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PAPER – 1: FINANCIAL REPORTING

Question No.1 is compulsory.

Candidates are also required to answer any five questions from the remaining six questions.

Wherever necessary suitable assumptions may be made and disclosed by way of a note.

Working Notes should form part of the answer

Question 1

- (a) Sun Co-operative Society Ltd. has borrowed a sum of US\$12.50 million at the commencement of the financial year 2011-12 for its solar energy project at LIBOR (London Interbank Offered Rate) of 1% + 4% . The interest is payable at the end of the respective financial year. The loan was availed at the then rate of ₹ 45 to the US dollar while the rate as on 31st March, 2012 is ₹ 48 to the US dollar. Had Sun Co-operative Society Ltd. borrowed the Rupee equivalent in India, the interest would have been 11%. You are required to compute 'Borrowing Cost'. Also show the amount of exchange difference as per prevailing Accounting Standards.
- (b) Acute Ltd. is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is ₹ 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets at ₹ 555 lakhs. The value of the block of assets as per the Income tax Records is ₹ 777 lakhs. The Board of Directors of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91%.
- (c) PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2012. Using this data and applying the relevant Accounting Standard you are required to:
- Compute the amount of profit/loss for the year ended 31st March, 2012.
 - Arrive at the contract work in progress as at the end of financial year 2011-12.
 - Determine the amount of revenue to be recognized out of the total contract value.
 - Work out the amount due from/to customers as at year end.
 - List down relevant disclosures with figures as per relevant Account Standard

	(₹ crore)
Total Contract Price	2,400
Work Certified	1,250
Work pending certification	250
Estimated further cost to completion	1,750
Stage wise payments received	1,100
Progress payments in pipe line	300

- (d) On 30-6-2011, X Limited incurred ₹ 3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid ₹ 80,000 for property taxes assessed for the calendar year 2011. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30-9-2011?

(4 × 5 = 20 Marks)

Answer

- (a) Computation of Borrowing Cost as per para 4(e) of AS 16 "Borrowing Costs" and Amount of Exchange Difference as per AS 11 "The Effects of Changes in Foreign Exchange Rates":

- (a) Interest for the period 2011-12

$$= \text{US\$ } 12.5 \text{ million} \times 5\% \times ₹ 48 \text{ per US\$} = ₹ 30 \text{ million}$$

- (b) Increase in the liability towards the principal amount

$$= \text{US\$ } 12.5 \text{ million} \times ₹ (48 - 45) = ₹ 37.5 \text{ million}$$

- (c) Interest that would have resulted if the loan was taken in Indian currency

$$= \text{US\$ } 12.5 \text{ million} \times ₹ 45 \times 11\% = ₹ 61.875 \text{ million}$$

- (d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 61.875 million - ₹ 30 million = ₹ 31.875 million.

Therefore, out of ₹ 37.5 million increase in the liability towards principal amount, only ₹ 31.875 million will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 61.875 million being the aggregate of interest of ₹ 30 million on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 31.875 million.

Hence, ₹ 61.875 million would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 5.625 million (37.5 - 31.875) would be considered as the exchange difference to be accounted for as per AS 11.

- (b) **Assumption:** It is assumed that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year. The assumption has been taken on the basis that impairment loss is calculated on carrying value after charging depreciation of the year.

In the absence of specific instructions, deferred tax workings of current year have been shown as below:

Statement showing Deferred Tax workings for the current year

	₹ in lakhs
Depreciation as per Accounting books for the current year $\frac{999}{(1 - .1391)} \times .1391$	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1 - .15)} \times .15$	<u>137.12</u>
Timing difference	<u>24.29</u>
Tax effect of the above timing difference at 33%* (deferred tax asset) (A)	<u>8.02</u>
Impairment Loss recognised in the profit and loss account (999- 555)	444
Impairment Loss allowed for tax purposes	<u>Nil</u>
Timing difference	<u>444</u>
Tax effect of the above timing difference at 33% (deferred tax asset) (B)	<u>146.52</u>
Total deferred tax asset (A+B)	<u>154.54</u>

Note:

- Deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. The Board of Directors of Acute Ltd. have issued signed statement confirming virtual certainty of taxable incomes in the foreseeable future. Therefore, the company can recognize deferred tax asset during the current year.
- The deferred tax asset calculated on account of difference of depreciation as per accounting and tax records is actually a reversal of deferred tax liability created in the previous years.

* Tax rate = 30% x 110% = 33%.

(c)

(i) Calculation of profit/ loss for the year ended 31 st March, 2012	(₹ in crores)
Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
Less: Total contract price	<u>(2,400)</u>
Total foreseeable loss to be recognized as expense	<u>850</u>

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

(ii) Contract work-in-progress i.e. cost incurred to date	(₹ in crores)
Work certified	1,250
Work not certified	<u>250</u>
	<u>1,500</u>

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

$$= (1,500 / 3,250) \times 100 = 46.15\%$$

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

$$= ₹ [1,500 + \text{Nil} - 850 - (1,100 + 300)] \text{ crores}$$

$$= ₹ [1,500 - 850 - 1,400] \text{ crores}$$

Amount due to customers (shown as liability) = ₹ 750 crores.

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

	₹ in crores
Contract revenue till 31 st March, 2012	1,107.60
Contract expenses till 31 st March, 2012	1,500.00
Recognized losses for the year 31 st March, 2012	(850)
Progress billings ₹ (1,100 + 300)	1,400
Retentions (billed but not received from contractee)	300
Gross amount due to customers	750

(d) Para 28 of AS 25 "Interim Financial Reporting" states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports. As at

September 30, 2011, X Ltd. would report the entire ₹ 3,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since ₹ 80,000 property tax payment relates to the entire 2011 calendar year, only ₹ 40,000 of the payment would be reported as an expense at September 30, 2011, while out of the remaining ₹ 40,000, ₹ 20,000 for Jan. 2011 to March, 2011 would be shown as payment of the outstanding amount of previous year and another ₹ 20,000 related to quarter October, 2011 to December, 2011, would be reported as a prepaid expense.

Question 2

The Balance Sheets of A Ltd. and its subsidiaries B Ltd. and C Ltd. as on 31-3-2011 were as follows:

	₹ in lakhs		
	A Ltd.	B Ltd.	C Ltd.
<i>Investments:</i>			
1,00,000 shares in B Ltd.	100	-----	-----
80,000 shares in C Ltd.	200	-----	-----
Other Assets	<u>700</u>	<u>600</u>	<u>500</u>
	<u>1,000</u>	<u>600</u>	<u>500</u>
<i>Share Capital:</i>			
Shares of ₹ 100 each	400	100	100
Reserves and Surplus	400	300	200
<i>Liabilities</i>	<u>200</u>	<u>200</u>	<u>200</u>
	<u>1,000</u>	<u>600</u>	<u>500</u>

A Ltd. acquired shares in B Ltd. in April 2008 when B Ltd. was formed with share capital of ₹ 100 lakhs.

A Ltd. acquired shares in C Ltd. in April 2008 when C Ltd. had share capital of ₹ 100 lakhs and reserves and surplus of ₹ 100 lakhs.

The group amortises goodwill on consolidation on a SLM basis over a period of 5 years. A full year's amortization is provided if the goodwill exists for more than 6 months.

On 1st April, 2011, A Ltd. sold 40,000 shares of C Ltd. for cash consideration of ₹ 150 lakhs. The Balance Sheets of the companies for the year 2011-12 were as follows:

(1) Balance Sheet as on 31-3-2012 ₹ in lakhs

	A Ltd.	B Ltd.	C Ltd.
<i>Investments at cost:</i>			
1,00,000 shares in B Ltd.	100		
40,000 shares in C Ltd.	100		
Other Assets	<u>1,000</u>	<u>800</u>	<u>700</u>
	<u>1,200</u>	<u>800</u>	<u>700</u>
<i>Share Capital</i>	400	100	100
<i>Reserves and Surplus</i>	550	420	280
<i>Liabilities</i>	<u>250</u>	<u>280</u>	<u>320</u>
	<u>1200</u>	<u>800</u>	<u>700</u>

(2) Profit and Loss A/c for the year ended 31-3-2012 ₹ n lakhs

	A Ltd.	B Ltd.	C Ltd.
Profit before tax	150	180	120
Extraordinary items	<u>50</u>	—	—
	200	180	120
Tax	<u>50</u>	<u>60</u>	<u>40</u>
Profit after tax	150	120	80
Reserves & Surplus Beginning	<u>400</u>	<u>300</u>	<u>200</u>
Reserves & Surplus-End	<u>550</u>	<u>420</u>	<u>280</u>

Prepare for A Ltd., group Balance Sheets as on 31-3-2011 and as on 31-3-2012.

(16 Marks)

Answer

Consolidated Balance Sheet as on 31.3.2011

	₹ in lakhs
Assets:	
Other Assets (700+600+500)	1,800
Goodwill (after amortisation) (W.N. 1(c))	<u>16</u>
	<u>1,816</u>
Capital and Liabilities:	
Share capital	400
Minority Interest (W.N. 1(b))	60

Reserves and surplus (W.N. 1(d))	756
Liabilities (200+200+200)	<u>600</u>
	<u>1,816</u>

Consolidated Balance Sheet* as on 31.3.2012

	₹ in lakhs
Assets:	
Other Assets (1,000+800)	1,800
Carrying amount of Investment in Associate – C Ltd. [W.N.2(a)] 128	
(Identified goodwill included in the above ₹ 8 lakhs) [W.N.2(b)]	
Add: Increase in reserves and surplus during the year (280-200) x 40% 32	
Less: Goodwill written off in the fourth year ₹ 8 lakhs x ½ (4)	<u>156</u>
	<u>1,956</u>
Capital and Liabilities:	
Share capital	400
Reserves and surplus (W.N.2(c))	1,026
Liabilities (250+280)	<u>530</u>
	<u>1,956</u>

Working Notes:

1. For Consolidated Balance Sheet as on 31.3.2011

(a) Analysis of Profits

	B Ltd.		C Ltd.	
	Pre-acquisition	Post Acquisition	Pre-acquisition	Post Acquisition
		₹ in lakhs	₹ in lakhs	₹ in lakhs
Reserves and Surplus		<u>300</u>	<u>100</u>	<u>100</u>
A Ltd.		300	80	80
Minority Interest		<u>-</u>	<u>20</u>	<u>20</u>

* With effect from 1st April, 2011, Balance Sheet of a company is to be prepared as per Revised Schedule VI. Since, Revised Schedule VI was not applicable in May, 2012 examination, Balance Sheet had been presented as per old Schedule VI as on 31.3.2012.

(b) Minority Interest

	C Ltd.
	₹ in lakhs
Share Capital (20%)	20
Reserves and Surplus	
Pre-acquisition (W.N. 1(a))	20
Post-acquisition (W.N. 1(a))	<u>20</u>
	<u>60</u>

(c) Cost of Control

	B Ltd.	C Ltd.
	₹ in lakhs	₹ in lakhs
Investment by A Ltd.	100	200
Less: Share capital (80%)	(100)	(80)
Capital profit (pre-acquisition) (W.N. 1(a))	<u>-</u>	<u>80</u>
Goodwill	-	40
Less: Amortization for 3 years [(40/5) x3]		<u>(24)</u>
Carrying value of goodwill after 3 years		<u>16</u>

(d) Consolidated Reserves and Surplus

	₹ in lakhs
Balance of A Ltd. as on 31.3.2011	400
Post-acquisition reserves and surplus of B Ltd. (W.N. 1(a))	300
Post-acquisition reserves and surplus of C Ltd. (W.N. 1(a))	<u>80</u>
	780
Less: Amortisation of goodwill	<u>(24)</u>
	<u>756</u>

2. For Consolidated Balance Sheet as on 31.3.2012

C Ltd. became a subsidiary of A Ltd. on 1st April 2008 when 80% thereof was acquired. The holding –subsidiary relationship continued till 31st March, 2011 and from 1st April, 2011 the relationship between the two companies changed to Associate. As per para 24 of AS 21, “Consolidated Financial Statements”, the carrying value of the investment at the date it ceases to be subsidiary is regarded as cost thereafter.

Accordingly, if the nature of the investee changes to that of an associate, the carrying amount of the investment in Consolidated Financial Statements of the investor, as on date it ceases to be a subsidiary, would be considered as cost of investment in the associate. Goodwill or capital reserve arising on account of the change in the nature of the investment will be computed as on the date of such change.

(a) Ascertainment of carrying value of investment in C Ltd. disposed off and retained

	₹ in lakhs
Net Assets of C Ltd. on the date of disposal (Total assets of ₹ 500 lakhs - total liabilities of ₹ 200 lakhs)*	300
Less: Minority's interest in C Ltd. on the date of disposal (20%)	<u>(60)</u>
Share of A Ltd. in Net Assets	240
Add: Carrying value of Goodwill (Refer W.N.1(c))	<u>16</u>
Total value of investment in consolidated financial statements of A Ltd.	256
Less: Carrying Value of investment disposed off (₹ 256 lakhs x 40,000/80,000)	<u>(128)</u>
Carrying Value of investment retained	<u>128</u>

(b) Goodwill arising on the Carrying Value of Unsold Portion of the Investment

	₹ in lakhs
Carrying value of retained 40% holdings in C Ltd. as on 1 st April, 2011	128
Less: Share in value of equity of C Ltd., as at date of investment when its subsidiary relationship is transformed to an associate (300 x 40%)	<u>(120)</u>
Goodwill arising on such investment under Equity method as per AS 23	<u>(8)</u>

(c) Consolidated Reserves and Surplus

	₹ in lakhs
Balance of reserves and surplus of A Ltd. as on 31.3.2012	550
Add: Post-acquisition reserves and surplus of B Ltd. (subsidiary)	420
Profit accumulated over the years on investment of A Ltd. (128-100)	28

* Calculation of net assets has been made on the basis of Balance Sheet as on 31.3.2011.

Post-acquisition reserves and surplus of C Ltd. (280-200) x 40%	32
Less: Goodwill amortised for the period	<u>(4)</u>
	<u>1,026</u>

Note: As sale of part investment took place on 1st April, 2011; therefore, it is not accounted again in the consolidated balance sheet assuming that the profit of A Ltd. includes the profit on sale of such investments.

Question 3

The shareholders of Sunrise Ltd. decided on a corporate restructuring exercise necessitated due to economic recession and a slump in business. From the audited statements as on 31-3-2010 and the information supplied, you are requested to prepare:

- Balance Sheet after the completion of the restructuring exercise,
- The capital reduction account,
- The cash account of the entity.

Balance Sheet of Sunrise Ltd. as on 31.3.2010

Liabilities	₹	Assets	₹
<u>Share Capital</u>		<u>Fixed Assets</u>	
30,000 Equity shares of ₹10 each	3,00,000	Trademarks and Patents	1,10,000
40,000 8% Cumulative Preference shares ₹10 each	4,00,000	Goodwill at cost	36,100
<u>Reserves and Surplus</u>		Freehold Land	1,20,000
Securities Premium Account	10,000	Freehold Premises	2,44,000
Profit and Loss Account	(1,38,400)	Plant and Equipment	3,20,000
Secured Borrowings:		Investment (marked to Market)	64,000
9% Debentures (₹100) 1,20,000		<u>Current Assets</u>	
Accrued Interest <u>5,400</u>	1,25,400	Inventories:	
Creditors	1,20,000	Raw materials and packing materials	60,000
		Finished goods <u>16,000</u>	76,000
Deferred vat payable	50,000	Trade receivable	<u>1,20,000</u>
Temporary bank overdraft	<u>2,23,100</u>		<u>10,90,100</u>
	<u>10,90,100</u>		

Note: Preference dividends are in arrears for 4 years.

The scheme of reconstruction that received the permission of the Court was on the following lines:

- (1) The authorized capital of the Company to be re-fixed at ₹ 10 lakhs (preference capital ₹ 3 lakhs and equity capital 7 lakhs both ₹ 10 shares each).
- (2) The preference shares are to be reduced to ₹ 5 each and equity shares reduced by ₹ 3 per share. Post reduction, both classes of shares to be re-consolidated into ₹ 10 shares.
- (3) Trade Investments are to be liquidated in open market.
- (4) One fresh equity shares of ₹ 10 to be issued for every ₹ 40 of preference dividends in arrears (ignore taxation).
- (5) The securities premium is to be fully utilized to meet the reconstruction programme.
- (6) The debenture holders took over freehold land at ₹ 2,10,000 and settled the balance after adjusting their dues.
- (7) Unprovided contingent liabilities were settled at ₹ 54,000 and a pending insurance claim receivable settled at ₹ 12,500 on condition that claim will be immediately settled.
- (8) The intangible assets were all to be written off along with ₹ 10,000 worth obsolete packing material and 10% of the receivables.
- (9) Expenses for the scheme were ₹ 10,000.
- (10) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.
- (11) The Equity shareholders agree that they will bring in cash to liquidate the balance outstanding on the overdraft account and also agree that sufficient funds will be brought in to bring up the net working capital, after completing the re-structuring exercise, to ₹ 2 lakhs. The equity shares will be issued at par for this purpose. (16 Marks)

Answer

Balance Sheet (as reduced) as on 31.3.2010

Liabilities	₹	Assets	₹	₹
Authorised share capital:		Freehold premises		2,44,000
70,000 Equity shares of ₹ 10 each	7,00,000	Plant & equipment		3,20,000
30,000 Preference shares of ₹ 10 each	<u>3,00,000</u>	Inventories:		
	<u>10,00,000</u>	Raw materials and packing materials	50,000	
		(60,000 – 10,000)		
Issued share capital:		Finished goods	<u>16,000</u>	66,000

56,400 Equity shares of ₹ 10 each (W.N.1)	5,64,000	Trade receivables (1,20,000-12,000)	1,08,000
20,000 Preference shares of ₹ 10 each (W.N.1)	2,00,000	Cash	1,96,000
Creditors	1,20,000		
Deferred vat payable	<u>50,000</u>		
	<u>9,34,000</u>		<u>9,34,000</u>

Capital Reduction Account

	Particulars	₹		Particulars	₹
To	Equity share capital	32,000	By	Preference share capital	2,00,000
To	Cash (contingent liability settled)	54,000	By	Equity share capital	90,000
To	Trademarks and Patents	1,10,000	By	Freehold land (2,10,000-1,20,000)	90,000
To	Goodwill	36,100	By	Cash (insurance claim)	12,500
To	Raw material and Packing materials	10,000			
To	Trade receivables	12,000			
To	Profit and loss account	<u>1,38,400</u>			
		<u>3,92,500</u>			<u>3,92,500</u>

Cash Account

	Particulars	₹		Particulars	₹
To	Investment	64,000	By	Capital reduction (Contingent liability)	54,000
To	9% Debenture holders (2,10,000-1,25,400)	84,600	By	Securities Premium – Expenses (See Note)	10,000
To	Capital reduction (insurance claim)	12,500	By	Temporary bank overdraft (64,000+84,600+12,500-54,000-10,000)	97,100
To	Equity share capital (1,26,000 + 1,96,000)	<u>3,22,000</u>	By	Temporary bank overdraft (2,23,100 – 97,100)	<u>1,26,000</u>
		<u>4,83,100</u>	By	Balance c/d (W.N.1)	<u>1,96,000</u>
					<u>4,83,100</u>

Working Notes:**1. Calculation of cash brought in by Equity shareholders:**

Net working capital:		₹
Raw Materials & Packing materials		50,000
Finished goods		16,000
Trade Receivables		<u>1,08,000</u>
		1,74,000
Less: Creditors	1,20,000	
Deferred VAT payable	<u>50,000</u>	<u>1,70,000</u>
		4,000

Add : Cash brought in to maintain net working capital of ₹ 2,00,000 (Bal.fig.) 1,96,000

Desired net working capital 2,00,000

2. Determination of number of shares issued

	Equity shares		Preference shares	
	₹	No. of shares	₹	No. of shares
Share capital as per balance sheet before reconstruction	3,00,000		4,00,000	
Less: Capital reduction	<u>90,000</u>		<u>2,00,000</u>	
Share capital of ₹ 7 each	2,10,000			
Share capital of ₹ 5 each			2,00,000	
Consolidated value per share	10	21,000	10	20,000
Add: Shares issued against arrears of preference dividend (₹ 4,00,000 x 8% x 4 years) / ₹ 40		3,200		
Add: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft (1,26,000/10)		12,600		
Add: Shares issued to existing equity shareholders for bringing cash for maintaining net working capital of ₹ 2,00,000 (1,96,000/10)		<u>19,600</u>		
		<u>56,400</u>		<u>20,000</u>

Note: As per section 78 of the Companies Act, 1956, securities premium can be utilized only for limited purpose. Since, the question requires utilization of securities premium to

meet the reconstruction programme, it is assumed that 'Expenses for the scheme ₹ 10,000' has been incurred on account of issue of shares to existing shareholders which is an eligible expense to be set off against securities premium amount.

Question 4

The following was the abridged Balance Sheet of X Co. Ltd, as at 31st March, 2012:

Liabilities	₹	Assets	₹
Capital:		Plant and machinery at depreciated value	8,60,000
Authorized:		Land	7,00,000
10,000 Equity shares of ₹ 100 each	<u>10,00,000</u>		
Issued and paid up:		Current assets	8,00,000
8,000 Equity shares of ₹100 each, fully paid up	8,00,000	Patents, trademarks and copyrights	6,00,000
Reserves and surplus:			
General reserve 5,00,000			
Securities premium 4,00,000			
Profit and loss <u>3,60,000</u>	12,60,000		
11% Debentures secured against the assets of the Co.	5,00,000		
Sundry Creditors	<u>4,00,000</u>		
	<u>29,60,000</u>		<u>29,60,000</u>

The Company ran two distinct departments utilizing the trademarks and copyrights owned and generated by it. The assets and liabilities of one of the departments as on the date of Balance Sheet were:

	₹
Plant and machinery	4,00,000
Land (used for business)	2,00,000
Current assets	2,00,000
Trademarks and copyrights	<u>3,50,000</u>
	11,50,000
Sundry creditors	<u>2,50,000</u>
	<u>9,00,000</u>

Due to managerial constraints, X is unable to develop this department. An overseas buyer is interested to acquire this department and after due diligence, offers a consideration of ₹ 20,00,000 to the company for transfer of business. The buyer offered to discharge the purchase consideration immediately after 31st March, 2012, in the following manner:

- (i) Issue of equity shares of the buyer's company for ₹ 10,00,000 nominal value at a premium of 20% over the face value; and*
- (ii) Payment of the balance consideration in £ Sterling. The exchange rate agreed upon is ₹ 80 per £ Sterling. This amount will be retained in London, till the actual takeover of the business is done by the buyer.*
 - (a) expenses to put through the transaction come to ₹ 8,00,000 initially to be incurred by X but to be shared equally by the parties.*
 - (b) the balance value of trademarks, copyrights and patents left with X does not enjoy any market value and has to be written off.*
 - (c) the value of the balance of land in X's possession will be taken at its market value in the books of account. Such a value, determined by an approved valuer, is 200 percent of the book value.*
 - (d) the parties agree that the date of legal ownership of the transferred business shall be 31st March, 2012 though certain formalities may have to be gone through and agree that the actual transfer to the buyer will be effected before 30th April, 2012.*

X Co. Ltd to carry on the business in the normal course and account for the profits of the transferred department to the foreign buyer. X made a net profit of ₹2,40,000 from the whole business for April, 2012; 40 percent of the net profit related to the business of the transferred department.
 - (e) the shares of the overseas buyer's company were quoted on the London Stock Exchange and on 30th April, 2012 were quoted at 95 percent of their face value.*
 - (f) the cash received by X at London was remitted by it to its Indian banking account on 30th April 2012 when the rupee sterling rate was ₹ 75 per UK sterling pound.*

Draw the Balance Sheet of X Co. Ltd. as at 30th April, 2012, after the transfer of the business to the overseas buyer.

(16 Marks)

Answer

Balance Sheet of X Co. Ltd. as at 30th April, 2012 (after demerger)

Liabilities	₹	Assets	₹
Authorised share capital:		Plant & Machinery at depreciated value (8,60,000-4,00,000)	4,60,000
10,000 Equity shares of ₹ 100 each	<u>10,00,000</u>	Land (W.N.6)	10,00,000
Issued share capital:		Current Assets (8,00,000-2,00,000)	6,00,000
8,000 Equity shares of ₹ 100 each	8,00,000	Investments in shares of Overseas Buyers (at market value)	9,50,000
Revaluation reserve (W.N.6)	5,00,000	Cash and bank (W.N.2)	4,94,000
General reserve	5,00,000		
Securities Premium	4,00,000		
Profit and Loss Account (W.N.1)	6,54,000		
11% Debentures secured against the assets of the Co.	5,00,000		
Sundry Creditors	<u>1,50,000</u>		
	<u>35,04,000</u>		<u>35,04,000</u>

Working Notes:

1. Computation of Profit and Loss Account as on 30th April, 2012

		₹
Balance as on 31 st March, 2012		3,60,000
Add: Profit on sale of one of the department (W.N.3)	11,00,000	
Profit earned during the month of April, 2012 (W.N.4)	<u>1,44,000</u>	<u>12,44,000</u>
		16,04,000
Less: Expenses on sale of department (share of X Co.) (₹ 8,00,000 x 50%)	4,00,000	
Patents, trademarks and copyrights written off (W.N.5)	2,50,000	
Diminution in the value of investment (W.N.7)	2,50,000	
Loss on foreign exchange translation (W.N.8)	<u>50,000</u>	<u>9,50,000</u>
		<u>6,54,000</u>

2. Cash and bank

		₹
Cash received from Overseas buyer on 30 th April, 2012 (£ 10,000 x ₹ 75)		7,50,000
Add: Cash reimbursed by Overseas buyer (₹ 8,00,000 x 50%)		4,00,000
Cash profit earned during the month of April, 2012 by X Co. Ltd. (See Note)		<u>2,40,000</u>
		13,90,000
Less: Expenses on sale of department to overseas buyer	8,00,000	
Share of profit (for April, 2012) paid to Overseas buyer (W.N.4)	<u>96,000</u>	<u>8,96,000</u>
		<u>4,94,000</u>

3. Calculation of gain on sale of department and discharge of purchase consideration

	₹
Purchase consideration	20,00,000
Less: Net assets sold	<u>9,00,000</u>
Gain on sale of department	<u>11,00,000</u>
Purchase consideration	20,00,000
Less: Discharged by issue of Overseas Buyer's Equity shares of ₹ 10,00,000 at 20% premium	<u>12,00,000</u>
Balance discharged in cash i.e. (8,00,000/80) = £ 10,000	<u>8,00,000</u>

4. Profit earned during the month of April, 2012

	₹
Total profit earned by X Co. Ltd. during the month of April, 2012	2,40,000
Less: 40% Profit of the sold department	<u>96,000</u>
Profit of X Co. Ltd. on the retained department	<u>1,44,000</u>

5. Patents, trademarks and copyrights written off

	₹
Patents, trademarks and copyrights as per balance sheet of X Co. Ltd.	6,00,000

Less: Patents, trademarks and copyrights taken over by Overseas buyer	<u>(3,50,000)</u>
Patents, trademarks and copyrights written off (charged to Profit and Loss Account)	<u>2,50,000</u>

6. Land

	₹
Land as per balance sheet of X Co. Ltd.	7,00,000
Less: Land taken over by Overseas buyer	<u>(2,00,000)</u>
Book value of land retained by X Co. Ltd.	<u>5,00,000</u>
Revalued value (200% of book value)	<u>10,00,000</u>
Revaluation reserve (10,00,000-5,00,000)	5,00,000

7. Diminution in the market value of equity shares of Overseas Buyer

	₹
Nominal value of shares	<u>10,00,000</u>
Issued at 20% Premium	12,00,000
Market value of shares on 30 th April, 2012 is 95% of nominal value (10,00,000 x 95%)	<u>9,50,000</u>
Diminution charged to Profit and Loss Account	<u>2,50,000</u>

8. Loss on foreign exchange translation

	₹
Cash payment by overseas buyer £ 10,000 due on 31 st March, 2012 @ ₹ 80 per £	8,00,000
Exchange rate on 30 th April, 2012 is ₹ 75 per £	
Less: Amount remitted in Indian Currency (£ 10,000 x ₹ 75)	<u>(7,50,000)</u>
Loss on foreign exchange translation transferred to Profit and Loss Account	<u>50,000</u>

Note:

- The above solution has been given on the assumption that X Co. Ltd intends to hold investment in shares of overseas buyer as temporary investment. Therefore, its carrying value has been shown in the balance sheet at market value and reduction to market value has been included in the profit and loss account. In case it is assumed as long term investment, then investment in shares of Overseas buyer will be shown at cost i.e.

₹ 12,00,000 and Profit and Loss account balance will be ₹ 9,04,000. The Balance Sheet total will be ₹ 37,54,000.

2. It is also assumed that the profit earned during the month of April, 2012 is entirely the cash profit and also the amount of current assets and current liabilities of X Co. Ltd. has been same as on 31.3.2012.

Question 5

- (a) As point of staff welfare measures, Y Co. Ltd. has contracted to lend to its employees sums of money at 5 percent per annum rate of interest. The amounts lent are to be repaid alongwith the interest in five equal annual instalments. The market rate of interest is 10 per cent per annum.

Y lent ₹ 16,00,000 to its employees on 1st January, 2011.

Following the principles of recognition and measurement as laid down in AS 30, you are required to record the entries for the year ended 31st December, 2011 for the transaction and also calculate the value of the loan initially to be recognized and the amortized cost for all the subsequent years.

For purposes of calculation, the following discount factors at interest rate of 10 percent may be adopted

At the end of year

1	.909
2	.827
3	.751
4	.683
5	.620

- (b) Hindusthan Corporation Limited (HCL) has been consistently preparing Value Added Statement (VAS) as part of Financial Reporting. The Human Resource department of the Company has come up with a new scheme to link employee incentive with 'Value Added' as per VAS. As per the scheme an Annual Index of Employee cost to Value Added annually (% of employee cost to Value Added rounded off to nearest whole number) shall be prepared for the last 5 years and the best index out of results of the last 5 years shall be selected as the 'Target Index'. The Target Index percentage shall be applied to the figure of 'Value Added' for a given year to ascertain the target employee cost. Any saving in the actual employee cost for the given year compared to the target employee cost will be rewarded as 'Variable incentive' to the extent of 70% of the savings. From the given data, you are requested to ascertain the eligibility of 'Variable Incentive' for the year 2011-2012 for the employees of the HCL.

Value added statement of HCL for last 5 years (₹ lakhs)

Year	2006-07	2007-08	2008-09	2009-10	2010-11
Sales	3,200	3,250	2,900	3,800	4,900
Less:					
Bought out goods and services	<u>2,100</u>	<u>2,080</u>	<u>1,940</u>	<u>2,510</u>	<u>3,200</u>
Value added	1,100	1,170	960	1,290	1,700

Application of Value Added

Year	2006-07	2007-08	2008-09	2009-10	2010-11
To Pay Employees	520	480	450	600	750
To Providers of Capital	160	170	120	190	210
To Government Tax	210	190	220	300	250
For Maintenance and expansion	210	330	170	200	490

Summarized Profit and Loss Account of the HCL for 2011-2012 (₹ in lakhs)

Sales		5,970
Less:		
Material consumed	1,950	
Wages	400	
Production salaries	130	
Production expenses	500	
Production depreciation	150	
Administrative salaries	150	
Administrative expenses	200	
Administrative depreciation	100	
Interest	150	
Selling and distribution salaries	120	
Selling expenses	350	
Selling depreciation	<u>120</u>	<u>4,320</u>
Profit		<u>1,650</u>

(8 + 8 = 16 Marks)

Answer

(a) (i) Calculation of initial recognition amount of loan to employees

Year end	Cash Inflow		Total ₹	P.V. factor @10%	Present value ₹
	Principal ₹	Interest @ 5% ₹			
2011	3,20,000	80,000	4,00,000	0.909	3,63,600
2012	3,20,000	64,000	3,84,000	0.827	3,17,568
2013	3,20,000	48,000	3,68,000	0.751	2,76,368
2014	3,20,000	32,000	3,52,000	0.683	2,40,416
2015	3,20,000	16,000	3,36,000	0.620	<u>2,08,320</u>
Present value or Fair value					<u>14,06,272</u>

(ii) Calculation of amortised cost of loan to employees

Year	Amortised cost (Opening balance) [1] ₹	Interest to be recognised @10% [2] ₹	Repayment (including interest) [3] ₹	Amortised Cost (Closing balance) [4]=[1]+ [2]-[3] ₹
2011	14,06,272	1,40,627	4,00,000	11,46,899
2012	11,46,899	1,14,690	3,84,000	8,77,589
2013	8,77,589	87,759	3,68,000	5,97,348
2014	5,97,348	59,735	3,52,000	3,05,083
2015	3,05,083	30,917*	3,36,000	Nil

(iii) Journal Entries in the books of Y Ltd.
For the year ended 31st December, 2011 (regarding loan to employees)

	Dr. Amount (₹)	Cr. Amount (₹)
Staff loan A/c Dr. To Bank A/c (Being the disbursement of loans to staff)	16,00,000	16,00,000

* ₹ 3,05,083 x 10% = ₹ 30,508. The difference of ₹ 409 (₹ 30,917 – ₹ 30,508) is due to approximation in computation.

Staff cost A/c ₹ (16,00,000 –14,06,272) [Refer part (ii)] To Staff loan A/c (Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of ₹ 14,06,272)	Dr.	1,93,728	
Staff loan A/c To Interest on staff loan A/c (Being the charge of interest @ market rate of 10% on the loan)	Dr.	1,40,627	1,93,728
Bank A/c To Staff loan A/c (Being the repayment of first instalment with interest for the year)	Dr.	4,00,000	1,40,627
Interest on staff loan A/c To Profit and loss A/c (Being transfer of balance of staff loan Interest account to profit and loss account)	Dr.	1,40,627	4,00,000
Profit and loss A/c To Staff cost A/c (Being transfer of balance of staff cost account to profit and loss account)	Dr.	1,93,728	1,40,627
			1,93,728

(b) 1. Calculation of Target index

	(₹ in lakhs)				
Year	2006-07	2007-08	2008-09	2009-10	2010-11
Employees cost	520	480	450	600	750
Value added	1,100	1,170	960	1,290	1,700
Percentage of 'Employee cost' to 'Value added' (to the nearest whole number)	47%	41%	47%	47%	44%

Target index percentage is taken as least of the above from companies viewpoint on conservative basis i.e. 41%.

2. Value Added Statement for the year 2011-12

	(₹ in lakhs)	(₹ in lakhs)
Sales		5,970
Less: Cost of bought in goods & services		
Material consumed	1,950	
Production expenses	500	
Administrative expenses	200	
Selling expenses	350	3,000
Added value		2,970

3. Employee cost for 2011-12

	(₹ in lakhs)
Wages	400
Production salaries	130
Administrative salaries	150
Selling salaries	120
	800

4. Calculation of target employee cost = Target Index Percentage x Value added
= 41% x ₹ 2,970 lakhs = ₹ 1217.70 lakhs

5. Calculation of savings

Target employee cost	= ₹ 1,217.70 lakhs
Less: Actual Cost	= ₹ 800 lakhs
Saving	= ₹ 417.70 lakhs

6. Calculation of Variable incentive for the year 2011-12:

70% of saving is variable incentive = 70% x ₹ 417.70 lakhs = ₹ 292.39 lakhs.

Question 6

- (a) NRPL (Nuclear Reactors Private Limited) is engaged in the business of design and construction of nuclear reactors that are supplied exclusively to the Atomic Energy Department. The core component of such reactors is outsourced by NRPL from FIL (Fusion Industrials Ltd.) the sole manufacturer of this item. NRPL wants to gain leadership in this industry and seeks to take over FIL. NRPL estimates that its Goodwill in the industry will increase by a minimum of ₹ 300 crores consequent on the acquisition. NRPL has made the following calculation of the economic benefits presently available and that foreseen as a result of the acquisition.

(i) Projected Cash Flows of NRPL for the next 5 years:

Year	1	2	3	4	5
Cash flow (₹ in crores)	1,000	1,500	2,000	2,500	3,000

(ii) Projected Cash Flow of FIL for the next 5 years.

Year	1	2	3	4	5
Cash flow (₹ in crores)	400	400	600	800	1,000

(iii) Audited net worth of FIL

	₹
Fixed assets	2,000
Investments (non-trade)	1,000
Current assets	<u>1,000</u>
Total	4,000
Current liabilities	<u>1,000</u>
Net worth	<u>3,000</u>

(iv) Other information:

- 10% of the fixed assets of FIL will not be required in the event of the acquisition and the same has ready buyers for ₹100 crore.
- Current Assets include surplus stocks of ₹20 crore that can realize ₹30 crore.
- Investments have a ready market for ₹1,500 crore.
- The current liabilities are to be paid off immediately; ₹510 crores are payable on account of a compensation claim awarded against FIL, which has been treated as a contingent liability in the accounts on which 20 percent was provided for.

(v) NRPL has estimated the combined cash flows post merger as under:

Year	1	2	3	4	5
Cash flow (₹ in crores)	1,500	2,000	2,500	3,000	3,500

You are required to advise NRPL the maximum value it can pay for takeover of FIL; also show the current valuation of FIL as a 'Stand Alone' entity. The Discount rate of 15% is advised appropriate, values for which are given below:

Year	P.V
1	0.870
2	0.756

3	0.658
4	0.572
5	0.497

(b) The following information (as of 31-03-2012) is supplied to you by M/s Fox Ltd.:

			(₹ in crores)
(i)	Profit after tax (PAT)		205.90
(ii)	Interest		4.85
(iii)	Equity Share Capital	40.00	
	Accumulated surplus	<u>700.00</u>	
	Shareholders fund	740.00	
	Loans (Long term)	<u>37.00</u>	
	Total long term funds		777.00
(iv)	Market capitalization		2,892.00
Additional information:			
(a)	Risk free rate		12.00 percent
(b)	Long Term Market Rate (Based on BSE Sensex)		15.50 percent
(c)	Effective tax rate for the company		25.00 percent
(d)	Beta (β) for last few years		
	Year		
	1	0.48	
	2	0.52	
	3	0.60	
	4	1.10	
	5	0.99	

Using the above data you are requested to calculate the Economic Value Added of Fox Ltd. as on 31st March, 2012. (12 + 4 = 16 Marks)

Answer

(a) (1) Calculation of operational synergy expected to arise out of merger

(₹ in crores)

Year	1	2	3	4	5
Projected cash flows of NRPL after merger with FIL	1,500	2,000	2,500	3,000	3,500
Less: Projected cash flows of NRPL Ltd. without merger	<u>(1,000)</u>	<u>(1,500)</u>	<u>(2,000)</u>	<u>(2,500)</u>	<u>(3,000)</u>
	<u>500</u>	<u>500</u>	<u>500</u>	<u>5,00</u>	<u>500</u>

(2) Valuation of FIL in case of merger

Year	Cash Flows from operations (₹ in crores)	Discount Factor	Discounted Cash Flow (₹ in crores)
1	500	0.870	435.00
2	500	0.756	378.00
3	500	0.658	329.00
4	500	0.572	286.00
5	500	0.497	<u>284.50</u>
			<u>1,676.50</u>

(3) Maximum value to be quoted

	₹ in crores	₹ in crores
Value as per discounted cash flows from operations		1,676.50
Add: Increase in goodwill of NRPL on acquisition of FIL		<u>300</u>
		1,976.50
Add: Cash to be collected immediately by disposal of assets:		
Fixed Assets	100	
Investments	1,500	
Stock	<u>30</u>	<u>1,630.00</u>
		3,606.50
Less: Current liabilities (1,000 – 102) (See Note below)	898	
Compensations claim	<u>510</u>	<u>(1,408.00)</u>
		<u>2,198.50</u>

So, NRPL. can quote as high as ₹ 2,198.50 crores for taking over the business of FIL.

(4) Valuation of FIL ignoring merger (as a 'Stand Alone' entity)

Year	Cash Flows (₹ in crores)	Discount Factor	Discounted Cash Flow (₹ in crores)
1	400	0.870	348.00
2	400	0.756	302.40
3	600	0.658	394.80
4	800	0.572	457.60
5	1,000	0.497	<u>497.00</u>
			<u>1,999.80</u>

(b) Net Operating Profit After Tax (NOPAT) = Profit After Tax (PAT) + Interest (net of tax)

$$= 205.90 + 4.85 \times (1-0.25) = ₹ 209.54 \text{ crores}$$

Debt Capital ₹ 37 crores

Equity capital (40 + 700) = ₹ 740 crores

Capital employed = ₹ 37 + ₹ 740 = ₹ 777 crores

Debt to capital employed = ₹ 37 crores / ₹ 777 crores = 0.0476

Equity to capital employed = ₹ 740 crores / ₹ 777 crores = 0.952

Interest cost before Tax ₹ 4.85 crores

Less: Tax (25% of ₹ 4.85 crores) (₹ 1.21 crores)

Interest cost after tax ₹ 3.64 crores

Cost of debt = (₹ 3.64 crores / ₹ 37 crores) x 100

$$= 9.83\%$$

According to Capital Asset Pricing Model (CAPM)

Beta for calculation of EVA should be the highest of the given beta for the last few years. Accordingly,

Cost of Equity Capital = Risk Free Rate + Beta (Market Rate – Risk Free Rate)

$$= 12\% + 1.10 \times (15.50\% - 12\%)$$

$$= 12\% + 1.10 \times 3.5\% = 15.85\%$$

Weighted Average Cost of Capital (WACC) = Equity to Capital Employed (CE) x Cost of Equity Capital + Debt to CE x Cost of Debt

$$= 0.952 \times 15.85\% + 0.0476 \times 9.83\%$$

$$= 15.09\% + 0.47\% = 15.56\%$$

Cost of Capital Employed (COCE) = WACC × Capital Employed

$$= 15.56\% \times ₹ 777 \text{ crores} = ₹ 120.90 \text{ crores}$$

Economic Value Added (E.V.A.) = NOPAT – COCE

$$= ₹ 209.54 \text{ crores} - ₹ 120.90 \text{ crores} = ₹ 88.64 \text{ crores}$$

Question 7

Answer any **four** of the following:

- (a) Bellhop LLC submits the following information pertaining to year 2011. Using the data, you are required to find the ending cash and bank balances given an opening figure thereof was ₹ 1.55 million.

	(₹ millions)
Additional shares issued	6.50
CAPEX (Capital expenditure)	9.90
Proceeds from assets sold	1.60
Dividends declared	0.50
Gain from disposal of assets	(1.20)
Net income	3.30
Increase in Accounts Receivable	1.50
Redemption of 4.5% debentures	2.50
Depreciation & Amortization	0.75

- (b) From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2011 to 31-03-2012 and adjusted EPS for the year 01-04-2010 to 31-03-2011.

Net profit for year ended 31-03-2011	₹ 75,50,000
Net profit for year ended 31-03-2012	₹ 1,00,25,000
No. of equity shares as on 01-04-2011	50,00,250
Bonus issue on 01-01-2012	1 share for every 2 held
No. of 12% Convertible Debentures of ₹ 100 each issued on 01-01-2012	1,00,000
Conversion ratio of Debentures	10 shares per debenture
Tax rate	30 percent

- (c) X Limited was making provisions up to 31-3-2011 for non-moving stocks based on no issues for the last 12 months. Based on a technical evaluation the company wants to make provisions during the year 31-03-2012 in the following manner:

Total value of stock ₹ 3 crores.

Provision required based on 12 months ₹ 8 lakhs.

Provision required based on technical evaluation ₹7.50 lakhs.

Does this amount to change in accounting policy?

Can the company change the method of provision?

- (d) X Limited began construction of a new plant on 1st April 2011 and obtained a special loan of 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 per cent per annum.

The expenditure that was made on the project of plant construction was as follows:

	₹
1-4-2011	10,00,000
1-8-2011	24,00,000
1-1-2012	4,00,000

The Company's other outstanding non specific loan was ₹ 46,00,000 at an interest of 12 percent per annum.

The construction of the plant was completed on 31-3-2012. You are required to calculate the amount of interest to be capitalized as per the provision of AS 16 of the borrowing cost (including cost).

- (e) X Ltd. on 1-1-2012 had made an investment of ₹600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2012 became ₹ 200 lakhs as Y* Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2012. (4 × 4 = 16 Marks)

Answer

- (a) Bellhop LLC

Cash Flow Statement for the year ended 31st March, 2011

	₹ in millions	₹ in millions
Cash flows from operating activities		
Net income	3.30	
Add: Depreciation & amortization	0.75	

* 'X Ltd.' Printed in the question paper should be read as 'Y Ltd.'.

Loss from disposal of assets	1.20	
Less: Increase in accounts receivables	<u>(1.50)</u>	
Net cash generated from operating activities		3.75
Cash flows from investing activities		
Capital expenditure	(9.90)	
Proceeds from sale of fixed assets	<u>1.60</u>	
Net cash used in investing activities		(8.30)
Cash flows from financing activities		
Proceeds from issuance of additional shares	6.50	
Dividend declared	(0.50)	
Redemption of 4.5% debentures	<u>(2.50)</u>	
Net cash generated from financing activities		<u>3.50</u>
Net decrease in cash		(1.05)
Cash at beginning of the period		<u>1.55</u>
Cash at end of the period (Balancing figure)		<u>0.50</u>

Note: Since, question is not specifying to use Cash Flow Statement for finding the closing cash balance, therefore, one can prepare cash and bank account for calculation of closing cash and bank balance.

(b) No. of Bonus shares issued as on 1.1.2012

On existing shares $(50,00,250 \times \frac{1}{2})$ 25,00,125 shares

On convertible debentures as per SEBI Guidelines on Bonus Issue

$(1,00,000 \text{ debentures} \times 10 \text{ shares} \times \frac{1}{2})$ 5,00,000 shares

Basic Earnings per share for the year 2011-12=

$$\frac{\text{Net profit for the year ended 31.3.2012}}{\text{Weighted average number of equity share as on 31.3.2012}}$$

$$\frac{\text{₹ } 1,00,25,000}{(50,00,250 + 25,00,125 + 5,00,000)} = \text{₹ } 1.25$$

Adjusted earnings per share for the year 2010-11 =
$$\frac{\text{₹ } 75,50,000}{(50,00,250 + 25,00,125 + 5,00,000)} = \text{₹ } 0.94$$

For Diluted EPS

Interest expense for the current year = ₹ 12,00,000

Tax relating to interest expense (30%) = ₹ 3,60,000

$$\begin{aligned}\text{Adjusted net profit for the current year} &= ₹ 1,00,25,000 + (12,00,000 - 3,60,000) \times 3/12 \\ &= ₹ 1,02,35,000\end{aligned}$$

No. of equity shares resulting from conversion of debentures

$$= 1,00,000 \times 10 \text{ shares} = 10,00,000$$

No. of equity shares used to compute diluted earnings per share

$$\begin{aligned}&= 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 \times 3/12) \\ &= 50,00,250 + 25,00,125 + 5,00,000 + 2,50,000 \\ &= 82,50,375 \text{ shares}\end{aligned}$$

$$\text{Diluted earnings per share} = 1,02,35,000 / 82,50,375 = ₹ 1.24$$

Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2010-11, the earliest period reported.

- (c) Basis of provisioning whether on no issues or on technical evaluation is the basis of making estimates and cannot be considered as Accounting Policy. As per AS 5, due to uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving stock on account of change. Hence, it is not a change in accounting policy. Accounting policy is the valuation of inventory on cost or on net realizable value or on lower of cost or net realizable value. Any interchange of this valuation base would have constituted change in accounting policy.

Further, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months issue. If that is the case, then the company can change the method of provision.

- (d) (i) Computation of average accumulated expenses

		₹
₹ 10,00,000 x 12 / 12	=	10,00,000
₹ 24,00,000 x 8 / 12	=	16,00,000
₹ 4,00,000 x 3 / 12	=	<u>1,00,000</u>
		<u>27,00,000</u>

(ii) Non-specific Borrowings

$$\begin{aligned}\text{Non-specific Borrowings} &= \text{Average accumulated capital expenses} - \text{Specific borrowings} \\ &= ₹ 27,00,000 - ₹ 8,00,000 = ₹ 19,00,000\end{aligned}$$

(ii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 8,00,000 X 10%)	=	80,000
Non-specific borrowings (₹ 19,00,000 × 12%)	=	<u>2,28,000</u>
Amount of interest to be capitalized	=	<u>3,08,000</u>

(iii) Total expenses to be capitalized for Plant

	₹
Cost of plant ₹ (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalised	<u>3,08,000</u>
Total cost of plant	<u>41,08,000</u>

- (e) X limited invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by X Limited only for 3 months (from 1.1.2012 to 31.3.2012), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2012 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quite a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it

will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and shown the investments at ₹ 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternatively for treatment of long term investment

If one assumes that the decline in the value of long term investment is temporary and Y Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.