹ 15 crores and total cost is estimated at ₹ 20 crores. No work began on the contract. Is contractor required to give any accounting effect for the year ended December, 31<sup>st</sup> 2009 in his accounts?*
- (e) *Can PT Ltd. a wire netting company, while valuing its finished stock at the year end include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses?* (4 x 4 = 16 Marks)

### Answer

- (a) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.  
The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprises can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of three years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than three years.
- (b) As per para 8 of AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

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According to the first alternative, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Therefore, on the basis of this alternative, the cost of special purpose machinery will be recorded in the books after reducing it by the amount of government subsidy of ₹25 lakhs. Thus the depreciable value of the machinery recorded in the books will be ₹75 lakhs (i.e. ₹1 crore – ₹25 lakhs). Depreciation of ₹9.375 lakhs (i.e. ₹75 lakhs / 8 years) will be charged on it every year on straight line method.

Under the second alternative, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, machinery will be recorded in the books by ₹ 1 crore and depreciation will be charged on it for ₹12.5 lakhs (i.e. ₹1 crore / 8 years) per year on straight line method. Government subsidy of ₹25 lakhs will be treated as deferred income which will be recognized as income in the statement of profit and loss every year by ₹ 3.125 lakhs (i.e. ₹ 25 lakhs / 8 years).

- (c) Since AS 26 'Intangible Assets' was mandatory for the period when the intangible asset was acquired i.e. 1<sup>st</sup> April 2008, the revision of amortization period from 5 years to 8 years is a change in Accounting estimate and accordingly, para 78 of AS 26 would apply in this case. According to this para, if the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. AS 5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset i.e. 6 years.

**Note:** It is assumed that since the date of purchase of intangible item, the enterprise has been following a policy of amortizing the intangible asset over a period of 5 years on straight line basis by applying paragraph 63 of AS 26 i.e. being the best estimate of its useful life. On 1.4.2010, the company again reviewed the useful life of the intangible asset.

- (d) As per para 35 of AS 7 'Construction Contracts, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. The amount of such loss is determined irrespective of whether or not work has commenced on the contract. Thus, Certain Ltd. should recognize loss amounting ₹5 crores for the year ended 31<sup>st</sup> December, 2009. The contract should be reviewed at the end of the each accounting period for additional losses to be incurred, if any.
- (e) As per AS 2 "Valuation of Inventories", cost of inventories comprise of all costs of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Interest and other borrowing costs are usually considered as overheads that don't contribute to bringing the inventories to their present location and condition. Therefore, the proposal of PT Ltd., to include interest on bank overdraft as an element of cost is not acceptable. Interest on bank overdraft will not form part of cost of production.