

PAPER – 1 : FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, ANNOUNCEMENTS AND NOTIFICATIONS

A. Applicable for May, 2012 examination

(i) Securities and Exchange Board of India (Merchant Bankers) (Second Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/17/26149 dated 16th August, 2011 had made amendment to the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992. These Regulations may be called as the Securities and Exchange Board of India (Merchant Bankers) (Second Amendment) Regulations, 2011. The following amendments have been made in regulation 14, sub-regulation (1) of the SEBI (Merchant Bankers) Regulations, 1992:

- (a) in clause (d), for the full stop, the figure “ ; ” shall be substituted;
- (b) after clause (d), the following new clause shall be inserted, namely:-
 - “(e) Records and documents pertaining to due diligence exercised in pre-issue and post-issue activities of issue management and in case of takeover, buyback and delisting of securities.”

(ii) Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/19/26273 dated 17th August, 2011 had made amendment to the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992. These Regulations may be called as the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2011. The following amendments have been made:

- (i) in regulation 17, in sub-regulation (1), clause (n) shall be substituted with the following, namely:-
 - “(n) Client account opening form in the format as may be specified by the Board.”
- (ii) in regulation 26, existing clause (xii), shall be substituted with the following, namely:-
 - “(xii) Failure to maintain client account opening form.”
- (iii) in Schedule II,
 - (a) under the head “Code of Conduct for Stock Brokers”, clause D shall be omitted.

- (b) under the head "Code of Conduct for Sub-Brokers", in clause C, sub-clause (4) shall be omitted.

(iii) Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/27668 dated 30th August, 2011 had made amendment to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996. These Regulations may be called as the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011. The SEBI (Mutual Funds) (Amendment) Regulations, 2011 can be downloaded from the link http://www.sebi.gov.in/cms/sebi_data/attachdocs/1315305030302.pdf

(iv) Application of AS 30, Financial Instruments: Recognition and Measurement, for the accounting periods ending on or before 31st March 2011 and from 1st April, 2011 onwards

1. Accounting Standard Board of ICAI has issued a clarification regarding applicability of AS 30 (dated 11th February, 2011). It is clarified that in respect of the financial statements or other financial information for the accounting periods commencing on or after 1st April 2009 and ending on or before 31st March 2011, the status of AS 30 would be as below:
 - (i) To the extent of accounting treatments covered by any of the existing notified accounting standards (for eg. AS 11, AS 13 etc.) the existing accounting standards would continue to prevail over AS 30.
 - (ii) In cases where a relevant regulatory authority has prescribed specific regulatory requirements (eg. Loan impairment, investment classification or accounting for securitizations by the RBI, etc), the prescribed regulatory requirements would continue to prevail over AS 30.
 - (iii) The preparers of the financial statements are encouraged to follow the principles enunciated in the accounting treatments contained in AS 30. The aforesaid is, however, subject to (i) and (ii) above.
2. From 1st April 2011 onwards,
 - (i) the entities to which converged Indian accounting standards will be applied as per the roadmap issued by MCA, the Indian Accounting Standard (Ind AS) 39, *Financial Instruments: Recognition and Measurement*, will apply.
 - (ii) for entities other than those covered under paragraph 2(i) above, the status of AS 30 will continue as clarified in paragraph 1 above.
3. The abovementioned clarifications would also be relevant to the existing AS 31, *Financial Instruments: Presentation* and AS 32, *Financial Instruments: Disclosures*

as well as for Ind AS 32, *Financial Instruments: Presentation* and Ind AS 107, *Financial Instruments: Disclosures*, after 1st April 2011 onwards.

Note: Ind AS, have not been notified till date. AS 30, 31 and 32 have also not been notified. Therefore, AS 30, 31 and 32 will be presumed as encouraged to follow by all the entities.

(v) Provision of 0.25% for standard assets of all NBFCs

RBI has issued a notification no. DNBS.PD.CC.No.207/03.02.002/2010-11 dated January 17, 2011. As per the notification, in terms of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, and Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, all NBFCs are required to make necessary provisions for non performing assets. In the interests of counter cyclical and so as to ensure that NBFCs create a financial buffer to protect them from the effect of economic downturns, it has been decided to introduce provisioning for standard assets also.

Accordingly,

- (i) NBFCs should make a general provision at 0.25 per cent of the outstanding standard assets.
- (ii) The provisions on standard assets should not be reckoned for arriving at net NPAs.
- (iii) The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.
- (iv) NBFCs are allowed to include the 'General Provisions on Standard Assets' in Tier II capital which together with other 'general provisions/ loss reserves' will be admitted as Tier II capital only up to a maximum of 1.25 per cent of the total risk-weighted assets.

Notifications No. DNBS. 222 CGM(US)2011 and No. DNBS. 223 CGM (US) 2011 both dated January 17, 2011 are also issued for meticulous compliance of the said norms.

(vi) All Deposit taking NBFCs - CRAR Fifteen percent w.e.f March 31, 2012

In terms of paragraph 16 of Non Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, every deposit taking NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 12% of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items. However, in terms of paragraph 16 of Non Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, dated February 22, 2007, every systemically important non-deposit taking NBFC (NBFC-ND-SI) has to maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15% of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items by March 31, 2011.

RBI vide circular no. RBI/2010-11/408 DNBS.PD/CC.No.211 /03.02.002/2010-11 dated February 17, 2011 has decided to align the minimum capital ratio of all deposit taking as well as systemically important non-deposit taking NBFCs to 15%. Accordingly, all deposit taking NBFCs shall maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off-balance sheet items w.e.f. March 31, 2012.

(vii) Amendment to Definition of Infrastructure Loan under Non-Banking Financial (Non-Deposit/Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

The term "Infrastructure Loan" has been defined in Para 2(viii) of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, respectively. It has now been decided to include "Telecom Towers" also as an infrastructure facility for availing credit facility. Thus, amendment of paragraph 2 of the said directions has been made as:

'In sub-clause (e) of clause (viii) in sub-paragraph (1) of the said Directions, the term "Telecom Towers" shall be inserted before the term "network of trunking".'

B. Not applicable for May 2012 examination

(i) Schedule VI revised by the Ministry of Corporate Affairs

The Ministry of Corporate Affairs (MCA) has revised Schedule VI to the Companies Act 1956 on the 28th February, 2011 pertaining to the preparation of Balance Sheet and Profit and Loss Account under the Companies Act, 1956. This revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards), Rules, 2006. The Revised Schedule VI shall come into force for the Balance Sheet and Profit and Loss Account to be prepared for the financial year commencing on or after 1.4.2011. However, the revised Schedule VI is not made applicable for May, 2012 examination.

(ii) Ind ASs issued by the Ministry of Corporate Affairs

The Ministry of Corporate Affairs (MCA) has issued 35 Converged Indian Accounting Standards (known as "Ind-AS"), without announcing the applicability date. The issuance of Ind-AS is a significant step towards the implementation of converged standards in India. The MCA will intimate the implementation date later. However, Ind ASs are not made applicable for May, 2012 examination.

(iii) Inflation Accounting

As per the Council's decision, in its 306th meeting, the topic of 'Inflation Accounting' has been excluded from the syllabus of Financial Reporting. Therefore, the chapter on 'Inflation Accounting' is not applicable for May, 2012 examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS WITH HINTS

Accounting Standards

AS-1

1. (a) XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

(Hint: Para 10 & 17 of AS 1)

AS-29

- (b) Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2010-11, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2006 based on the recommendations of the commission. The company makes the provision of ₹ 680 lakhs for pay revision in the financial year 2010-11 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts

"Salaries and benefits include the provision of ₹ 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

The accountant feels that the company should also book/recognise the income by ₹ 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit.

(Hint: Para 46 of AS 29)

AS-13

- (c) XYZ & Company has acquired 100% of the equity shares of Company 'X' during 2008. Company 'X' is a defunct company. The net worth of the Company 'X' is represented by land and building it owns. XYZ & Company acquired the shares of Company 'X' only for the land and building owned by it. XYZ & Company had proposed to start a software development facility at this site at the time of share purchase. The software development facility has not yet been set up, as Company's existing facility itself is under utilized.

In the financials of the year 2009, the above investment was classified as fixed assets under the head 'land and building' to reflect the substance of the transaction, as the intention to acquire the shares was to use the land and building owned by Company 'X'.

During the year 2011, the Company has decided to sell these shares and has passed a resolution authorizing the chairman to negotiate and settle the price. As of March 2011, this investment is reflected as fixed assets in the books. The property is prime one and is an ideal one for setting up new software units, warehouses etc.

- a) Should the above shares be classified under investments or is the current treatment of grouping it under fixed assets correct?
- b) If the current treatment of disclosing the shares as land and building is correct, should we disclose the same as assets held for disposal, with appropriate classification and disclosures?

(Hint: Para 20 & 23 of AS 13)

AS-7

- (d) From the following data, show Profit and Loss A/c (Extract) as would appear in the books of a contractor following Accounting Standard-7:

	(₹ in lakhs)
Contract Price (fixed)	480.00
Cost incurred to date	300.00
Estimated cost to complete	200.00

(Hint: Para 21 & 35 of AS 7)

AS-27

2. (a) What are the different forms of joint ventures? Elucidate the presentation and disclosure norms of Joint Ventures under AS 27.

(Hint: Para 4 and 50-54 of AS 27)

Applicability of AS

- (b) PQR Ltd., with a turnover of ₹ 35 lakhs and borrowings of ₹ 10 lakhs at the end of the relevant accounting year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2011. Advise the management the exemptions that are available as per the Companies (AS) Rules, 2006.

(Hint: Application of AS to SMCs)

AS-2 & AS-10

- (c) A company is engaged in the manufacture of electronic products and systems. As per Chief Accountant a prototype system was installed at one of the customer's locations in June 2010 for getting acceptance on the performance of the system. The Chief Accountant has stated that as the ownership of the system installed for field trials was vested with the company, for accounting & control purposes, the prototype system installed at customer's location in 2010 was capitalized in the accounts for the year 2010-11 at its bought-out cost. State whether the accounting treatment adopted by the company is correct or not?

(Hint: Para 3 of AS 2 and Para 6.1 of AS 10)

AS-6

- (d) An item of machinery was purchased on 1-4-2008 for ₹ 2,00,000. The WDV depreciation rate applicable to the machinery was 15%. The written down value of the machinery as on 31-3-2010 was ₹ 1,44,500. On 1-4-2010, the enterprise decided to change the method from written down value (WDV) to straight line method (SLM). The enterprise decided to write off the book value of ₹ 1,44,500, over the remaining useful life of machinery i.e. 5 years. Out of the total useful life 7 years, 2 years have already elapsed.

Comment whether the accounting treatment is correct. If not, give the correct accounting treatment with reasons.

(Hint: Para 15 of AS 6)

AS-28

3. (a) Light Ltd. is a multi-product manufacturing company, having its corporate office in a big building. As the area of building is large, Light Ltd. has let out 1/3 area of the building at a monthly rent of ₹ 100 lakhs, the lease agreement with tenant is for next 5 years. Is the building cash-generating unit? If not what is the cash-generating unit of the building?

(Hint: Para 66 of AS 28)

AS-25 and AS-2

- (b) Fixed production overheads for the financial year is ₹ 19,200. Normal expected production for the year, after considering planned maintenance and normal breakdown, and the future demand of the product is 4,800 MT. It is considered that there are no quarterly/seasonal variations. Therefore, the normal expected production for each quarter is 1200 MT and the fixed production overheads for the quarter are ₹ 4,800.

Actual production achieved	
First quarter	1000 MT
Second quarter	1400 MT
Third quarter	800 MT
Fourth quarter	1400 MT

Required:

- Presuming that there is no quarterly/seasonal variation, calculate the allocation of fixed production overheads for all the four quarters as per relevant Accounting Standards.
- In case there are quarterly and seasonal variation how the estimate of normal capacity to be made as per relevant Accounting Standards.

(Hint: Para 27 & 29(a) of AS 25 and Para 9 of AS 2)

AS-18

- (c) If a majority of directors of X Ltd. constitute the majority of the board of directors of Y Ltd. in their individual capacity as professional (and not by virtue of their being directors in X Ltd.), can it be considered that the companies are related?

(Hint: Para 3, 10 & 11 of AS 18)

AS-20

- (d) (i) Explain the concept of 'weighted average number of equity shares outstanding during the period'. State how would you compute, based on AS-20, the weighted average number of equity shares in the following case:

		No. of shares
1 st April, 2010	Balance of equity shares	7,20,000
31 st August, 2010	Equity shares issued for cash	2,40,000
1 st February, 2011	Equity shares bought back	1,20,000
31 st March, 2011	Balance of equity shares	8,40,000

- (ii) Compute adjusted earning per share and basic EPS based on the following information:

Net profit 2009-10	₹ 7,20,000
Net profit 2010-11	₹ 24,00,000
No. of equity shares outstanding until 31 st December, 2010	8,00,000

Bonus issue on 1st January, 2011, 2 equity shares for each equity share outstanding at 31st December, 2010.

(Hints: (i) Para 15 & 16 of AS 20; (ii) Para 44 of AS 20)

AS-17

4. (a) Following details are given for Sunder Ltd. for the year ended 31st March, 2011:

	(₹ in lakhs)	(₹ in lakhs)
Sales (including inter-segment sales):		
Food Products	10,000	
Plastic and Packaging	1,240	
Health and Scientific	690	
Others	<u>364</u>	12,294
Expenses:		
Food products	7,170	
Plastic and Packaging	800	
Health and Scientific	444	
Others	<u>400</u>	8,814
Other items:		
General corporate expenses		1,096
Income from investments		252
Interest expenses		126
Identifiable assets:		
Food products	15,096	
Plastic and Packaging	4,000	
Health and Scientific	1,400	
Others	<u>1,364</u>	21,860
General corporate assets		1,664

Other information:

	(₹ '000)
(a) Inter-segment sales are as below:	
Food Products	120
Plastic and Packaging	168
Health and Scientific	36
Others	10

(b) Operating profit includes ₹('000) 66 on inter-segment sales.

You are required to identify reportable segments.

(Hint: Para 27 of AS 17)

AS-19

- (b) On January 1, 2011, Santa Ltd. sold equipment to Banta Ltd. for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for a ten-year term. The economic life of the asset is estimated at 10 years. The minimum lease rents payable by the lesser has been fixed at ₹ 1,00,000 payable annually beginning December 31, 2011. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% per annum. Calculate the net effect on the profit and loss account?

(Hint: Para 48 of AS 19)

AS-26

- (c) Write short note on 'retirement and disposal of intangible assets'.

(Hint: Para 87 to 89 of AS 26)

AS-15

- (d) Rock star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. In this, if the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Assuming the following:

- (a) Immediately before the curtailment, based on current actuarial assumption, the

gross obligation was estimated at ₹ 6,000.

- (b) The fair value of plan assets on the date was estimated at ₹ 5,100.
- (c) The unamortized past service cost was ₹ 180.
- (d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

Rock star Ltd. estimates the shares of unamortized service cost that relates to the part of the obligation that is estimated at 10% of ₹ 180 at ₹ 18. Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet.

(Hint: Para 110 and 111 of AS 15)

AS-9

- (e) 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. 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 correct accounting treatment.

(Hint: Para 6 of AS 9 and Para 8 of AS 4)

IFRS

5. Explain the significant difference among IFRS, US GAAP and AS (applicable in India) with regard to :
- Inventories
 - Earnings per share – diluted.

Corporate Financial Reporting

6. The following information has been extracted from the books of account of X Ltd. as at 31st March, 2011:

	Dr. (₹ ' 000)	Cr. (₹ ' 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 (1 st April, 2010)		130
Distribution costs	51	
Factory closure cost	30	
Fixtures, Fittings, Tools and Equipment at cost	340	
Profit & Loss account (at 1 st April, 2010)		40
Purchase of equipment	60	
Purchases of goods for resale	855	
Sales (net of excise duty)		1,500
Share capital (50,000 shares of ₹ 10 each fully paid)		500
Stock (as on 1 st April, 2010)	70	
Trade creditors		40
Trade debtors	390	
	2,250	2,250

Additional information:

- (1) The stock as on 31st March, 2011 (valued at the lower of cost or net realisable value) was estimated to be worth ₹ 1,00,000.
- (2) Fixtures, fittings, tools and equipment all related to administration. Depreciation is charged @ 20% on cost. A full year's depreciation is charged in the year of acquisition, but no depreciation is charged in the year of disposal.
- (3) During the year to 31st March, 2011 the company purchased ₹ 60,000 of equipment, it also sold some fittings (which had originally cost ₹ 30,000) for ₹ 5,000 and for which depreciation of ₹ 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 X Ltd.'s Profit & Loss Account for the year ending 31st March, 2011 and Balance Sheet as at that date in accordance with the Companies Act, 1956 along with the Notes on Accounts containing only the significant accounting policies. Details of the schedules are not required. Ignore Corporate Dividend Distribution Tax.

Corporate Restructuring-Internal Reconstruction

7. The Balance Sheet as at 31st March 2011 of Sick Ltd. was as under:

Liabilities	₹	Assets	₹	₹
Share Capital		Fixed Assets		
4,000 Equity shares of ₹ 100 each, ₹ 50 per share paid-up	2,00,000	Goodwill at cost		20,000
2,000, 11% Cumulative preference shares of ₹ 100 each, fully paid up	2,00,000	Others	4,25,000	
Premium received on preference shares	20,000	Less: Depreciation	<u>1,35,000</u>	2,90,000
General reserve	30,000	Investment		12,500
Current Liabilities	<u>1,55,000</u>	Stock in trade		1,05,000
	<u>6,05,000</u>	Sundry Debtors		1,27,500
		Cash and Bank		
		balances		50,000
				<u>6,05,000</u>
Contingent liability not provided:				
Preference dividend is in arrears for three years including the year ended 31 st March, 2011				

The funds of the Company are sufficient to discharge its liabilities including Preference Dividends in arrears. However, the Company does not want to deplete its resources. It

would also like to reflect the values of some of its assets in a realistic manner. The Board of Directors of the Company decided and proposed the following scheme of reconstruction to be effective from 1st April, 2011.

- (i) The cumulative preference shareholders are to be issued, in exchange of their holdings, 13% Debentures of the face value of ₹ 100 each at a premium of 10%. Fractional holdings are to be paid off in cash.
- (ii) Arrears in preference dividends to be converted into equity shares of ₹ 100, ₹ 50 per share paid-up
- (iii) After the issue of the shares mentioned in (ii) above, the paid-up value of all the equity shares is to be reduced to ₹ 25 each.
- (iv) The face value of all the equity shares to be reduced to ₹ 50 each and the balance of the unpaid portion is to be called up fully.
- (v) Goodwill has lost its value and has to be written off. Market value of other fixed assets is determined, as at 31st March, 2011 at ₹ 2,50,000.
- (vi) Investments have no market value and have to be written off.
- (vii) Stock-in-trade is to be valued at 110% of its book value and Sundry Debtors are to be discounted by 5%.

The scheme, as approved by the Directors, is duly accepted by all the authorities and put into effect. During the working for the half-year ended 30th September, 2011 it is noticed that the trading for the period has resulted in an increase of bank balances by ₹ 27,550, Sundry Debtors by ₹ 20,000, Trade creditors by ₹ 13,000 and a decrease in stock by ₹ 4,000. Depreciation for the half year on fixed assets at 10% per annum is to be provided. The increase in the bank balances was prior to the company paying the half yearly interest on the debentures and redeeming one half of the debentures on 30th September, 2011.

From the above information you required to prepare the Balance Sheet of Sick Ltd. as on 30th September, 2011.

Corporate Restructuring -Absorption

8. Major Ltd. has a subsidiary X Ltd. holding 76% of the later's paid-up-capital. The balance of shares in X Ltd. is 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 Major Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years which were ₹ 15 lakhs, ₹ 20 lakhs and ₹ 32.5 lakhs.

- (b) The actual cost of the shares to the foreign company was ₹ 1,20,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Major 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.

Major Ltd. decided to absorb X Ltd. simultaneously. It decided to write down fixed assets of X Ltd. by 5%. The Balance Sheet figures included a sum of ₹ 75,000 due by X Ltd. to Major Ltd.

The entire arrangement was approved by all concerned for being given effect to on 1.4.2011.

The summarised Balance Sheets as at 31.3.2011 immediately before the implementation of the scheme were as follows:

	Major Ltd. (₹)	X Ltd. (₹)
Shares of ₹ 10 each	40,00,000	10,00,000
Reserves and Surplus	80,00,000	30,00,000
Secured Loans	20,00,000	--
Current Liabilities	<u>30,00,000</u>	<u>10,00,000</u>
	<u>1,70,00,000</u>	<u>50,00,000</u>
Fixed Assets	60,00,000	17,50,000
Investments in X Ltd.	3,70,000	----
Sundry Debtors	35,00,000	5,00,000
Inventories	30,00,000	25,00,000
Cash and Bank	<u>41,30,000</u>	<u>2,50,000</u>
	<u>1,70,00,000</u>	<u>50,00,000</u>

You are required to show the Balance Sheet of Major Ltd. as it would appear after the arrangement is put through on 1.4.2011.

Corporate Restructuring-Demerger

9. The following is the Balance Sheet of Complete Ltd. having an authorised capital of ₹ 1,000 crores as on 31st March, 2011:

(₹ in crores)

Sources of funds:

Shareholders' funds:

Share capital

Equity shares of ₹ 10 each fully paid in cash 250

Reserves and surplus (Revenue)	<u>750</u>	1,000
Loan funds:		
Secured against: (a) Fixed assets ₹ 300 Cr.		
(b) Working capital <u>₹ 100 Cr.</u>	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 ₹ 1,000 Cr.)		400
Net current assets:		
Current assets	3,000	
Less: Current liabilities	<u>(2,000)</u>	<u>1,000</u>
		<u>2,000</u>

Capital commitments : ₹ 700 crores.

The company consists of 2 divisions:

- (i) Settled division whose gross block was ₹ 200 crores and net block was ₹ 30 crores; current assets were ₹ 1,500 crores and working capital was ₹ 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 Much Ltd. and More Ltd. are to be formed. The authorised capital of Much Ltd. is to be ₹ 1,000 crores. The authorised capital of More Ltd. is to be ₹ 500 crores.
- (b) More Ltd. is to take over investments at ₹ 800 crores and unsecured loans at balance sheet value. It is to allot equity shares of ₹ 10 each at par to the members of Complete Ltd. in satisfaction of the amount due under the arrangement.
- (c) Much 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 Complete Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of ₹ 10 each as consideration to Complete Ltd. Much Ltd. made an issue of unsecured convertible debentures of ₹ 500 crores carrying interest at 15% per annum and having a right to convert into equity shares of ₹ 10 each at par on 31.3.2016. This issue was made to the members of Much Ltd. as a right who grabbed the opportunity and subscribed in full.
- (d) Complete Ltd. is to guarantee all liabilities transferred to the 2 companies.

- (e) Complete 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:

- Pass journal entries in the books of Complete Ltd., and
- 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.

Consolidated Financial Statements

10. The following information has been extracted from the Books of 'P' Ltd. group (as at 31st December, 2011):

	P Ltd.	Q Ltd.	R Ltd.		P Ltd.	Q Ltd.	R Ltd.
	₹	₹	₹		₹	₹	₹
Share capital (Fully paid equity shares of ₹ 10 each)	8,00,000	6,00,000	4,00,000	Fixed Assets less depreciation	4,20,000	3,76,000	5,22,000
Profit and Loss Account	2,10,000	1,90,000	1,28,000	Investment at cost	6,30,000	4,00,000	---
Dividend received: From Q Ltd. in 2010	60,000			Current Assets	1,20,000	60,000	40,000
From Q Ltd. in 2011	60,000						
From R Ltd. in 2011		36,000					
Current Liabilities	40,000	10,000	34,000				
	11,70,000	8,36,000	5,62,000		11,70,000	8,36,000	5,62,000

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.

'P' Ltd. acquired 50,000 equity shares of Q Ltd. on 31st December, 2009.

'Q' Ltd. acquired 30,000 equity shares of R Ltd. on 31st December, 2010.

The detailed information of Profit and Loss Accounts are as follows:

	P Ltd. ₹	Q Ltd. ₹	R Ltd. ₹
Balance of Profit and Loss Account on 31 st December, 2009 after dividends of 12% in respect of calendar year 2009, but excluding dividends received	86,000	78,000	60,000
Net profit earned in 2010	<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 2011)	<u>(96,000)</u>	<u>(72,000)</u>	<u>(48,000)</u>
	1,10,000	90,000	68,000
Net profit earned in 2011 (Before taking into account proposed dividends of 12% in respect of calendar year 2011)	<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 2009 to 2011 and ignoring taxation, you are required to prepare:

- (i) The Consolidated Balance Sheet of P Limited group as at 31st December, 2011.
- (ii) The Consolidated Profit and Loss Account for the year ending 31st December, 2011.
- (iii) Cost of control.
- (iv) Minority shareholders interest.

Investment in Associates

11. Morning Ltd. acquired 60,000 equity shares of ₹ 10 each in Evening Ltd. on 1-1-2011 at ₹ 15 per share. The total issued equity share capital of Evening Ltd. was ₹ 15,00,000 divided into 1,50,000 equity shares of ₹ 10 each. During the year 2011, the fixed assets of Evening Ltd., have been revalued up by ₹ 2,50,000. On the date of acquisition of shares, reserves and surplus of Evening Ltd. was ₹ 5,00,000. Evening Ltd. earned a profit after tax of ₹ 3,37,500 for the year 2011. During 2011, Evening Ltd. paid an Interim dividend of 5%.

Show in the books of Morning Ltd. the value of investments in shares of Evening Ltd. that would appear at 31-12-2011:

- I. In separate Balance Sheet of Morning Ltd., and
- II In the Consolidated Balance Sheet of Morning Ltd. and its subsidiaries.

Financial Instruments

12. On 1st April 2009, A Ltd. issued a 10 per cent convertible debentures with a face value of ₹ 1,000 maturing on 31st March 2018. The debentures are convertible into equity shares of A Ltd. at a conversion price of ₹ 25 per share. Interest is payable half-yearly in cash. At the date of issue, A Ltd. could have issued non-convertible debt with a ten year term bearing a coupon interest rate of 11 per cent. On 1st April 2014, the convertible debenture has a fair value of ₹ 1,700. A Ltd. makes a tender offer to debenture holders to repurchase the debentures for ₹ 1,700, which the holders accepted. At the date of repurchase, A Ltd. could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 per cent. Show how an entity accounts for (i) equity and liability at the inception and (ii) at the repurchase of the convertible instrument.

Share Based Payments

13. At the beginning of year 1, the enterprise grants 100 stock options to each of its 500 employees, conditional upon the employees remaining in the employment of the enterprise during the vesting period. The options will vest at the end of year 1 if the earnings of the enterprise is 18 per cent; at the end of year 2 if the earnings of the enterprise is an average of 13 per cent per year over the two year period; and at the end of year 3 if the earnings of the enterprise is an average of 10 per cent per year over the three year period. The fair value of the options, calculated at the grant date using an option pricing model, is ₹ 30 per option. No dividends are expected to be paid over the three-year period.

By the end of year 1, the earnings of the enterprise was 14 per cent, and 30 employees had left. The enterprise expected that earnings will continue at a similar rate in year 2, and, therefore, expected that the options will vest at the end of year 2. The enterprise expected on the basis of a weighted average probability, that a further 30 employees will leave during the year 2, and, therefore, assumed that options will vest in 440 employees at the end of the year 2.

By the end of year 2, the earnings of the enterprise was only 10 per cent. 28 employees have left during the year. The enterprise expected that a further 25 employees will leave during year 3, and that the earnings of the enterprise will be at least 6 per cent, thereby achieving the average of 10 per cent per year.

By the end of the year 3, 23 employees had left and the earnings of the enterprise had been 8 per cent. You are required to determine the compensation expense to be recognised each year.

(Hint: Para 14 of GN on “Accounting for Employee Share Based Payments”)

Mutual Fund

14. On 1st April, 2011, Fair Return Mutual Fund has the following assets and prices at 3.00 p.m.

Shares of	No. of shares	Market price per share (₹)
P Ltd.	5000	19.70
Q Ltd.	25000	482.60
R Ltd.	5000	264.40
S Ltd.	50000	674.90
T Ltd.	15000	25.90
No. of units of fund		4,00,000 units

Calculate:

- NAV of the Fund.
- Assuming Mr. Mohan, send a cheque of ₹ 25,00,000 to the Fund on 1st April, 2011 and Fund Manager purchases 9,000 shares of R Ltd. and balance is held in bank. What will be the new position of the fund?
- Now suppose on 2nd April 2011, at 3.00 p.m. the market price of shares is as follows:

Shares	₹
P Ltd.	20.30
Q Ltd.	513.70
R Ltd.	290.80
S Ltd.	671.90
T Ltd.	44.20

Calculate the new NAV?

NBFC

15. Provider Ltd. is a non-banking finance company who accepts public deposit and also deal in hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.3.2009:

Few machines were sold on hire purchase basis. The hire purchase price was set as ₹ 100 lakhs as against the cash price of ₹ 80 lakhs. The amount was payable as :
 (i) ₹ 20 lakhs down payment and balance in 5 equal instalments. The hire vendor collected 1st instalment as on 31.3.2010 but could not collect the second instalment, which was due on 31.3.2011. The company was finalizing accounts for the year

31.3.2011. Till 15.5.2011, the date on which the Board of Directors signed the accounts, the second instalment was not collected. Presume I.R.R. to be 10.42%.

Required:

- (i) What should be the principal outstanding as on 1.4.2010? Should the company recognise financial charge for the year 2010-11 as income?
- (ii) What should be the net book value of assets as on 31.3.2011 so far as Provider Ltd. is concerned as per NBFC prudential norms requirement for provisioning?
- (iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

Valuation of Goodwill

16. The Balance Sheet of Steel Ltd. as on 31st March, 2011 is given below:

Liabilities	₹	Assets	₹
Share capital:		Fixed assets:	
Equity shares of ₹ 10 each 6,00,000		Goodwill 70,000	
Less: Calls in arrear		Machinery 3,00,000	
(₹ 2 for final call) <u>20,000</u>	5,80,000		
7% Preferences shares of ₹ 10 each fully paid	3,00,000	Freehold properties 4,50,000	
Reserves 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	
	18,80,000		18,80,000

Additional Information:

- (i) On 1.4.2008 a new furniture costing ₹ 20,000 was purchased and wrongly charged to revenue. No rectification has yet been made for the same. Depreciation charged on furniture is @ 10% on reducing balance system.
- (ii) Fixed assets are worth 15% above their book value.
- (iii) Stock is overvalued by 50,000 and 10% Debtors are doubtful.

(iv) Of the investments, 10% is trade investment and the balance is non-trade investment. Trade investments are to be valued at 10% below cost. A uniform rate of dividend of 10% is earned on all investments.

(v) Profits after tax are as follows:

	₹
2008-09	2,50,000
2009-10	2,80,000
2010-11	3,30,000

(vi) In a similar business normal return on capital employed is 20%.

You are required to calculate the value of goodwill on the basis of 2 years' purchase of super profits based on the average profit of last 3 years, assuming tax rate of 50%.

Valuation of Shares

17. The summarized balance sheets of Precious Ltd. as on 31st December, 2011 is as follows:

Liabilities	₹	Assets	₹
Share capital (in shares of ₹ 100 each)		Fixed assets:	
4,500 Equity shares	4,50,000	Goodwill	1,50,000
1,500, 6% Preference shares	1,50,000	Freehold property	3,75,000
Profit and loss A/c	7,50,000	Plant and machinery (less depreciation)	1,50,000
5% Debentures	3,00,000	Quoted investments	3,00,000
Sundry creditors	2,39,250	Current assets:	
		Stock	2,70,000
		Debtors (net)	2,99,250
		Bank balance	<u>3,45,000</u>
	<u>18,89,250</u>		<u>18,89,250</u>

Profits for the three years 2009, 2010 and 2011 after charging debenture interest and tax but before providing for preference dividend were ₹ 2,20,500, ₹ 3,22,500 and ₹ 2,40,000 respectively.

- Preference shares are payable at par on liquidation.
- The purchaser wants to acquire all the 4,500 equity shares.
- The price for equity shares is to be based on the following assumptions:
 - The normal return of 10% on net assets (at revised valuation) attributable to

equity shares.

2. Debentures will be redeemed at a discount of 25% prior to the sale of the business. In order to provide funds for this purpose, investments will be sold out.
3. The value of freehold property is agreed to be ascertained on the basis of 8% return. The current annual rental value is ₹ 50,400.
4. A claim of ₹ 8,250 was omitted to be provided in the year 2011.
5. Market value of quoted investments was ₹ 3,75,000.
6. Non - recurring profits are to be eliminated. 10% of the profits for 2010 referred above arose from a transaction of a non- recurring nature.
7. A provision of 5% on sundry debtors was made in 2011 which is no longer required (the provision when made was taken into account for purposes of Income – tax @ 50%).

Calculate the value of the of the company's shares (from the point of view of purchaser) after taking into account the revised values of assets and liabilities and value the goodwill based on three year's purchase of the super profit based on the average profit of the last three years.

Value Added Statement

18. From the following Profit and Loss Account of Alpha 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, 2011

Income	(₹ in lakhs)	(₹ in lakhs)
Sales		800
Other Income		<u>50</u>
		850
Expenditure :		
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:		(₹ in lakhs)
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>

Economic Value Added

19. You are given the following information about Ram Ltd.:

- (i) Beta for the year 2010-11 1.05
- (ii) Risk Free Rate 12%
- (iii) Long Range Market Rate (based on BSE Sensex) 15.14%
- (iv) Extracts from the liability side of Balance Sheet as at 31st March, 2011.

	(₹ in lakhs)
Equity	29,160
Reserves and surplus	<u>43,740</u>
Shareholder's fund	72,900
Loan funds	<u>8,100</u>
Total funds (long-term)	81,000

(v) Profit after tax ₹ 20,394.16 lakhs

(vi) Interest deducted from profit ₹ 487.00 lakhs

(viii) Effective tax rate (i.e. (Provision for Tax/PBT) x 100) 24.45%

Calculate Economic Value Added of Ram Ltd. as on 31st March 2011.

Human Resource Accounting

20. "Jaggi & Lau suggested that a proper valuation of human resource is not possible unless the contribution of individuals as a group is taken into consideration." Comment.

SUGGESTED ANSWERS/HINTS

1. (a) Para 17 of AS-1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Also as per para 10 of the AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.

- (b) As per para 46 of AS-29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

In this case, the provision of salary to employees of ₹ 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be made reducing the claim to be made from the client. It appears that the whole amount of ₹ 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding non-recognition of income of ₹ 680 lakhs is not as per AS-29 and AS-9. However, the concept of prudence will not be followed if ₹ 680 lakhs is simultaneously recognized as income. ₹ 680 lakhs is not the revenue at present but only reimbursement of claim. However the accountant is correct to the extent as that non- recognition of ₹ 680 lakhs as income will result in the under statement of profit.

- (c) As per para 20 of AS 13 'Accounting for Investments', the cost of any shares in a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property as long term investment.

In the given case, the acquisition of shares in Company X was with the sole motive of using the land and buildings, and not for earning income by way of dividends. The substance of the transaction is an investment in fixed assets, though the "form" may be acquisition of shares.

In view of the foregoing, the accounting treatment so far accorded by the Company, in classifying the shares as fixed assets is correct.

Since the original intention has undergone a change, therefore, on account of the changed intention, i.e. "to dispose of the shares", the accountant should reclassify the holdings in the Company X as investments, and bring the same in the books as "current investment".

As per para 23 of the standard when long term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. Accordingly reclassified current investment should be shown at cost or carrying amount whichever is less.

(d) Calculation of total estimated cost

	(₹ in lakhs)
Cost incurred to date	300
Estimate of cost to completion	<u>200</u>
Estimated total cost	<u>500</u>

Degree of completion $(300/500) \times 100 = 60\%$

Revenue recognised as a percentage to contract price

= 60% of ₹ 480 lakhs = ₹ 288 lakhs

	(₹ in lakhs)
Total foreseeable loss (500-480)	20
Less: Loss for the current year (300-288)	<u>(12)</u>
Expected loss to be recognized immediately as per para 35 of AS 7	<u>8</u>

Profit and Loss A/c (An extract)

	₹		₹
To Construction cost	300	By Contract price	288
To Estimated loss on completion of contract	<u>8</u>		<u>—</u>
	<u>?</u>		<u>?</u>

2. (a) Joint ventures take many different forms and structures. AS 27, 'Financial Reporting of Interests in Joint Ventures' identifies three broad types of joint ventures— jointly controlled operations, jointly controlled assets and jointly controlled entities. The following characteristics are common to all joint ventures:

- (a) two or more venturers are bound by a contractual arrangement; and
- (b) the contractual arrangement establishes joint control.

In its separate financial statements as well as in consolidated financial statements, a venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

- (a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

- (b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
- (c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should also disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- (a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
- (b) its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.

A venturer should disclose, in its separate financial statements only, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

- (b)** This case deals with the issue of Applicability of Accounting Standards.

Small and Medium-Sized Company (SMC) as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2006 means, a company

- (i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- (ii) which is not a bank, financial institution or an insurance company;
- (iii) whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;
- (iv) which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
- (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

For the purposes of clause (f), a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

On the basis of the above criteria, PQR Ltd. is classified as Small and Medium-Sized Company (SMC) with a turnover of ₹ 35 lakhs and borrowings of ₹ 10 lakhs.

On the basis of this classification, following relaxations and exemptions are available to PQR Ltd. (SMC)

1. AS 3 "Cash Flow Statements" is not mandatory.

2. AS 17 "Segment Reporting" is not mandatory.
 3. SMCs are exempt from some paragraphs of AS 19 "Leases".
 4. SMCs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
 5. SMCs 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. SMCs are exempt from disclosure requirements of paragraphs 66 and 67 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets".
 7. SMCs are exempt from certain requirements of AS 15 "Employee Benefits".
 8. Accounting Standards 21, 23, 27 are not applicable to SMCs.
- (c) As per para 3 of AS-2 'Valuation of Inventories', inventories mean assets held for sale in the ordinary course of business, or in the process of production for such sale, or for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.
- And as per para 6.1 of AS 10 'Accounting for fixed Assets', fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.
- Accordingly, the system installed by the company at customer's site for his acceptance, based on the field trials of the system, is an item of inventory, and is not a fixed asset. Installation of such prototype system at customers' sites for their acceptance is akin to sale of goods on approval basis. Therefore, the capitalisation of such prototype system at its bought-out-cost is not correct.
- At the time of installation of such systems at the customers' site, value of the same should be transferred to a separate account such as 'Goods sent for approval account'.
- As it does not qualify the definition of fixed asset, therefore, no depreciation can be charged on it.
- (d) As per para 15 of Accounting Standard 6, 'Depreciation Accounting', when the method of depreciation is changed, depreciation is recalculated in accordance with the new method from the date of the assets coming into use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method is adjusted in the statement of profit & loss in the year in which the method of depreciation is changed.

Calculation of Surplus/Deficiency due to change in method of depreciation

	₹
Purchase price of plant as on 01-04-2008	2,00,000

Less: Depreciation as per SLM, for the year 2008-09 (₹ 2,00,000 , 7 years)	<u>28,571</u>
Balance as on 31-3-2009	1,71,429
Less: Depreciation for the year 2009-10 (₹ 2,00,000 , 7 years)	<u>28,571</u>
Balance as on 31-3-2010	<u>1,42,858</u>
Book value as per WDV method	1,44,500
Book value as per SLM	<u>1,42,858</u>
Deficiency	<u>1,642</u>

Deficiency of ₹ 1,642 should be charged to Profit & Loss account.

Therefore, the accounting treatment done by the enterprises is wrong i.e. book value of ₹ 1,44,500 will not be written off over the remaining useful life of machinery i.e. 5 years.

Note: It is assumed that when the company changed method of depreciation from WDV to SLM, it re-calculated the depreciation amount on the basis of useful life and has not continued with WDV rate of depreciation.

3. (a) As per para 66 of AS 28 'Impairment of Assets, the cash-generating unit is smallest group of asset that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets.

In the instant case the primary purpose of the building is to serve as a corporate office of Light Ltd., which is engaged in multi product manufacturing activities. Therefore, the building as a whole cannot be considered to generate cash inflows which are largely independent of the cash flows for the company as a whole. The building is not held as an investment; therefore, it would be inappropriate to determine 'value in use' of the building based on future market rent.

Hence, building is not a cash generating unit; the cash-generating unit for the building is Light Ltd., the company as a whole.

- (b) (i) It is considered that there is no quarterly/seasonal variation, therefore normal expected production for each quarter is 1200 MT and fixed production overheads for the quarter are ₹ 4,800.

Fixed production overhead to be allocated per unit of production in every quarter will be ₹ 4 per MT (Fixed overheads/Normal production i.e. ₹ 4,800/1200 MT).

First quarter

Actual fixed production overheads = ₹ 4,800.

Fixed production overheads based on the allocation rate of ₹ 4 per unit allocated to actual production = ₹ 4 x 1000 MT = ₹ 4,000.

Unallocated fixed production overheads to be charged as expense as per paragraph 9 of AS-2 and consequently as per AS-25 = ₹ 800.

Second quarter

Actual fixed production overheads as per para 27 of AS 25, on year-to-date basis = ₹ 9,600.

Fixed production overheads to be absorbed on year-to-date basis

$$2400 \text{ MT} \times ₹ 4 = ₹ 9,600.$$

₹ 800 was not allocated to production in the first quarter. To give effect to the entire ₹ 9,600 to be allocated in the second quarter, as per paragraph 29(a) of AS-25, ₹ 800 is reversed by way of a credit to the profit and loss account of the second quarter.

Third quarter

Actual production overheads on year-to-date basis = ₹ 14,400.

Fixed production overheads to be allocated on year-to-date basis

$$3,200 \text{ MT} \times ₹ 4 = ₹ 12,800$$

Under allocated overheads of ₹ 1600 is to be charged as expense as per para 9 of AS 2 and consequently as per AS-25.

Fourth quarter/Annual

Actual fixed production overheads on year-to-date basis = ₹ 19,200.

Fixed production overheads to be allocated on year-to-date basis

$$4,600 \text{ MT} \times ₹ 4 = ₹ 18,400$$

₹ 1600 was not allocated to production in the third quarter due to less production. However, due to over production of 200 MT in the fourth quarter, excess allocable fixed overhead in the fourth quarter is given effect to by reversal of previously charged amount to Profit and Loss account (i.e. in the third quarter) to the extent of ₹ 800 (200 MT x ₹ 4). Therefore, ₹ 800, over allocable in the fourth quarter, are to be reversed as per para 29(a) of AS-25 by way of a credit to the profit and loss account of the fourth quarter.

Unallocated overheads for the year ₹ 800 are expensed in the profit and loss account as per para 9 of AS-2.

The cumulative result of all the quarters would also result in unallocated overheads of ₹ 800. Hence, the requirements of para 27 of AS-25 that the quarterly results should not affect the measurement of the annual results has been complied with.

- (ii) In a case where there are quarterly/seasonal variations, the estimates of normal capacity would have to be made on the quarterly/seasonal basis. The enterprise will have to estimate its normal capacity on the basis of the average of the relevant quarters/seasons of past few years, say 3 to 5 years, also considering the demand of the product during the season. (For example, a company is having seasonal variations say, in the 3rd quarter. The estimate for the 3rd quarter should be based on the capacity utilisation of the 3rd quarter for the past few years, say 3 to 5 years, also keeping in mind the future demand of the product during the quarter). Once the normal capacity for a quarter is determined, as aforesaid, the quarter should be considered for measurement purposes, as per paragraph 27 of AS-25 on year –to-date basis, i.e. on cumulative basis, which would then be added up to determine the normal capacity for the year on the basis of which the absorption rate will be determined. The variations between the seasons would thus be considered normal and treated accordingly.

If there is an abnormal breakdown during a period, as per AS-2, the amount of fixed production overheads not allocated to units of production is charged to the profit and loss account. However, the result of under allocation of overheads or over allocation of overheads should not affect the measurement of its annual results since interim periods are parts of a financial year.

- (c) The companies are not related merely because the majority of the directors of X Ltd. became the majority of the directors of the Y Ltd. in their individual capacity as professionals.

As per para 10 of AS 18, 'Related Party Disclosures', control has been defined as

- (i) ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
- (ii) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
- (iii) a substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise.

Further, as per para 11 of AS-18, an enterprise is considered to control the composition of the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or removal all or a majority of directors of that company. In the given example, X Ltd. cannot be said to control the composition of the board of directors of the Y Ltd. as the directors have been appointed in their individual capacity and not by virtue of their being directors in the X Ltd.

Further, an evaluation is required to ascertain whether any of the directors has a relationship with both companies [as specified in para 3 (c) and (d) of AS-18 which would create a related party relationship between the two companies]. Such relationships would include these directors being key management personnel in both companies, being a key management person in one company and owing an interest in another which enables him to exercise significant influence etc.

- (d) (i) As per para 16 of AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	<u>= 1,40,000 shares</u>
	<u>= 8,40,000 shares</u>

- (ii) Equity per share

Basic EPS 2010-11 = ₹ 24,00,000/24,00,000 = ₹ 1

Adjusted EPS 2009-10 = ₹ 7,20,000/24,00,000 = ₹ 0.30

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2009-10, the earliest period reported.

4. (a) As per 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.

Calculation of Segment Result

	Sales (₹ in lakhs)	Expenses (₹ in lakhs)	Segment result (₹ in lakhs)
Food products	10,000	7,170	2,830
Plastic & packaging	1,240	800	440
Health & scientific	690	444	246
Other	364	400	(36)

Sunder Ltd. operates through four segments, namely, 'Food Products', 'Plastic and Packaging', 'Health and Scientific' and 'Others'. The relevant information about these segments is given in the following table:

(₹ in lakhs)						
		Food Products	Plastic and Packaging	Health and Scientific	Others	Total
1.	Segment Assets	15,096	4,000	1,400	1,364	21,860
2.	Segment assets as a percentage of total assets of all segments	69.06%	18.3%	6.4%	6.24%	
3.	Segment Results	2,830	440	246	(36)	3,480
4.	Combined Result of all Segments in profits	2,830	440	246		3,516
5.	Combined Result of all Segments in loss				(36)	
6.	Segment Result as a percentage of the greater of the totals arrived at 4 and 5 above in absolute amount (i.e., 3516)	80.49%	12.51%	7%	1.02%	
7.	Segment Revenue	10,000	1,240	690	364	12,294
8.	Total Revenue of each segment as a percentage of total revenue of all segments	81.34%	10.09%	5.61%	2.96%	

(a) On the basis of 'Revenue' criteria segments 'Food Products' and 'Plastic and

Packaging' are reportable segments.

- (b) On the basis of 'Result' criteria, segments 'Food Products' and 'Plastic and Packaging' are reportable segments (since their results in absolute amount is 10% or more of ₹ 3516 lakhs).
- (c) On the basis of 'Asset' criteria, 'Food Products' and 'Plastic and Packaging' are reportable segments.
- (b) The PV of minimum lease payments at 10% discount rate:

$$= ₹ 1,00,000 \times 6.1446 = ₹ 6,14,460$$

Santa Ltd. should recognize the asset and the liability at ₹ 6,14,460.

The excess of sales proceeds over carrying amount

$$= ₹ 6,14,460 - ₹ 1,00,000 = ₹ 5,14,460$$

As per para 48 of AS 19 'Leases', if a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that Santa Ltd. has decided to charge depreciation on straight line basis, AS 19 requires Santa Ltd. to:

- Recognize depreciation of ₹ 61,446 per annum for 10 years
- Allocate excess of ₹ 5,14,460 over the lease term at the rate of ₹ 51,446 p.a.

The net effect is a debit of (₹ 61,446 – ₹ 51,446) ₹ 10,000 per annum to the profit and loss account for 10 years, as covered under the lease term.

Had there been no sale and lease back transaction, the profit and loss account for each year covered in the lease term would have been charged by (₹ 1,00,000/10) or ₹ 10,000, towards depreciation. Thus, the sale and lease back transaction has no impact on profit or loss to be reported by the lessee (vendor in the sale transaction) over the lease period.

The deferred income (excess) should be presented as a deduction from the carrying amount of the asset. Thus, the asset should be presented by Santa Ltd. in its balance sheet dated December 31, 2011 as follows:

	₹
Gross Block	6,14,460
Less: Accumulated depreciation	<u>(61,446)</u>
Net Block	5,53,014
Less : Deferred Income (5,14,460 – 51,446)	<u>(4,63,014)</u>
Net Block	<u>90,000</u>

In effect, the carrying amount of the equipment does not change with the sale and lease back transaction. In substance, the sale and lease back transaction is a borrowing transaction resulting in recognition of a liability in the balance sheet and recognition of interest expense in the profit and loss account.

- (c) Para 87, 88 and 89 of AS 26 'Intangible Assets' states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

- (d) Gain from curtailment is estimated as under

	₹
Reduction in gross obligation	600
Less: Proportion on unamortised past service cost	<u>18</u>
Gain from curtailment	<u>582</u>

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	₹
Reduced gross obligation	5,400
Less: Fair value of plan assets	<u>5,100</u>
	300
Less: Unamortised past service cost	<u>162</u>
Liability to be recognised in the balance sheet	<u>138</u>

- (e) (i) As per para 6 of AS 9 'Revenue Recognition', revenue is recognized at the time when the significant risks & rewards of ownership is transferred i.e. when the invoice is raised to the customers. However, the treatment of deduction as trade discount is not as per AS 9.

According to the treatment prescribed by para 8 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", the adjustment of the difference between the invoiced amount and the amount finally settled against

“Ship Repair Income” account is correct. 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. However, 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.

5. Table showing differences among AS (applicable in India), IFRS and US GAAP

Topic	Accounting Standard	IFRS	US GAAP
Inventories	Carried at lower of cost and net realizable value. FIFO or weighted average method is used to determine cost. LIFO method is however, prohibited.	Carried at lower of cost and net realizable value. For cost determination, FIFO or weighted average method is used. LIFO basis of valuation is prohibited. Reversal is required for subsequent increase in value of previous write-downs.	Similar to IFRS; however, use of LIFO is permitted. Reversal of write-down is prohibited.
Earnings per share – diluted	Weighted average potential dilutive shares are used as denominator for diluted EPS except in certain circumstances where advance share	Weighted average potential dilutive shares are used as denominator for diluted EPS.	

	application money received is treated as dilutive potential equity shares.		
--	--	--	--

6. **Balance Sheet of X Ltd. as at 31st March, 2011**

	(₹ in thousands)	(₹ in thousands)
1. Sources of Funds		
(1) Shareholders' Funds:		
(a) Capital	500	
(b) Reserves and Surplus (64.875 + 10.125)	<u>75</u>	575
(2) Loan Funds:		
(a) Secured Loans	35	
(b) Unsecured loans	<u>-</u>	<u>35</u>
Total		<u>610</u>
2. Application of Funds:		
(1) (a) Gross Block (W.N. 2)	370	
(b) Less: Depreciation (W.N. 5)	<u>189</u>	
(c) Net Block		181
(2) Investment		100
(3) Current Assets, Loans and Advances:		
(a) Inventories	100	
(b) Sundry debtors	390	
(c) Cash and bank balances	114	
(d) Other current assets	--	
(e) Loans and advances	<u>--</u>	
	604	
Less: Current Liabilities and Provision		
(a) Trade Creditors	40	
(b) Provision (W.N.)	<u>235</u>	
	<u>275</u>	329
(4) Miscellaneous expenditure (to the extent not written off or adjusted)		<u>-</u>
Total		<u>610</u>
Contingent liabilities	Nil	

Profit and Loss Account for the year ended 31st March 2011

	(₹ in thousands)	(₹ in thousands)
Income :		
Sales (Net of excise duty)		1,500
Increase in stock (100 – 70)		<u>30</u>
		1,530
Expenditure:		
Purchase of goods for resale	855	
Administration expenses	240	
Distribution expenses	51	
Loss on sale of equipment (W.N. 1)	10	
Depreciation (W.N. 2)	<u>74</u>	<u>1,230</u>
Less: Extra-ordinary items :		
Profit before extraordinary items		300
Factory closure costs		<u>30</u>
Profit before taxation		270
Provision for tax (50%)		<u>135</u>
Profit after tax		135
Balance brought forward		<u>40</u>
Profit available for appropriations or profit after tax		175
Appropriations:		
Proposed dividend	100.000	
Amount transferred to Reserve (W.N. 3)	<u>10.125</u>	<u>110.125</u>
Balance carried toward		<u>64.875</u>

Notes on accounts for the year ended 31st March, 2011**Significant Accounting Policies:**

- (1) Basis for preparation of financial statements: The financial statement have been prepared under the historical cost convention in accordance with generally accepted accounting principles and the provisions of the Companies Act, 1956 as adopted consistently by the company.
- (2) Depreciation: Depreciation on fixed assets is provided using straight line method based on a period of five years. Depreciation on new additions in provided for full year but no depreciation is provided on assets sold in the year of their disposal.

- (3) Inventories: Inventories are valued at the lower of historical cost or the net realisable value.

Working Notes:

(1) Loss on Equipment sold

	₹
Original Cost	30,000
Less: Accumulated Depreciation as on 1.4.2010	<u>(15,000)</u>
	15,000
Less: Realisation from equipment sold	<u>(5,000)</u>
Loss of Equipment sold	<u>10,000</u>

(2) Fixtures/Fittings, Tools and Equipment

	₹
Cost	3,40,000
Less: Disposed off during the year	<u>30,000</u>
	3,10,000
Add: Equipment purchased	<u>60,000</u>
Depreciable value is on 31.3.2011	<u>3,70,000</u>
Depreciation 20% on ₹ 3,70,000	<u>74,000</u>

(3) Transfer to Reserve

Rule 2 (ii) of the Companies (Transfer of Profits to Reserve) Rules 1975 provides that where dividend proposed, exceeds 15% but does not exceed 20% of the paid-up capital, the amount to be transferred to the reserves shall not be less than 7.5% of the current profits. In this case dividend is 20%. Therefore, transfer of reserve should be ₹ 10,125 (i.e. 7.5% of ₹ 1,35,000) or more. Hence, ₹ 10,125 has been transferred to Reserve Account.

(4) Reserves and Surplus

	₹
Balance of Profit and Loss A/c carried forward to Balance Sheet	64,875
Transferred to Reserve	<u>10,125</u>
	<u>75,000</u>

(5) Depreciation (Accumulated)

	₹
Balance as on (1.4.2010)	1,30,000

Less: Depreciation as asset disposed off	<u>15,000</u>
	1,15,000
Add: Depreciation for the year (Note 2)	<u>74,000</u>
	<u>1,89,000</u>

(6) Provision

	₹
Provision for tax	1,35,000
Proposed dividend (20% of 5,00,000)	<u>1,00,000</u>
	<u>2,35,000</u>

7. Balance Sheet of Sick Ltd. as at 30th September 2011

Liabilities	₹	Assets		₹
Share Capital:		Fixed Assets:	2,50,000	
5,320 Equity Shares of ₹ 50 each fully paid	2,66,000	Less: Depreciation	<u>12,500</u>	2,37,500
Reserve and Surplus:		Current Assets:		
Securities Premium	20,000	Stock		1,11,500
		(1,15,500-4,000)		
Premium on issues of Debentures	18,180	Sundry Debtors		1,41,125
		(1,21,125 + 20,000)		
General Reserve	28,625	Cash and Bank (Refer to note 5)		1,07,813
Profit and Loss A/c (Refer to note 4)	6,233			
Secured Loan:				
13% Debentures	90,900			
Current liabilities	<u>1,68,000</u>			
	<u>5,97,938</u>			<u>5,97,938</u>

Working Notes:**(i) Journal Entries**

Particulars	Dr (₹)	Cr (₹)
(i) 11% Cumulative Preference Share Capital A/c Dr.	2,00,000	
To 13% Debentures A/c		1,81,800
To Premium on issue of Debentures A/c		18,180

To Cash (Being issue of 1,818, 13% Debentures of ₹ 100 each at a premium of 10% in exchange of ₹ 2,000, 11% cumulative preference shares of ₹100 each and fractional holdings was paid in cash)		20
(ii) Capital Reduction A/c Dr. To Equity Share Capital (Being issue of 1,320, equity shares of ₹ 100 each ₹ 50 paid up in lieu of arrears of preference dividend for three years i.e. $[(11\% \text{ of } ₹ 2,00,000) \times 3] \div ₹ 50$)	66,000	66,000
(iii) Equity Share Capital A/c Dr. To Capital Reduction A/c (Being reduction of paid-up value of 5,320 equity shares of ₹ 100 each ₹ 50 paid-up to shares of ₹ 25 paid-up)	1,33,000	1,33,000
Equity share capital A/c Dr. To Equity share capital (₹ 50) (Being the face value of equity shares reduced to ₹ 50 each)	1,33,000	1,33,000
(iv) Cash and Bank A/c Dr. To Equity Share Capital A/c (Being call money on 5,320 equity shares @ ₹ 25 each received to make equity shares of ₹ 50 each fully paid-up)	1,33,000	1,33,000
(v) Capital Reduction A/c Dr. To Goodwill To Investment To Fixed Assets A/c To Sundry Debtors A/c (Being the value of assets written down)	78,875	20,000 12,500 40,000 6,375
(vi) Stock A/c Dr. To Capital Reduction A/c (Being the value of stock written up)	10,500	10,500
(vii) General Reserve A/c Dr. To Capital Reduction A/c (Being the debit balance of Capital Reduction Account transferred to General Reserve Account)	1,375	1,375

(2)

Ledger Account**Capital Reduction Account**

	₹		₹
To Equity Share Capital A/c	66,000	By Equity Share Capital A/c	1,33,000
To Assets A/c	78,875	By Stock A/c	10,500
	_____	By General Reserve A/c	<u>1,375</u>
	1,44,875		1,44,875

(3)

Balance Sheet after Internal Reconstruction

Liabilities	₹	Assets	₹
Share Capital: 5,320 Equity shares of ₹ 50 each fully paid up	2,66,000	Fixed Assets: Current Assets: Stock in trade (1,05,000 + 10,500)	2,50,000 1,15,500
Reserve & Surplus: Securities Premium	20,000	Sundry Debtors (1,27,500 - 6,375)	1,21,125
Premium on issue of Debentures	18,180	Cash and Bank (50,000 + 1,33,000 – 20)	1,82,980
General Reserve (₹ 30,000 - ₹ 1,375)	28,625		
Secured Loans: 13% Debentures	1,81,800		
Current Liabilities	<u>1,55,000</u>		_____
	<u>6,69,605</u>		<u>6,69,605</u>

- (4) In this question, result of half-yearly operations are not given but consequential figures after half-yearly operations are given. Based on these figures, profit figures can be worked out as follows:

Liabilities	₹	Assets	₹
Increase in Creditors	13,000	Increases in Cash & Bank	27,550
Debtors in Stock	48,000	Increase in Debtors	20,000
Increase in Depreciation	12,500		
Profit (Bal. fig.)	<u>18,050</u>		_____
	<u>47,550</u>		<u>47,550</u>

Capital Reduction A/c is used, when a liability is not represented by corresponding asset.

Total increase in profit = ₹ 18,050

Less Interest on Debentures for ½ year = (₹ 11,817)

Net Increase in profit = ₹ 6,233

(5) **Cash and Bank Account**

	₹		₹
To Balance b/d	1,82,980	By interest	11,817
To Increase	27,550	By Debentures (1,81,800 + 2)	90,900
		By Balance c/d	<u>1,07,813</u>
	<u>2,10,530</u>		<u>2,10,530</u>

8. **Balance Sheet of Major Limited**
as on 1.4.2011

Liabilities	₹	Assets	₹
Share Capital		Fixed Assets	76,62,500
Shares of 10 each	40,00,000	[60,00,000 + (17,50,000 – 87,500)]	
Reserves & Surplus	80,00,000	Current Assets:	
Capital Reserves	21,02,500	Sundry Debtors 40,00,000	
Secured Loans	20,00,000	Less: Mutual	
Unsecured Loans	5,22,000	Indebtedness <u>75,000</u>	39,25,000
Current Liabilities 40,00,000		Inventories	55,00,000
Less: Mutual		Cash and Bank	34,62,000
Indebtedness <u>75,000</u>	<u>39,25,000</u>	(Refer to note 7)	
	<u>2,05,49,500</u>		<u>2,05,49,500</u>

Working Notes:

1. Yield of X Ltd.

$$(15,00,000 + 20,00,000 + 32,50,000) / 3 \times 40\% = ₹ 9,00,000$$

2. Capitalised value of yield of X Ltd.
 $= ₹ 9,00,000 \times (100/15) = ₹ 60,00,000$
3. Value per share of X Ltd. = ₹ 60,00,000 / No. of shares of X Ltd.
 $= ₹ 60,00,000 / (₹ 10,00,000/10) = ₹ 60$
4. Purchase consideration
 24% (i.e. 100% - 76%) held by the outside shareholders
 $= ₹ 60,00,000 \times 24\% = ₹ 14,40,000$
5. Payment of purchase consideration:
 Tax Payable = $(₹ 14,40,000 - ₹ 1,20,000) \times 30\% = ₹ 3,96,000$
 Net Consideration = $₹ 14,40,000 - ₹ 3,96,000 = ₹ 10,44,000$
 50% of Net Purchase Consideration payable in cash = ₹ 5,22,000
 Balanced to be treated as loan = ₹ 5,22,000
6. Goodwill/Capital Reserve to Major Ltd.

Total Assets:	₹
Total Assets	50,00,000
Less: 5% reduction in Fixed Assets (17,50,000 x 5%)	<u>(87,500)</u>
Fair Value of total assets	49,12,500
Less: Current liabilities	<u>(10,00,000)</u>
Net Assets	39,12,500
Less: Amount paid to Foreign collaborating Co. (24%)	(14,40,000)
Investment in X Ltd. (76%)	<u>(3,70,000)</u>
Capital Reserve	<u>21,02,500</u>

7 **Bank Account**

	₹		₹
To Balance b/d	41,30,000	By Foreign Co.	5,22,000
To X Ltd.	2,50,000	By Tax Authorities	3,96,000
	<u>43,80,000</u>	By Balance c/d	<u>34,62,000</u>
To Balance b/d	34,62,000		<u>43,80,000</u>

9. Journal Entries in the books of Complete Ltd.

(₹ in crores)

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

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

Complete Ltd.**Balance Sheet after the scheme of arrangement**

	Schedule		(₹ in crores)
	No.		
I Sources of Funds			
(1) Shareholders' funds:			
(a) Capital	A	500	
(b) Reserves and surplus	B	<u>740</u>	
			1,240

(2) Loan funds:		
(a) Secured against:		
Fixed assets	—	
Working capital	—	
(b) Unsecured	—	—
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	510
(3) Current assets (1,500 – 500)	1,000	
Less: Current liabilities	<u>300</u>	
Net current assets		<u>700</u>
Total		<u>1,240</u>
1. Capital commitments		Nil
2. Contingent Liability		
Guarantee given in respect of:		
Capital commitments by Much Ltd.		700
Liabilities transferred to Much Ltd.		2,100
Liabilities transferred to More Ltd.		600

Schedules to Accounts*(₹ in crores)*

A Share capital:	
Authorised:	
100 crores Equity shares of ₹ 10 each	<u>1,000</u>
Issued, Subscribed and Paid-up:	
50 crores Equity shares of ₹ 10 each fully paid-up	500
Of the above shares, 25 crores fully paid Equity shares of ₹ 10 each have been issued as bonus shares by capitalisation	

of revenue reserves.

B Reserves and Surplus:

Capital reserve on transfer of :

Investments to More Ltd.	200	
Business of new project division to Much 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 Much Ltd.	<u>600</u>	
		200

Provision for depreciation:

As per last balance sheet	200	
Less: In respect of assets transferred to Much Ltd.	<u>30</u>	
		<u>170</u>
		<u>30</u>

D Investments (at cost):

In wholly owned subsidiary Much Ltd.

(a) 1 crore equity shares of ₹ 10 each		10
(b) 15% unsecured convertible debentures		<u>500</u>
		<u>510</u>

Balance Sheet of Much Ltd. after the scheme of arrangement

Schedule No. (₹ in crores)

I Sources of Funds

(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>
Total			<u>910</u>
II Application of Funds			
(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>
Total			<u>910</u>
1. Capital commitments			
2. Guarantee given by Complete Ltd. in respect of:			
Capital commitments		700	
Liabilities		<u>2,100</u>	
		<u>2,800</u>	

Schedules to Accounts

(₹ in crores)

A	Share Capital	
	Authorised	
	100 crores Equity shares of ₹ 10 each	<u>1,000</u>
	Issued, Subscribed and Paid-up	
	1 crore Equity shares of ₹ 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 Complete Ltd.	
	All the above shares are held by the holding company Complete 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 ₹ 10 each at par on 31.3.2016)	

Balance Sheet of More Ltd. after the scheme of arrangement

	Schedule No.		(₹ 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>
Application of Funds			
Investments			<u>800</u>
Total			<u>800</u>
Guarantee given by Complete Ltd. in respect of unsecured loans			600

Schedule to Accounts

	(₹ in crores)
A Share Capital	
Authorised	
50 crores Equity shares of ₹ 10 each	<u>500</u>
Issued, Subscribed and Paid-up	
20 crores Equity shares of ₹ 10 each fully paid-up	200
All the above shares have been issued to members of Complete Ltd. for consideration other than cash, on acquisition of investments and taking over of liability for unsecured loans from Complete Ltd.	

Working Notes:

(₹ in crores)				
		Settled division	New Project division	Total
1.	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 Complete Ltd. against:			
	(a) (i) Capital commitments			700
	(ii) Liabilities transferred to Much Ltd.			
	Secured loans against fixed assets			300
	Secured loans against working capital			100
	Current liabilities			<u>1,700</u>
				2,100
	(b) Liabilities transferred to More Ltd.			600

**10. (i) Consolidated Balance Sheet of P Ltd. and its subsidiaries Q Ltd. and R Ltd.
as on 31st December, 2011**

Liabilities	₹	Assets	₹
<i>Share Capital:</i>		<i>Fixed Assets:</i>	
80,000 Equity shares of ₹10 each fully paid	8,00,000	Goodwill [Refer (iii)]	18,000
<i>Minority Interest</i> [Refer (iv)]	2,47,167	Other Fixed Assets less depreciation	13,18,000
<i>Reserves and Surplus:</i>		<i>Current Assets, Loans and Advances:</i>	
Profit and Loss Account [Refer (ii)]	3,04,833	Current Assets	2,20,000
<i>Current Liabilities and Provision:</i>			
Current Liabilities	84,000		
Proposed Dividend:			
P 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 31st December, 2011

(in ₹)

Particulars	P Ltd.	Q Ltd.	R Ltd.	Adjustments	Total	Particulars	P Ltd.	Q Ltd.	R Ltd.	Adjustments	Total
To Dividend (paid for 2010)	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 Interest	-	39,167	32,000	-	71,167	By Dividend received in 2010 (for 2009)	60,000	-	-	-	60,000
To Capital Reserve (Cost of Control)	-	65,000	51,000	-	1,16,000	By Dividend received in 2011 (for 2010)	60,000	36,000	-	96,000	-
To Investments Accounts (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) P Ltd. receives from Q Ltd., dividend amounting to Rs.60,000 for the year 2009 in the year 2010 for shares acquired in 2009. It is a capital profit, therefore it has been transferred to cost of control to reduce the cost of investment.
- (2) Q Ltd. receives a dividend of Rs.36,000 from R Ltd. for the year 2010 in the year 2011. The shares were acquired by Q Ltd on 31st December, 2010. 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:

	₹	₹
Cost of Investment in Q Ltd. on 31 st December 2009	6,30,000	
Less: Dividend of the year 2009 received in 2010 out of Pre-acquisition profit	<u>60,000</u>	5,70,000
Cost of Investment in R Ltd.	4,00,000	
Less: Dividend of the year 2010 received in 2011 out of Pre-acquisition Profit	<u>36,000</u>	<u>3,64,000</u>
		9,34,000
Less: Paid up value of shares in Q Ltd.	5,00,000	
Paid up value of shares in R Ltd.	3,00,000	
Capital Profits in Q Ltd. (Refer W.N. 2)	65,000	
Capital Profits in R Ltd. (Refer W.N. 2)	<u>51,000</u>	<u>9,16,000</u>
Goodwill		<u>18,000</u>

(iv) Minority shareholders' interest:

	Q Ltd. ₹	R Ltd. ₹
Share Capital (Q Ltd. – 1/6 and R 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 (shown separately in the Balance Sheet)		
$\frac{1}{6}$ of Rs. 72,000 + $\frac{1}{4}$ 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 Q Ltd.		
P Ltd.	50,000	5/6

Minority Interest	10,000	1/6
In R Ltd.		
Q Ltd.	30,000	3/4
Minority Interest	10,000	1/4

2. Analysis of Profits

	<i>Pre – acquisition</i>	<i>Post – acquisition</i>
	<i>Capital Profit</i>	<i>Revenue Profit</i>
R Ltd.	₹	₹.
Balance on 31 st December, 2010 after dividend for 2010 (1,16,000 – 48,000)	68,000	-
Profit for the year ending 31 st December, 2011 before proposed dividends for 2011	<u>-</u>	<u>60,000</u>
	<u>68,000</u>	<u>60,000</u>
Share of Q Ltd. (3/4)	51,000	45,000
Minority Interest (1/4)	<u>17,000</u>	<u>15,000</u>
Q Ltd.		
Balance on 31 st December, 2009	78,000	-
Profit for the year 2010 after payment of dividend for 2010 (84,000 – 72,000)	-	12,000
Profit for the year 2011 (before payment of dividend of the year 2011)	-	1,00,000
Revenue Profit from R Ltd.	<u>-</u>	<u>45,000</u>
	<u>78,000</u>	<u>1,57,000</u>
Share of P Ltd. (5/6)	65,000	1,30,833
Share of Minority Shareholders' Interest (1/6)	<u>13,000</u>	<u>26,167</u>

Note: The problem has been solved by following 'direct approach'.

11. **Separate Financial Statement of Morning Ltd. (Extract)**

	₹		₹
		Investments in Evening Ltd.	9,00,000

Consolidated Financial Statements of Morning Ltd with Evening Ltd. (Extract)

	₹		₹
		Cost (Including Goodwill ₹ 1,00,000)	9,00,000
		Add:	
		Share of Revenue Profit (₹ 3,37,500 x 40%) - (75,000 x 40%)] [to be credited to Profit and Loss Account]	1,05,000
		Share of Revaluation Reserve (₹ 2,50,000 x 40%) [to be credited to Revaluation Reserve of Morning Ltd.]	<u>1,00,000</u>
		Investments in Evening Ltd. under Equity method	<u>11,05,000</u>

Working Notes:

1. Reserve & Surplus of Evening Ltd. as on 31.12.2011

Profit and Loss account of Evening Ltd.	₹
Opening balance	5,00,000
Add: Current year earnings	3,37,500
Less: Interim Dividend Capital	<u>(75,000)</u>
Closing balance	<u>7,62,500</u>
Revaluation Reserve	2,50,000

2. Analysis of Reserves and Surplus of Evening Ltd.

	100%	40%
Reserves and surplus (Capital Profit)	5,00,000	2,00,000
Revenue Profit	2,62,500	1,05,000
Equity Share Capital	15,00,000	6,00,000

3. Goodwill/Capital Reserve

	₹	₹
Investments		9,00,000

Less: Nominal Value	6,00,000	
Capital Profit	<u>2,00,000</u>	<u>8,00,000</u>
Goodwill		<u>1,00,000</u>

Note: If the net equity of an associate is increased on account of revaluation of fixed assets then the investments in associates should also be increased for the investor's share on such increase with a corresponding increase in the revaluation reserve of the investor. (ASI 17)

12. At the inception

Computation of fair value of Liability Component

	₹
Present value of 20 half yearly interest payments of ₹ 50, discounted @ 11% ($₹ 50 \times 11.9504$)	597
Present value of ₹ 1,000 due in ten years, discounted @ 11% compounded half yearly ($₹ 1,000 \times 0.343$)	<u>343</u>
Fair value of liability component	<u>940</u>

Computation of Equity Component

	₹
Issue proceeds from convertible debenture	1,000
Less: Fair value of liability component	<u>940</u>
Fair value of Equity Component	<u>60</u>

Journal Entries

	Debit (₹)	Credit (₹)
Cash/Bank A/c Dr.	1,000	
To Liability component		940
To Equity component		60
(Being issue of debentures recorded at fair values)		

At the time of repurchase

The repurchase price is allocated as follows:

	Carrying value (₹)	Fair Value (₹)	Difference (₹)
Liability component			
Present value of 10 remaining half-yearly interest payments of ₹ 50 discounted at 11%	377	405	

and 8% respectively			
Present value of ₹ 1,000 due in 5 years, discounted at 11% and 8% compounded half yearly, respectively	<u>593</u>	<u>680</u>	
	970	1085	115
Equity component	<u>60</u>	<u>615</u>	<u>555</u>
Total	<u>1,030</u>	<u>1,700</u>	<u>670</u>

Journal Entries

	Debit ₹	Credit ₹
Liability Component Dr.	970	
Debt settlement expenses (statement of profit and loss) Dr.	115	
To Cash A/c		1085
(Being repurchase of the liability component)		
Equity component Dr.	60	
Reserves and surplus Dr.	555	
To Cash A/c		615
(Being cash paid for the equity component)		

13. In the given case, the length of the vesting period varies, depending on when the performance condition is satisfied. In such a situation, as per paragraph 14 of the text of the Guidance Note, the enterprise estimates the length of the expected vesting period, based on the most likely outcome of the performance condition, and revises that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates.

Statement showing determination of the compensation expense to be recognised each year

Particulars	Year 1	Year 2	Year 3
Vesting condition (earnings)	18%	13% (avg.)	10% (avg.)
Actual earnings	14%	12% (avg.)	10.67% (avg.)
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
No. of employees expected to meet vesting conditions	440 employees	417 employees	419 employees
No. of options expected to vest	44,000	41,700	41,900
Fair value of options expected to vest @ ₹ 30 per option (₹)	13,20,000	12,51,000	12,57,000

Compensation expense accrued at the end of year (₹)	6,60,000 [13,20,000/2]	8,34,000 (12,51,000 × 2/3)	12,57,000
Compensation expense recognised till the end of previous year (₹)	Nil	6,60,000	8,34,000
Compensation expense to be recognized for the year (₹)	6,60,000	1,74,000	4,23,000

14. (a) NAV of the Fund on 1st April, 2011 = $\frac{\text{Net Assets}}{\text{No. of units of fund}}$

$$= \frac{₹ 98,500 + ₹ 1,20,65,000 + ₹ 13,22,000 + ₹ 3,37,45,000 + ₹ 3,88,500}{4,00,000 \text{ units}}$$

$$= \frac{₹ 4,76,19,000}{4,00,000 \text{ units}} = ₹ 119.0475$$

(b) The revised position of fund

Shares	No. of shares	Price	Amount (₹)
P Ltd.	5000	19.70	98,500
Q Ltd.	25000	482.60	1,20,65,000
R Ltd.	(5,000+9,000) 14,000	264.40	37,01,600
S Ltd.	50,000	674.90	3,37,45,000
T Ltd.	15,000	25.90	3,88,500
Cash	[25,00,000 - (9,000 × 264.40)]		<u>1,20,400</u>
			<u>5,01,19,000</u>

(c) No. of units of fund = $4,00,000 + \frac{25,00,000}{119.0475} = 4,21,000 \text{ units}$

Calculation the NAV of fund on 2nd April, 2011

Shares	No. of shares	Price	Amount (₹)
P Ltd.	5,000	20.30	1,01,500
Q Ltd.	25,000	513.70	1,28,42,500
R Ltd.	14,000	290.80	40,71,200
S Ltd.	50,000	671.90	3,35,95,000
T Ltd.	15,000	44.20	6,63,000
Cash			<u>1,20,400</u>
			<u>5,13,93,600</u>

$$\text{NAV as on 2nd April 2011} = \frac{\text{₹ } 5,13,93,600}{4,21,000 \text{ units}} = \text{₹ } 122.075 \text{ per unit}$$

15. It is necessary to segregate the instalments into principal outstanding and interest components by using I.R.R. @ 10.42%.

(₹ in lakhs)

Time	Opening outstanding amount (a)	Cash flow (b)	Interest (c)	Principal repayment (d)	Closing outstanding (e)
31-3-2009		(-) 60	-----	---	60.00
31-3-2010	60.00	16	6.25	9.75	50.25
31-3-2011	50.25	16	5.24	10.76	39.49
31-3-2012	39.49	16	4.11	11.88	27.60
31-3-2013	27.60	16	2.88	13.12	14.48
31-3-2014	14.48	16	1.52	14.49	0.00

- (i) As the hire-purchaser paid the first instalment, the notional principal outstanding on 1-4-2010 was ₹ 50.25 lakhs. Provider Ltd. should not recognise ₹ 5.24 lakhs as interest income as this should be treated as finance charge (not collected). (Refer W.N.1)
- (ii) The net book value of the assets as on 31-3-2011 (Refer to note 2)

	₹ in lakhs
Over due instalment	16.00
Instalments not due (₹ 16 lakhs x 3)	<u>48.00</u>
	64.00
Less: Finance charge (not collected)	<u>5.24</u>
	58.76
Less: Instalments not due	<u>48.00</u>
Net book value of assets for Provider Ltd.	<u>10.76</u>

- (iii) The asset under hire purchase should be classified as sub-standard and a provision should be made at 10% of net book value of assets. i.e. ₹ 10.76 lakhs = ₹ 1.08 lakhs as per NBFC Prudential Norms laid down by RBI.

Working Notes:

1. Cash price is ₹ 80 lakhs. Down payment is ₹ 20 lakhs. Therefore principal value of asset for purchasing company's point of view as on 31-3-2009 is ₹ 60 lakhs (i.e. ₹

80 lakhs – ₹ 20 lakhs). When company pays first instalment of ₹ 16 lakhs, it pays interest @ 10.42% for one year, i.e. ₹ 6.25 lakhs and repayment of principal in this instalment is of ₹ 9.75 (i.e. 16 - 6.25). The principal outstanding on 1-4-2010 is ₹ 50.25 lakhs (i.e. ₹ 60 lakhs – ₹ 9.75 lakhs)

2. As per Para 8(2)(ii)(b) of NBFC Prudential Norms (Reserve Bank of India) Directions 1988, provision is to be made at the rate of 10% of the net book value which is to be calculated as follows (as per Para 8(2)(ii):

Total Dues (Over due and future instalment)	-----
Less: Finance Charge not credited to profit and loss Account	-----
Less: Depreciated value of the underlying asset	-----
Net Book Value	-----

Depreciated Value= Original Cost – Depreciation Charge @20% p.a. on S.L.M. computed notionally on new asset.

= For second hand asset, actual acquisition cost is treated as original cost.

16. Computation of Goodwill

	₹
Capital Employed (W.N.1)	<u>11,89,767</u>
Average Profit (W.N.2)	2,65,097
Normal profit @ 20% on capital employed	<u>2,37,953</u>
Super profit	<u>27,144</u>
Goodwill at 2 years' purchase	54,288

Working Notes:

1. Capital Employed as on 31.3.2011

	₹	₹
Machinery		3,00,000
Free hold properties		4,50,000
Vehicles		1,00,000
Furniture (W.N.3)		<u>64,580</u>
		9,14,580
Add: 15% Appreciation		<u>1,37,187</u>
		10,51,767
Trade investment		18,000
Stock in trade		2,00,000

Sundry debtors (4,00,000-40,000)		3,60,000
Cash at bank		<u>60,000</u>
		16,89,767
Less : Outside Liabilities:		
Sundry creditors	3,00,000	
Bank Loan	<u>2,00,000</u>	<u>5,00,000</u>
Net assets/capital employed		<u>11,89,767</u>

2. **Future Maintainable Profit**

	2008-09	2009-10	2010-11
	₹	₹	₹
Reported profit	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 investment* (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: Over valuation of stock (net of tax)	-	-	25,000
Provision for doubtful debts (net of tax)	<u>-</u>	<u>-</u>	<u>20,000</u>
	<u>2,50,000</u>	<u>2,70,100</u>	<u>2,75,190</u>

Future Maintainable Profit $7,95,290/3 = 2,65,097$

3. **Value of Furniture as on 31.3.2011**

	₹	₹
Furniture (Given in B/S) as on 31.3.2011		50,000
Add: Purchased on 1.4.2008	20,000	
Less: Depreciation @10% on WDV method	<u>(2,000)</u>	

* Non-trading investments are assumed to be purchased before 1st April, 2008.

WDV as on 31.3.2009	18,000	
Less: Depreciation @10% on WDV	<u>(1,800)</u>	
WDV as on 31.3.2010	16,200	
Less: Depreciation @10% on WDV	<u>(1,620)</u>	
WDV as on 31.3.2011		<u>14,580</u>
Total		<u>64,580</u>

17. Valuation of a share of Precious Ltd.

Particulars	
Net trading assets (W.N. 2)	₹ 16,08,750
Add: Goodwill (W.N. 3)	₹ 2,67,375
Less: Preference capital	<u>₹ (1,50,000)</u>
Net assets available to equity share holders	<u>₹ 17,26,125</u>
Number of equity shares	4,500 shares
Value per equity share	₹ 383.58

Working Note :**1. A. Future maintainable profit**

Particulars	2009 ₹	2010 ₹	2011 ₹
Profit after interest and tax but before preference dividend	2,20,500	3,22,500	2,40,000
Less: Profit from non- recurring activity		(32,250)	
Less: Claims not recorded (net of tax) (W.N.4)			(4,125)
Add: Provision no longer required (net of tax) (W.N.4)			<u>7,875</u>
Adjusted profits	<u>2,20,500</u>	<u>2,90,250</u>	<u>2,43,750</u>
Simple average of the profits (as profits are fluctuating)			2,51,500
Adjustments for items which will not be reflected in future			7,500
Add: Debenture interest (debenture redeemed) (net of tax) (W.N.5)			
Total future maintainable profit			2,59,000

B. Future Maintainable Profit available for equity shareholders

Particulars	₹
Total future maintainable profits	2,59,000
Less: Dividend payable to preference share holders	<u>(9,000)</u>
Future maintainable profit available for equity shareholders	<u>2,50,000</u>

2. Computation of capital employed:

Particulars	₹	₹
Sundry assets :		
(i) Freehold property (₹ 50,400 , 8%)	6,30,000	
(ii) Plant and machinery	1,50,000	
(iii) Stock	2,70,000	
(iv) Debtors (₹ 2,99,250 , 95%)	3,15,000	
(v) Bank Balance (3,45,000+3,75,000- 2,25,000)	<u>4,95,000</u>	18,60,000
Less: Outside liabilities:		
(i) Creditors	2,39,250	
(ii) Omitted liability (claim)	8,250	
(iii) Tax provision (W.N. 6)	<u>3,750</u>	<u>(2,51,250)</u>
Capital employed		16,08,750

Note: Assets and liabilities are recorded at realizable value or fair value. In the absence of information, book values are assumed to be fair values.

3. Calculation of goodwill

Particulars	₹
Capital employed	
Net assets (W.N. 2)	<u>16,08,750</u>
Normal profit @ 10% of capital employed	1,60,875
Future Maintainable Profit (W.N.1B)	2,50,000
Super profits (FMP-NP)	89,125
Number of years of purchase	3 years
Goodwill (₹ 89,125 x 3 years)	2,67,375

4. Provision no longer required

The debtors as per balance sheet is after considering provision for doubtful debts.

Provision made in 2011	= 5 % of debtors
	= ₹ 2,99,250 × $\frac{5}{95}$
	= ₹ 15,750
Less : Tax @ 50%	= <u>(₹ 7,875)</u>
Provision no longer required	= <u>₹ 7,875</u>

5. Since, debentures will be redeemed; the interest thereon will no longer be, payable in future. This is to be added back, because the given profits were after charging debenture interest.

6. Calculation of tax provision

	Particulars	₹
(i)	Provision for bad debts not required	15,750
(ii)	Omitted claim (assuming tax deductible)	<u>(8,250)</u>
(iii)	Net incremental profit on which tax is payable	7,500
(iv)	Tax provision @ 50%	<u>3,750</u>

18.

Alpha Limited
Gross Value Added Statement
for the year ended 31st March, 2011

	(₹ in lakhs)	(₹ in lakhs)
Sales		800
Less: Cost of bought in material or services:		
Production and Operational Expenses (320 + 200)	520	
Administrative Expenses (6 + 6 + 10)	22	
Interest on working capital loans	<u>10</u>	<u>552</u>
Valued added by manufacturing and trading activities		248
Add: Other Income		<u>50</u>
Total Value Added		<u>298</u>

Application of Value Added:	(₹ in lakhs)	%
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>	16.78
To Pay Providers of Capital: Interest on Debentures	5	
Interest on Fixed Loans	15	
Dividend	<u>20</u>	13.42
To Provide for Maintenance and Expansion of the Company: Depreciation	20	
General Reserve	80	
Retained Profit (50 – 10)	40	46.98
	298	100.00

Reconciliation between Gross Value Added and Profit before Taxation

	(₹ in lakhs)	(₹ in lakhs)
Profit before tax		170
Add back:		
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>

19. We know that $EVA = NOPAT - \text{Cost of Capital Employed}$

Where $EVA = \text{Economic Value Added}$

$NOPAT = \text{Net Operating Profit After Tax}$

Required calculation are as follows:

(i) **NOPAT**

Profit After Tax	₹ 20,394.16 lakhs
Add Interest Net of Tax [₹ 487 lakhs (1-0.2445)]	₹ <u>367.93 lakhs</u>
NOPAT	₹ <u>20,726.09 lakhs</u>

(ii) **Cost of Equity:**

$$\begin{aligned}\text{Cost of Equity} &= \text{Risk free Rate} + b [\text{Market Rate} - \text{Risk Free Return}] \\ &= 12\% + 1.05 \times (15.14 - 12.00) \\ &= 12\% + 3.30\% = 15.30\%\end{aligned}$$

(iii) **Cost of Debt**

$$\text{Cost of Debt} = \frac{\text{Interest on Loan Funds (1 - Tax Rate)}}{\text{Loan funds}} \times 100$$

$$\text{Cost of Debt} = \frac{487 \times (1 - 0.2445)}{3717.90} \times 100 = 9.90\%$$

(iv) **Weighted Average Cost of Capital (WACC)**

	Amount (₹ in lakhs)	Weight	Cost	WACC %
Equity	72,900	.90	15.30	13.77
Debt	8,100	.10	9.90	0.99
	81,000	1.00		14.76

(v) Cost of Capital Employed = ₹ 81,000 x 14.76% = ₹ 11,955.60 lakhs

(vi) EVA = NOPAT – Cost of Capital Employed

$$= ₹ 20,726.09 \text{ lakhs} - ₹ 11,955.60 \text{ lakhs} = ₹ 8,770.49 \text{ lakhs}$$

20. 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. They referred group to homogeneous employees whether working in the same department or division of the organization or not. They believed that 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. Accordingly, they developed a model which 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.

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

1. This model ignores individual skills of the employees. The varied skills of the employees are not recognized in the valuation process under Jaggi and Lau model.
2. The performance of a group may be seriously affected in the event of exit of a single individual.