

PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

1. From the following Balance Sheets of a group of companies and the other information provided, draw up the Consolidated Balance Sheet as on 31.3.2005. Figures given are in Rupees Lakhs:

Balance Sheets as on 31.3.2005							
	X	Y	Z		X	Y	Z
Shares capital (in shares of Rs. 10 each)	300	200	100	Fixed Assets less depreciation	130	150	100
Reserves	50	40	30	Cost of investment in Y Ltd.	180	—	—
Profit and loss balance	60	50	40	Cost of investment in Z Ltd.	40	—	—
Bills payables	10	—	5	Cost of investment in Z Ltd.	—	80	—
Creditors	30	10	10	Stock	50	20	20
Y Ltd. balance	—	—	15	Debtors	70	10	20
Z Ltd. balance	50	—	—	Bills receivables	—	10	20
				Z Ltd. balance	—	10	—
				X Ltd. balance	—	—	30
	—	—	—	Cash and bank balance	<u>30</u>	<u>20</u>	<u>10</u>
	<u>500</u>	<u>300</u>	<u>200</u>		<u>500</u>	<u>300</u>	<u>200</u>

- X Ltd. holds 1,60,000 shares and 30,000 shares respectively in Y Ltd. and Z Ltd.; Y Ltd. holds 60,000 shares in Z Ltd. These investments were made on 1.7.2004 on which date the provision was as follows:

	Y Ltd.	Z Ltd.
Reserves	20	10
Profit and loss account	30	16

- In December, 2004 Y Ltd. invoiced goods to X Ltd. for Rs. 40 lakhs at cost plus 25%. The closing stock of X Ltd. includes such goods valued at Rs. 5 lakhs.
- Z Ltd. sold to Y Ltd. an equipment costing Rs. 24 lakhs at a profit of 25% on selling price on 1.1.2005. Depreciation at 10% per annum was provided by Y Ltd. on this equipment.
- Bills payables of Z Ltd. represent acceptances given to Y Ltd. out of which Y Ltd. had discounted bills worth Rs. 3 lakhs.
- Debtors of X Ltd. include Rs. 5 lakhs being the amount due from Y Ltd.
- X Ltd. proposes dividend at 10%.
2. The financial position of two companies Hans Ltd. and Varun Ltd. as on 31st March, 2005 was as under:

Assets	Hans Ltd. (Rs.)	Varun Ltd. (Rs.)
Goodwill	50,000	25,000
Building	3,00,000	1,00,000
Machinery	5,00,000	1,50,000
Stock	2,50,000	1,75,000
Debtors	2,00,000	1,00,000
Cash at Bank	50,000	20,000
Preliminary Expenses	<u>30,000</u>	<u>10,000</u>
	<u>13,80,000</u>	<u>5,80,000</u>

Liabilities

<i>Share Capital:</i>	<i>Hans Ltd. (Rs.)</i>	<i>Varun Ltd. (Rs.)</i>
Equity Shares of Rs. 10 each	10,00,000	3,00,000
9% Preference Shares of Rs. 100 each	1,00,000	–
10% Preference Shares of Rs. 100 each	–	1,00,000
General Reserve	1,00,000	80,000
Retirement Gratuity fund	50,000	20,000
Sundry Creditors	<u>1,30,000</u>	<u>80,000</u>
	<u>13,80,000</u>	<u>5,80,000</u>

Hans Ltd. absorbs Varun Ltd. on the following terms:

- (a) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of Hans Ltd.
- (b) Goodwill of Varun Ltd. is valued at Rs. 50,000, Buildings are valued at Rs. 1,50,000 and the Machinery at Rs. 1,60,000.
- (c) Stock to be taken over at 10% less book value and Reserve for Bad and Doubtful Debts to be created @ 7.5%.
- (d) Equity Shareholders of Varun Ltd. will be issued Equity Shares of Hans Ltd. @ 5% premium.

Prepare necessary Ledger Accounts to close the books of Varun Ltd. and show the acquisition entries in the books of Hans Ltd. Also draft the Balance Sheet after absorption as at 31st March, 2005.

3. (a) On 31st March, 2005, the balance sheet of Alpha Co. Ltd. disclosed the following position:

<i>Liabilities</i>	<i>Rs.</i>
Subscribed share capital in shares of Rs. 10 each, fully paid	4,00,000
General reserve	1,90,000
Profit and loss account	1,20,000
14% Debentures	1,00,000
Current liabilities	<u>1,30,000</u>
	<u>9,40,000</u>

<i>Assets</i>	<i>Rs.</i>
Goodwill	40,000
Fixed Assets (tangible)	5,00,000
Current assets	<u>4,00,000</u>
	<u>9,40,000</u>

On the above-mentioned date, the tangible fixed assets were independently valued at Rs. 3,50,000 and goodwill at Rs. 50,000. The net profits for the three years were – 2002-2003: Rs. 1,03,200; 2003-2004: Rs. 1,04,000; and 2004-2005: Rs. 1,03,300 of which 20% was placed to general reserve, this proportion being considered reasonable in the industry in which the company is engaged and where a fair return on investment may be taken at 18%.

Compute the value of the company's share by – (i) the net assets method; and (ii) the yield method. Ignore taxation.

- (b) Following are the information of two companies for the year ended 31st March, 2005:

<i>Particulars</i>	<i>Company A</i>	<i>Company B</i>
Equity Shares of Rs. 10 each	8,00,000	10,00,000
10% Preference Shares of Rs. 10 each	6,00,000	4,00,000
Profit after tax	3,00,000	3,00,000

Assume that the Market expectation is 18% and 80% of the Profits are distributed.

- (i) What is the rate you would pay to the Equity Shares of each Company ?
 - (a) If you are buying a small lot.
 - (b) If you are buying controlling interest shares.
 - (ii) If you plan to invest only in preference shares which company's preference shares would you prefer ?
4. The following is the Profit and Loss Account of F Ltd. from which you are required to prepare a gross value added statement and reconcile the same with profit before taxation.

	<i>Rs. in ('000)</i>
Sales	28,500
Other Income	<u>750</u>
	<u>29,250</u>
Expenditure:	
Operating Cost	25,600
Excise Duty	1,700
Interest on Bank Overdraft	100
Interest on 12% Debentures	<u>1,150</u>
	<u>28,550</u>
Profit before Depreciation	700
Less: Depreciation	<u>250</u>
Profit before tax	450
Tax Provision	<u>270</u>
Net Profit after tax	180
Less: Transfer to Replacement Reserve	<u>30</u>
	150
Less: Dividend	<u>50</u>
Retained Profit	<u>100</u>

Note:

- (i) Sales are net after deducting discounts, returns, and sales tax.
- (ii) Operating Cost includes Rs. ('000) 10,200 as wages, salaries and other benefits to employees.
- (iii) Bank Overdraft is a temporary source of finance.
- (iv) Provision for tax includes Rs. ('000) 70 for deferred tax.

5. (a) Chennai University of Advanced Dental Research provides you with the following details relating to its loan funds for the year 2004-2005:

	<i>Rs.</i>
Private and Government Grants	7,50,000
Transfer from revenue funds to loan funds	15,000
Transfer from unrestricted fund to loan fund	1,50,000
Investment income	22,500
Interest on loan	37,500
Amount refunded to grantors	30,000
Loan cancellation and written off	15,000
Administrative and Collection costs	22,500
Loan Fund Balance at the beginning of the year	30,22,500

Required:

Prepare a statement showing changes in fund balance during the year.

- (b) Write short note on Annuity and Life Income Funds.
6. (a) What are the various requirements to make EVA successful in an enterprise?
 (b) Explain 'Cost of Capital' in the context of EVA.
7. (a) Write short notes on:
 (i) Jaggi and Lau model on valuation on group basis of Human Resources.
 (ii) Opportunity cost (HRA).
 (b) What is corporate social reporting? Why is the necessity for corporate social reporting felt?
8. Define the following terms in the context of NBFC:
 (a) Earning value (equity share).
 (b) Subordinated debt.
9. (a) What should be the minimum components of an annual report of a mutual fund?
 (b) On what basis income from investments is recognised by a NBFC?
10. What is meant by a 'merchant banker'? What books of account are required to be maintained by a merchant banker?
11. Explain the significance of Environmental Accounting in brief.
12. (a) Define the following terms with reference to Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options :-
 (i) Exercise of an Option
 (ii) Daily Settlement Price
 (iii) Open Interest
 (iv) Put Option
 (b) Explain the procedure of accounting for payment/ receipt of mark-to-market margin money in the case of equity index futures and equity stock futures and options?

13. Write short note on significant differences between IAS and AS in respect of
 - (a) Effects of changes in foreign exchange rates
 - (b) Segment reporting
 - (c) Accounting for amalgamation
14. Write a short note on accounting of income during construction period.
15. A company is in the business of refining, transportation through pipelines and marketing petroleum products. Can the stock of crude oil in pipelines and dead stock in tanks can be capitalized as fixed assets or valued as inventory at a fixed base price?
16. A Limited company closes its accounts on 31st March every year. It issued a cheque in favour of one of its customers towards the refund of advance in December, 2004. In April 2005, the customer returned the cheque to the company without presentation to the bank while accounts of the company for that year were being finalized. Since the cheque was cancelled, the reversal entry was passed in the books of account as on 31.3.2005 with a view to disclose the correct balance as on that date, instead of showing the bank balance lower by treating the cheque as "issued but not encashed as on 31.3.2005". Whether the reversal entry passed in the books of account of the company as on 31.3.2005 was proper since the cheque was cancelled before closing of the accounts for the year?
17. (a) An asset with an initial useful life of 10 years was acquired by Sagar Ltd. at the end of 6 years. At this stage the remaining useful life of the asset was determined by Sagar Ltd. to be 7 years and not 4 years. Whether depreciation should be provided based on useful life of 7 years or 4 years?
- (b) Jadu Ltd. purchased certain plant and machinery for Rs. 40 lakhs. 20% of the cost net of Modvat credit is the subsidy component to be realised from a State Government for establishing industry in a backward district. Cost Rs. 40 lakhs include excise Rs. 5 lakhs against which Cenvat credit can be claimed. Compute depreciable amount.
18. Discuss with reference to the Accounting Standards the nature of classification and disclosure requirements in the statement of profit and loss of an entity in the following cases –
 - (a) Losses sustained as a result of enemy action.
 - (b) Disposal of long-term investments of a trading entity.
19. (a) In the following cases state with reasons whether the classification adopted by the respective enterprises is in consonance with AS 3 (Revised):
 - (i) Shubra Ltd. has purchased fixed assets from Egypt for \$ 10,000 on 1.1.2005. it has entered into currency option contract for purchase of foreign exchange to pay for fixed asset and paid a premium of Rs. 17,000. The premium has been classified as financing activity.
 - (ii) Withdrawal of demand deposits have been classified by Punjab National Bank as an operating activity.
- (b) S Ltd. manufactures machinery used in Steel Plants. It quotes prices in various tenders issued by Steel Plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only.
20. A company adopts the following policy – to the extent that the proceeds from sale of fixed assets are in excess of their written down value but less than or equal to the original cost, the excess is credited to the profit and loss account as 'Profit on Sale of Assets'; the amount which exceeds the original cost of the asset is treated as a capital receipt and credited to capital reserve in the balance sheet. The company justifies the treatment using the following reasons: (a) It is a fundamental accounting concept that any gain arising beyond the original cost of an asset is a

capital receipt/profit and may not be treated as a revenue profit. (b) The 'Guidance Note on Terms Used in Financial Statements' issued by the Institute of Chartered Accountants of India defines the term 'Capital Profit' as "Excess of the proceeds realized from the sale, transfer or exchange of the whole or a part of a capital asset over its cost." (c) The capital profits are not distributable profits. This is supported by section 205 and Explanation of the term 'Capital Reserve' in section 293 of the Companies act, 1956. (d) In case the capital profits are credited to profit and loss account and appropriated to capital reserve subsequently, the book profit will be higher to that extent, thereby attracting Minimum Alternative Tax (MAT) even on capital profits.

21. (a) Following items appear in the trial balance of a foreign branch (integral foreign operation):

Head Office Account	Fixed Assets
Salaries and Wages	Sales
Creditors	Equity Share Capital
Opening Stock	Loans and Borrowings
Closing Stock	Sundry Debtors
Purchases	Provision for Taxes

Give the exchange rates to be applied for translation into Rupee. How would you treat the exchange difference?

- (b) Hind Export Ltd. exported goods for \$ 2,00,000 in February (exchange rate Rs. 48.38). The amount was received in June (exchange rate Rs. 48.43). The company closes books of accounts on March 31 every year. The exchange rate on 31st March current year was Rs. 48.50. Find out the exchange fluctuation gain/loss on the balance sheet date and on the date of receipt.
22. A Company held long term investments of another company, some of which were acquired on amalgamation. Despite losses made by the investee company, the investor has not provided for any diminution in value of these investments, considering future profitability of the investee company. The investee company has gone in for a capital reduction, reducing face value of shares from Rs. 10 to Rs. 7, thereby eliminating its accumulated losses. How is such devaluation recognized in the books of the investor company? If devaluation is to be recognised can the amalgamation reserve be used for that purpose?
23. A steel manufacturing company has a turnover of Rs. 45 crores and net pre-tax profit of Rs. 6 crores. The company's financial year ends on 31st March, 2005. Company's policy is to treat grants received in respect of fixed assets as deferred income and to deduct all grants identified as relating to specific revenue expenditure against that expenditure. All other grants recognized are credited to profit and loss account. Answer the following questions:
- (a) During the year the company received a grant from the Defence Department of Government of India for Rs. 3,00,000 towards the cost of new equipment. The equipment has an estimated useful economic life of ten years and cost Rs. 7,00,000. Company policy is to depreciate all depreciable fixed assets by the straight line method.
- (b) In December, 2004 the company spent Rs. 70,000 on training, in respect of which it is due to receive government grant of 50%. The grant formalities have been completed but payment is not expected until mid-June.
- (c) In October, 2005 a grant of Rs. 40,000 was received from the Government in recognition of the high quality, that the company's production had maintained over the five years, which had ended on 31st March, 2005, the previous year.

24. Advise X Ltd. on the Weighted Average Cost of Borrowing and the interest cost to be capitalised based on the following:

- (a) Total Borrowings and interest costs of X Ltd. for year ending 31st March, 2005 are as follows:

Borrowings	Date of Borrowings	Amount Rs. '000	Interest Rs. '000
18% Bank Loan	01.05.2003	1,000	180
14% Debentures	01.10.2004	2,000	140
16% Term Loan	01.07.2004	3,000	360
Total		6,000	680

- (b) Qualifying assets in which these borrowed funds are utilized are:

Assets	Rs. '000	Period
Factory Shed	2,500	12 months
Plant 1	1,500	9 months
Plant 2	1,000	7 months

25. (a) Transactions between two segments are routed through the head office account. For example, Division A sells its products to the Division B. The accounting entries would be as follows:

Accounting entries passed by Division A Head office account debit	Rs. 1 million	
Sales account credit		Rs. 1 million
Accounting entries passed by Division B Purchase account debit	Rs. 1 million	
Head office account credit		Rs. 1 million

The Head Office account is eliminated on an enterprise wide consolidation. Since inter-segment asset and liability balances are not available, would it be permissible to show these balances at the net amount?

- (b) Power Ltd. acquired 100% shares of Energy Ltd. prior to 31st March, 2004. During 2004-2005 the individual companies included in their financial statements the following items:

	Power Ltd.	Energy Ltd.
Officer's salary	1,17,500	32,340
Officer's expenses	99,000	10,000
Loans to Officers	7,25,000	3,67,000
Inter-company sales to Energy Ltd.	16,43,420	

The CEO and Finance Directors of the Company are unable to decide, whether the amount of Rs. 16,43,420 being sales from Power Ltd. to Energy Ltd. should get reported as related-party disclosure in the notes to Accounts, for the accounting period ended 31st March, 2005. Advise.

26. Lessee Ltd. has an asset of Rs. 1 lakh, which it depreciates at 10% on SLM method. At the end of the 5th year, it sells the asset at Rs. 60,000 (fair value) and leases it back for the remaining useful life of 5 years. Lessee Ltd. agrees to pay at the end of each of the 5 years a lease rental

of Rs. 15,000 and guarantees a residual value of Rs. 6,000 at the end of the lease term. Lessees incremental borrowing rate is 10%. The PV of Re. 1 @ 10% at the end of 5th year is 0.62 and annuity is 3.79. Advice on accounting in the books of both the lessor and Lessee Ltd.

27. As a statutory auditor for the year ended 31st March, 2005, how would you deal with the following:

As on 31st March, 2004, the equity share capital of Q Ltd. is 10 crores divided into shares of Rs. 10 each. During the financial year 2004-2005, it has issued bonus shares in the ratio 1 : 1. The net profit after tax for the years 31st March, 2004 and 31st March, 2005 is Rs. 8.50 crores and Rs. 11.50 crores respectively. The EPS disclosed in the accounts for two years is Rs. 8.50 and Rs. 5.75 respectively.

28. (a) In the first CFS, how should unrealized profits/losses arising from intra-group transactions of earlier years be adjusted.
- (b) Your client is a full tax free enterprise for the first 10 years and is in the second year of operations. Depreciation timing difference resulting in a deferred tax liability in Year 1 and 2 is Rs. 100 million and Rs. 200 million respectively. From the 3rd year and onwards it is expected that the timing difference would reverse each year by Rs. 5 million. Determine deferred tax liability at the end of 2nd year and the charge to the Profit and Loss Account if any. Assume tax rate @ 35%.
29. (a) A Company belonging to the process industry carries out three consecutive processes. The output of the first process is taken as input of the second process, and the output of the second process is taken as input of the third process. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period a time cost of production of the first process is 10% higher than the market price of the intermediate product available freely in the market. The company has decided to close down the first process as a measure of cost saving (vertical spin off) and outsource. Should this event be treated as discontinuing operation?
- (b) An enterprise that reports quarterly has an operating loss carry forward of Rs. 100 lakhs for income-tax purposes at the start of the current financial year for which a deferred tax asset has not been recognised. The enterprise earns Rs. 100 lakhs in the first quarter of the current year and expects to earn Rs. 100 lakhs in each of the three remaining quarters. Excluding the loss carry forward, the estimated average annual income-tax rate is expected to be 40 per cent. Calculate the amount of income-tax expense reported in each quarter.
- (c) A Ltd. expects to receive dividend income of Rs. 100 crores on its investments in the quarter October to December, 2005. It proposes to recognise Rs. 25 crores dividend income in interim financial statement of each quarter. Is this justified.
30. An Enterprise has incurred expense for purchase of Technical Know-how for manufacturing a Moped. The Enterprise has paid Rs. 5 crores for the use of Know-how for a period of 4 years. The Enterprise estimates the production of mopeds as follows:

Year	No. of Mopeds
1	25,000
2	50,000
3	75,000
4	1,00,000

On going into production, at the end of the 1st year it achieved its targeted production, but considered to revise the estimates for the next 3 years as follows:

Year	No. of Mopeds
1	35,000
2	65,000
3	80,000

- (a) How will the Enterprise amortise the Technical Know-how Fees as per AS-26?

- (b) Whether this amortisation should be directly charged as an expense or should form part of Production Cost of the Mopeds?
31. Rajesh Industries Ltd., is in the business of manufacturing and export. In 2005, the Government put a restriction on export of goods exported by Rajesh industries Ltd. leading to impairment of its assets. Rajesh Industries acquired at the end of 2001, identifiable assets worth Rs. 400 lakhs for Rs. 600 lakhs, the balance being treated as goodwill. The useful life of the identifiable assets is 15 years and depreciated on straight-line basis. When Government put the restriction at the end of 2005, the company recognized the impairment loss by determining the recoverable amount of assets at Rs. 272 lakhs. In 2007, the "restriction" was withdrawn by the Government and due to this favourable change Rajesh Industries Ltd. estimates its recoverable amount at Rs. 342 lakhs. You are required to:
- (a) Calculate and allocate impairment loss in 2005.
- (b) Compute amount of Reversal of impairment loss and its allocation in 2007.
32. (a) How should transactions of services rendered by a venturer to a Joint Venture (JV) or vice-versa be eliminated in the Consolidated Financial Statements (CFS) of the venturer?
- (b) A cellular venture has two equal joint venturers holding 50% each, Wall Ltd. being one of them from the Wall Group. The other party is from outside the Wall Group. Wall Ltd. actually represents three parties of the Wall Group companies including itself, each of which hold some equity in the cellular venture which aggregates 50% and is represented by Wall Ltd. Is proportionate consolidation to be applied by Wall Ltd. only or by Wall Ltd. and the two other companies?
33. (a) A Company gives cash rebate to customers for prompt payment of bills. At the end of the year, sales are made in respect of which cash is expected to be recovered in the following month (next financial year), which will entitle the customer to a rebate. At the end of the year is the Company required to make a provision for expected liability on account of cash rebate? The Company believes that from a matching concept expenditure on cash rebate should be matched with the sales revenue.
- (b) An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted. Is provision required for the above costs?
- (c) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?

SUGGESTED ANSWERS/HINTS

1. **Consolidated Balance Sheet of X Ltd.
and its subsidiaries Y Ltd. and Z Ltd.
as at 31st March, 2005**

		<i>(Rs. in lakhs)</i>	
<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
Share capital	300.00	Fixed Assets	
Minority Interest		X Ltd.	130.00
Y Ltd.	63.08	Y Ltd.	150.00
Z Ltd.	<u>16.22</u>	Z Ltd.	<u>100.00</u>
	79.30		

Capital Reserve	13.40		380.00	
		Less: Unrealised profit	<u>7.80</u>	372.20
Other Reserves	81.60	Stock		
Profit and Loss Account	56.90	X Ltd.	50.00	
Bills Payables		Y Ltd.	20.00	
X Ltd.	10.00	Z Ltd.	<u>20.00</u>	
Y Ltd.	<u>5.00</u>		90.00	
	15.00	Less: Unrealised profit	<u>1.00</u>	89.00
Less: Mutual indebtedness	<u>2.00</u>	13.00 Debtors		
		X Ltd.	70.00	
Creditors		Y Ltd.	10.00	
X Ltd.	30.00	Z Ltd.	<u>20.00</u>	
Y Ltd.	10.00		100.00	
Z Ltd.	<u>10.00</u>	Less: Mutual indebtedness	<u>5.00</u>	95.00
	50.00	Cash and Bank Balances		60.00
Less: Mutual indebtedness	<u>5.00</u>	45.00 Bills Receivables		
		Y Ltd.	10.00	
Current Account Balances		Z Ltd.	<u>20.00</u>	
			30.00	
X Ltd.	50.00	Less: Mutual indebtedness	<u>2.00</u>	28.00
Z Ltd.	<u>15.00</u>			
	65.00			
Less: Mutual indebtedness				
(10+ 30)	<u>40.00</u>	25.00		
Proposed Dividend	<u>30.00</u>			
	<u>644.20</u>			<u>644.20</u>

Working Notes:

	(Rs. in lakhs)		
(1) Analysis of Profits of Z Ltd.	Capital Profit	Revenue Reserve	Revenue profit
Reserves on 1.7.2004	10.00		
Profit and Loss A/c on 1.7.2004	16.00		
Increase in Reserves		20.00	
Increase in Profit			<u>24.00</u>
	26.00	20.00	24.00
Less: Minority Interest (10%)	<u>2.60</u>	<u>2.00</u>	<u>2.40</u>
	<u>23.40</u>	<u>18.00</u>	<u>21.60</u>
Share of X Ltd.	7.80	6.00	7.20
Share of Y Ltd.	15.60	12.00	14.40
(2) Analysis of Profits of Y Ltd.			
Reserves on 1.7.2004	20.00		
Profit and Loss A/c on 1.7.2004	30.00		

	Increase in Reserves		20.00	
	Increase in Profit			<u>20.00</u>
		50.00	20.00	20.00
	Share in Z Ltd.		<u>12.00</u>	<u>14.40</u>
		50.00	32.00	34.40
	Less: Minority Interest (20%)	<u>10.00</u>	<u>6.40</u>	<u>6.88</u>
	Share of X Ltd.	<u>40.00</u>	<u>25.60</u>	<u>27.52</u>
(3)	Cost of Control			
	Investments in Y Ltd.			180.00
	Investments in Z Ltd.			<u>120.00</u>
				300.00
	Less: Paid up value of investments			
	in Y Ltd.	160.00		
	in Z Ltd.	<u>90.00</u>	250.00	
	Capital Profit			
	in Y Ltd.	40.00		
	in Z Ltd.	<u>23.40</u>	<u>63.40</u>	<u>313.40</u>
	Capital Reserve			<u>13.40</u>
(4)	Minority Interest	Y Ltd.	Z Ltd.	
	Share Capital	40.00	10.00	
	Capital Profit	10.00	2.60	
	Revenue Reserves	6.40	2.00	
	Revenue Profits	<u>6.88</u>	<u>2.40</u>	
		63.28	17.00	
	Less: Unrealised profit on stock (20% of 1)	.20		
	Unrealised profit on equipment (10% of 7.8)		<u>.78</u>	
		<u>63.08</u>	<u>16.22</u>	
(5)	Unrealised Profit on equipment sale			
	Cost	24.00		
	Profit	<u>8.00</u>		
	Selling Price	<u>32.00</u>		
	Unrealised profit = $8 - 8 \times \frac{10}{100} \times \frac{3}{12} = 8.00 - 0.20 = 7.80$			
(6)	Profit and Loss Account – X Ltd.			
	Balance	60.00		
	Less: Proposed Dividend	<u>30.00</u>		
		30.00		
	Share in Y Ltd.	27.52		
	Share in Z Ltd.	<u>7.20</u>		
		64.72		
	Less: Unrealised profit on equipment (90% of 7.8)	<u>7.02</u>		
		57.70		

Less: Unrealised profit on stock $\left(5 \times \frac{25}{125} \times 80\%\right)$	.80
	<u>56.90</u>
(7) Reserves – X Ltd.	
X Ltd.	50.00
Share in Y Ltd.	25.60
Share in Z Ltd.	<u>6.00</u>
	<u>81.60</u>

2.

In the books of Varun Ltd.**Realisation Account**

	Rs.		Rs.
To Sundry Assets (5,80,000 – 10,000)	5,70,000	By Gratuity Fund	20,000
To Preference Shareholders		By Sundry Creditors	80,000
(Premium on Redemption)	10,000	By Hans Ltd.	
To Equity Shareholders		(Purchase Consideration)	5,30,000
(Profit on Realisation)	<u>50,000</u>		
	<u>6,30,000</u>		<u>6,30,000</u>

Equity Shareholders Account

	Rs.		Rs.
To Preliminary Expenses	10,000	By Share Capital	3,00,000
To Equity Shares of Hans Ltd.	4,20,000	By General Reserve	80,000
		By Realisation Account	
		(Profit on Realisation)	<u>50,000</u>
	<u>4,30,000</u>		<u>4,30,000</u>

Preference Shareholders Account

	Rs.		Rs.
To 9% Preference Shares of Hans Ltd.	1,10,000	By Preference Share Capital	1,00,000
		By Realisation Account	
		(Premium on Redemption of Preference Shares)	<u>10,000</u>
	<u>1,10,000</u>		<u>1,10,000</u>

Hans Ltd. Account

	Rs.		Rs.
To Realisation Account	5,30,000	By 9% Preference Shares	1,10,000
		By Equity Shares	<u>4,20,000</u>
	<u>5,30,000</u>		<u>5,30,000</u>

**In the books of Hans Ltd.
Journal Entries**

		<i>Dr.</i> <i>Amount</i> <i>Rs.</i>	<i>Cr.</i> <i>Amount</i> <i>Rs.</i>
Goodwill Account	Dr.	50,000	
Building Account	Dr.	1,50,000	
Machinery Account	Dr.	1,60,000	
Stock Account	Dr.	1,57,500	
Debtors Account	Dr.	1,00,000	
Bank Account	Dr.	20,000	
To Gratuity Fund Account			20,000
To Sundry Creditors Account			80,000
To Provision for Doubtful Debts Account			7,500
To Liquidators of Varun Ltd. Account			5,30,000
(Being Assets and Liabilities takenover as per agreed valuation)			
Liquidators of Varun Ltd. Account	Dr.	5,30,000	
To 9% Preference Share Capital Account			1,10,000
To Equity Share Capital Account			4,00,000
To Securities Premium Account			20,000
(Being Purchase Consolidation satisfied as above)			

**Balance Sheet of Hans Ltd. (after absorption)
as at 31st March, 2005**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
<i>Share Capital:</i>		<i>Fixed Assets:</i>	
2,100, 9% Preference Shares of Rs. 100 each	2,10,000	Goodwill	1,00,000
1,40,000 Equity Shares of Rs. 10 each fully paid	14,00,000	Building	4,50,000
(1,100, 9% Preference Shares and 40,000 Equity Shares were issued in consideration other than for cash)		Machinery	6,60,000
Reserves and Surplus:	20,000	Current Assets:	
Securities Premium		Stock	4,07,500
General Reserve	1,00,000	Debtors	3,00,000
Current Liabilities:		Less: Provision for bad debts	<u>7,500</u>
Gratuity Fund	70,000		2,92,500
Sundry Creditors	<u>2,10,000</u>	Cash and Bank	70,000
	<u>20,10,000</u>	Miscellaneous expenses to the extent not written off:	
		Preliminary expenses	30,000
			<u>20,10,000</u>

Working Notes:

Purchase Consideration:

Purchase Consideration:	<i>Rs.</i>
Goodwill	50,000
Building	1,50,000
Machinery	1,60,000
Stock	1,57,500
Debtors	92,500
Cash at Bank	<u>20,000</u>
	6,30,000

Less: Liabilities:

Gratuity	20,000
Sundry Creditors	<u>80,000</u>
Net Assets	<u>5,30,000</u>

To be satisfied as under:

10% Preference Shareholders of Varun Ltd.	1,00,000
Add: 10% Premium	<u>10,000</u>
1,100, 9% Preference Shares of Hans Ltd.	1,10,000
Equity Shareholders of Varun Ltd. to be satisfied by issue of 40,000 equity shares of Hans Ltd. at 5% Premium	<u>4,20,000</u>
Total	5,30,000

3. (a) (i) Net Assets Method:

Net Assets Method:		<i>Rs.</i>
Goodwill as revalued		50,000
Tangible Fixed Assets (revalued)		3,50,000
Current Assets (as per balance sheet)		<u>4,00,000</u>
		8,00,000
Less: 14% Debentures	1,00,000	
Current liabilities	<u>1,30,000</u>	<u>2,30,000</u>
Net Assets		5,70,000

$$\text{Value per share} = \text{Net assets} / \text{No. of shares}$$

$$= \text{Rs. } 5,70,000/40,000$$

= Rs. 14.25

(ii) **Yield Method:**

Average profits for last 3 years	1,03,500
Less: Transfer to general reserve @ 20%	<u>20,700</u>
	82,800

$$\text{Expected return on equity} = \frac{\text{Rs. } 82,000}{\text{Rs. } 4,00,000} \times 100 = 20.7\%$$

$$\text{Value per share} = \frac{20.7}{18} \times 10 = \text{Rs. } 11.50$$

- (b) (i) (a)** Buying a small lot of equity shares: If the purpose of valuation is to provide data base to aid a decision of buying a small (non-controlling) position of the equity of the companies, dividend capitalisation method is most appropriate. Under this method, value of equity share is given by:

$$\frac{\text{Dividend per share}}{\text{Market capitalisation rate}} \times 100$$

$$\text{Company A : Rs. } \frac{2.4}{18} \times 100 = \text{Rs. } 13.33$$

$$\text{Company B : Rs. } \frac{2.08}{18} \times 100 = \text{Rs. } 11.56$$

(b) **Buying controlling interest equity shares**

If the purpose of valuation is to provide data base to aid a decision of buying controlling interest in the company, EPS capitalization method is most appropriate. Under this method, value of equity is given by:

$$\frac{\text{Earning per share (EPS)}}{\text{Market capitalisation rate}} \times 100$$

$$\text{Company A : Rs. } \frac{3}{18} \times 100 = \text{Rs. } 16.67$$

$$\text{Company B : Rs. } \frac{2.6}{18} \times 100 = \text{Rs. } 14.44$$

- (ii) Preference Dividend coverage ratios of both companies are to be compared to make such decision.

Preference dividend coverage ratio is given by:

$$= \frac{\text{Profit after tax}}{\text{Preference Dividend}}$$

$$\text{Company A : } \frac{\text{Rs. } 3,00,000}{\text{Rs. } 60,000} = 5 \text{ times}$$

$$\text{Company B : } \frac{\text{Rs. } 3,00,000}{\text{Rs. } 40,000} = 7.5 \text{ times}$$

If we are planning to invest only in preference shares, we would prefer shares of B Company as there is more coverage for preference dividend.

Working Notes:

Computation of earning per share and dividend per share (companies distribute 80% of profits)

	<i>Company A</i>	<i>Company B</i>
Profit before tax	3,00,000	3,00,000
Less: Preference dividend	<u>60,000</u>	<u>40,000</u>
Earnings available to equity shareholders (A)	<u>2,40,000</u>	<u>2,60,000</u>
Number of Equity Shares (B)	80,000	1,00,000
Earning per share (A/B)	3.0	2.60
Retained earnings – 20%	48,000	52,000
Dividend declared – 80% (C)	1,92,000	2,08,000
Dividend per share (C/B)	2.40	2.08

4. Gross Value Added Statement of F Ltd.

	<i>Rs. ('000)</i>	<i>Rs. ('000)</i>	<i>%</i>
Sales		28,500	
Less: Cost of materials and services			
Operating cost	15,400		
Excise Duty	1,700		
Interest on bank overdraft	<u>100</u>	<u>17,200</u>	
Value added by manufacturing and trading activities		11,300	
Add: Other Income		<u>750</u>	
Total Value added		<u>12,050</u>	
Application of Total Value added			
A To Pay employees			
Wages, salaries and other benefits		10,200	84.65
B To Pay Government			
Corporation Tax		200	1.60
C To Pay Providers of capital			
Interest on 12% Debentures	1,150		
Dividend	<u>50</u>	1,200	9.60
D To Provide for maintenance and expansion of company			
Depreciation	250		
Replacement Reserve	30		
Deferred Tax	70		
Retained Profit	<u>100</u>	<u>450</u>	<u>4.15</u>
		<u>12,050</u>	<u>100.00</u>

Reconciliation between Total Value Added and Profit before Taxation

	<i>Rs. ('000)</i>	<i>Rs. ('000)</i>
Profit before tax		450
Add: Depreciation	250	
Wages, salaries	10,200	
Debenture Interest	<u>1,150</u>	<u>11,600</u>
Total Value Added		<u>12,050</u>

Note:

- (i) Deferred Tax can also be shown as 'To Pay Government'.
- (ii) Bank Overdraft being a temporary source of finance, has been considered as a provision of a banking services, therefore interest thereon is taken as part of cost of bought in material and services.

5. (a) Statement of Changes in Loan Fund Balance

	<i>Rs.</i>
(1) Fund Balance at the beginning of the year	<u>30,22,500</u>
(2) Additions during 2004-2005	
Private and Government Grants	7,50,000

	Investment income	22,500
	Interest on loan	<u>37,500</u>
		<u>8,10,000</u>
(3)	Deductions during 2004-2005	
	Refunded to grantors	30,000
	Loans cancellation and write off	15,000
	Administration & Collection Costs	<u>22,500</u>
		<u>67,500</u>
(4)	Transfer from other funds	
	Mandatory:	
	Loan fund matching grant from revenue funds	15,000
	Non-Mandatory:	
	Other transfers from unrestricted revenue funds	<u>1,50,000</u>
		<u>1,65,000</u>
(5)	Net Additions {(2) – (3) + (4)}	<u>9,07,500</u>
(6)	Fund Balance at the end of the year {(1) + (5)}	<u>39,30,000</u>

- (b) The annuity and life income funds account for resources that are given to a non profit organisation provided that the organisation agrees to make periodic payment to a stated person. In case of annuity funds the agreement stipulates that periodic payments are made to a certain person for a specified amount for a specified period of time. Life income funds distribute their income to the individuals as long as they live. When the beneficiary dies, the funds become the property of the organisation and are used as specified in the gift agreement.

Annuity funds pay a fixed amount periodically whereas life income fund payments vary with the amount of income earned.

6. (a) A key to wiring EVA into the corporate culture is to make it the focal point for reporting, planning and decision-making. The first is the recognition that, because EVA is a measure of total factor productivity, it can and should supersede other financial and operating measures, resulting in a hierarchical as opposed to a “balanced” scorecard approach. If EVA is merely added to a list of many other performance measures, confusion and unnecessary complexity will arise. The second requirement is that EVA should be incorporated into the decision making process. While simply, measuring EVA can give companies a better focus on how they are performing, its true value comes in using it as the foundation for a comprehensive financial management system that encompasses all policies, procedures, methods and measures that guide operations and strategy. Just measuring EVA is not enough, it is important for an organisation, implementing EVA, to change behaviour of its managers and employees. It is important that these managers and employees think, act and are paid like owners. There should be enough freedom given to them to make decision and also hold them responsible for results. The managers and employees are required to operate in an improved set of corporate governance framework which should be self-propelling, self disciplining and self-correcting.
- (b) **Cost of Capital:** The term ‘Cost of Capital’ means the cost of long term funds of a company. It is the multiple of ‘Capital Employed’ and ‘Weighted Average Rate of Cost of Debt Capital’, ‘Cost of Equity Capital’ and ‘Cost of Preference Share Capital’. This is why cost of capital is known as Weighted Average Cost of Capital (WACC). WACC is post tax. Capital Employed represents the total of Debt Capital, Equity Capital and Preference Share Capital. The mix of Debt and Equity Capital has a vital role in the cost of capital. Equity Capital is generally more costlier than Debt Capital. Use of Debt Capital increases interest

payment risk, reduces WACC and increases Equity Shareholder's return. Optimum Debt Equity mix should always be aimed at considering the trade-off in between risk and return.

7. (a) (i) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

- (i) Ascertain the number of employees in each rank.
- (ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.
- (iii) Ascertain the economic value of an employee in a specified rank during each time period.
- (iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process, they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

- (ii) **Opportunity Cost:** It is one of the Economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.

- (b) Corporate Social Reporting is the information communicate with respect to discharge of social responsibilities of corporate entity. The transition in accounting function from historical cost based profitability accounting to social responsibility accounting is a good fit to the present-day data requirement of the "Users of accounts".

The content of Corporate Social Report is essentially based on the social objectives. Brummet identified five areas wherein social objectives can be traced out, namely, Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

In view of the social objectives, the importance of earning objective is not understated, rather attainment of social objectives is dependent on earning objective. A sick business entity becomes liability to the society and sustains social costs instead of generating social benefits.

Human Resource Contribution is the indicator of the impact of organisational activities (viz. pay and allowances, perks and incentives, recruitment, training and development, placement, promotion and transfer, welfare measure, etc.) on people of the organisation. Public Contribution is the indicator of general philanthropy in the cultural and social welfare programmes and contribution to national exchequer by way of tax and duties..

Industrial activity is supposed to consume irreplaceable resources and produces solid wastes. By this process it pollutes air and water, causes noise and spoils the environment.

These are termed as negative social effects. The corporate social objective is the abatement of such negative effect. It is covered by environmental contribution.

Lastly, the Product or Service Contribution covers the qualitative aspects of the organisation's product or service. It includes quality guarantee, redressal of customers' grievances, honest exposure in advertisement etc.

Although Brummet covered wide range of objectives, still these are not essentially exhaustive. Social objectives are determined by socio-economic conditions of a country. It is difficult to set universal list of social objectives to be pursued by the corporate sector. For example, in India, regional imbalance, unemployment, reservation for weaker sections of the population, scarcity of foreign exchange, energy deficit, population pressure and illiteracy are some of the widely accepted socio-economic problems. And obviously the general expectation is that the corporate sector will positively contribute to such socio-economic problems. Since the socio-economic problems of a country change over time or the priority attached to a problem shifts. Brummet's over simplified set of contributions should be suitably moulded to fit in the perspective of socio-economic problems of a country.

8. (a) Earning value means the value of an equity share calculated by taking the average profits after tax as reduced by preference dividend and adjustments for extraordinary and non-recurring items of the immediately three preceding years and further divided by the number of equity shares and capitalised at the following rate:

Predominantly manufacturing company	8%
Predominantly trading company	10%
Any other company including NBFC	12%

Earning value is zero in a loss making company.

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

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

to the extent such discounted value does not exceed fifty per cent of Tier-I capital.

9. (a) According to Eleventh Schedule, the annual report of a mutual fund shall contain:
- Report of the Board of Trustees on the operations of the various schemes of the fund and the fund as a whole during the year and the future outlook of the fund;
 - Balance Sheet and Revenue Account in accordance with paras 2, 3 and 4 respectively of the Eleventh Schedule;
 - Auditor's Report in accordance with paragraph 5 of the Eleventh Schedule;
 - Brief statement of the Board of Trustees on the following aspects, namely:-
 - Liabilities and responsibilities of the Trustees and the Settlor;
 - Investment objective of each scheme;
 - Basis and policy of investment underlying the scheme;

- (d) If the scheme permits investment partly or wholly in shares, bonds, debentures and other Scrips or securities whose value can fluctuate, a statement on the following lines:

“The price and redemption value of the units, and income from them, can go up as well as down with the fluctuations in the market value of its underlying investments.”

- (e) Comments of the Trustees on the performance of the scheme, with full justification.
- (v) Statement giving relevant perspective historical ‘per unit’ statistics in accordance with paragraph 6 of the Eleventh Schedule;
- (vi) Statement on the following lines:

“On written request, present and prospective unitholders/investors can obtain copy of the trust deed, the annual report [at a price] and the text of the relevant scheme.”

- (b) (1) Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis;

Provided that the income from dividend on shares of corporate bodies may be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the NBFC’s right to receive payment is established.

- (2) Income from bonds and debentures of corporate bodies and from Government Securities/bonds may be taken into account on accrual basis;

Provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.

- (3) Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been guaranteed by the Central Government or a State Government may be taken into account on accrual basis.

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

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

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

- 11. Environmental Accounting is useful for disclosing how natural resources are available in the country, their incomes and the costs incurred to use them and their depreciation, values etc. It is also helpful for measuring industrial development and social welfare and the fulfillment of social responsibilities by companies. The problem of environment protection is becoming more and more serious. Environmental accounting will help in evaluating this serious problem. Enterprises do not live in isolation and in order to maximize wealth, they take the support of social and ecological systems. Economic activity, social welfare and a diverse environment all are linked

and ultimately depend on each other. Recognising the importance of protecting and preserving the environment, a number of laws have been enacted throughout the world.

12. (a) (i) **Exercise of an Option:** Exercise of an Option means enforcing the right by the Option Buyer/Holder available under the option contract of buying or selling the underlying asset at the Strike Price.
- (ii) **Daily Settlement Price:** Daily Settlement Price is the closing price of the equity index/stock futures contract for the day or such other price as may be decided by the Clearing House from time to time.
- (iii) **Open Interest:** Open Interest means the total number of Equity Derivative Instruments contracts that have not yet been offset and closed by an opposite contract nor fulfilled either by delivery of cash or by actual delivery of underlying security.
- (iv) **Put Option:** Put Option is an Option to sell the specified underlying asset on or before the Expiry Date.
- (b) Payments made or received on account of Mark-to-Market Margin by the Client would be credited/debited to the bank account and the corresponding debit or credit for the same should be made to an appropriate account, say, 'Mark-to-Market Margin – Equity Index Futures Account' or 'Mark-to-Market Margin – Equity Stock Futures Account', as the case may be.

The amount of Mark-to-Market Margin received into/paid from lumpsum deposit with the Clearing/Trading Member should be debited/credited to the 'Deposit for Margin Money Account' with a corresponding credit/debit to the 'Mark-to-Market Margin – Equity Index Futures Account' or the 'Mark-to-Market Margin – Equity Stock Futures Account', as the case may be.

13. (a) Effects of changes in foreign exchange rates.
- The revised IAS 21 makes no distinction between integral foreign operation and non-integral foreign operation.
 - An entity is required to determine functional currency and measure results and financial position in that currency.
 - If financial statements are presented in any currency other than functional currency, the assets/liabilities are required to be translated at closing rate and incomes/expenses at average rate.
 - AS 11 provides separate treatment for integral and non-integral operations.
 - There is no concept of functional currency.
 - AS 11 does not contain any such requirement.
- (b) Segment reporting
- As per IAS 14, a business segment can be treated as a reportable segment, only if, inter alia, majority of its revenue is earned from sales to external customers.
 - As per AS 17, if segment revenue is not less than 10% of total revenue of all segments comprising both external and inter-segment sales, it becomes a reportable segment and if total external revenue of reportable segments constitutes less than 75% of total enterprise revenue, it means additional segments needs to be identified as reportable

		segments even if they do not meet 10% threshold.
	• IAS 14 prescribes treatment of revenue, expenses, profit / loss, assets and liabilities related with associates and joint ventures in consolidated financial statement. • If a reportable segment ceases to meet threshold requirements, then also it remains reportable for one year if management judges the segment to be of continuing significance.	• AS 17 does not cover the aspect of treatment in consolidated financial statements. • This is mandatory under AS 17 irrespective of judgement by management.
(c) Accounting for amalgamations	• Only purchase method is allowed under IFRS 3. • Assets and liabilities are valued at fair value and goodwill is tested for impairment. • IFRS 3 requires recognition of negative goodwill immediately in the profit and loss account. • IFRS 3 requires revaluation of financial assets to be dealt with as per IAS 39.	• Both pooling of interest and purchase method are permitted. • Valuation is done at carrying values and goodwill is amortised. • It is required to be credited to capital reserve. • AS 14 does not contain such provision.

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

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

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

15. Stock of crude oil in pipelines and dead stock in tanks can be neither capitalized as fixed assets nor valued at a fixed base price. They have to be valued in accordance with AS 2 at lower of cost or Net Realisable Value, and cost is determined using the FIFO or weighted average method.

The stock in pipelines and dead stock in tanks cannot be capitalised as a fixed asset irrespective of ownership of the pipelines. The dead stock in tanks cannot be valued at a fixed price without any changes made for changes in day-to-day prices.

The stock in pipelines can be valued at standard cost if the results approximate the actual cost. In case this method is used, the standard cost should be regularly reviewed and if necessary, should be revised in the light of current conditions. It would not be proper to adopt the same standard cost without changing it or revising it in the light of current conditions.

The increase/decrease in the value of stocks cannot be maintained as a reserve/deferred loss.

The provisions of AS 2 are applicable to valuation of inventories of raw materials as well as to finished products. Accordingly, the above opinion is applicable to valuation of inventories of both raw materials as well as finished products.

16. According to AS 4, "assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. Assets and liabilities should not be adjusted for but disclosure should be made in the report of the approving authority of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise." Bank balance as on the date of balance sheet should not be adjusted by passing a reversal entry since the event of cancellation of cheque after the balance sheet date did not relate to conditions existing at the balance sheet date. However, if the amount of the cheque is material enough to affect the financial position of the company, its disclosure should be made in the report of the approving authority.
17. (a) As per AS 6, useful life is the period over which a depreciable asset is expected to be used by the enterprise. This estimation is required to be made by the enterprise that acquires the asset, irrespective of whether the asset was used earlier or not. Sagar Ltd. need not consider the period over which the asset was used by the seller, though this may provide an useful basis for determining the remaining useful life of the asset. Sagar Ltd. should provide depreciation based on the 7 year useful life provided they do not derive rates that are not lower than the Schedule XIV rates. Providing depreciation based on a 7 year useful life rather than a 4 year useful life would not tantamount to revaluation of asset, since the ownership of the asset has changed.
- (b) In this case, it is first necessary to determine the historical cost of the plant and machinery. This is shown in the following table.

	<i>Rs. in lakhs</i>
Purchase price	40
Less: Specified duty against which MODVAT credit is available	<u>5</u>
Cost of plant & machinery for accounting purposes	35
Less: Subsidy provided by State Government	<u>7</u>
Depreciable Amount	<u>28</u>

18. (a) Losses sustained as a result of enemy action constitute an extraordinary item since it is an event which is clearly distinct from the ordinary activities of the enterprise and is not expected to recur frequently or regularly. As per AS 5, the nature and amount of each extraordinary item should be separately disclosed in a manner that its impact on current profit or loss can be perceived.
- (b) AS 13 on "Accounting for Investments" requires that on disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to profit and loss account. AS 5 (Revised) requires separate disclosure of items of income/expense from ordinary activities if their size, nature or incidence makes their disclosure relevant to explain entity's performance. The disposal of long-term investments, may fall in this category requiring separate disclosure particularly in view of the fact that "disposal of long-term investments" is visualized as one of the circumstances in AS 5 itself.

19. (a) (i) Incorrect: It is an investing activity.
 (ii) Correct.
- (b) The practice is not in consonance with AS 9. Revenue from sale of goods should be recognized on fulfillment of the following conditions:
- the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
 - no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the steel plants. The invoice raised by S Ltd. is for the full price. S Ltd. receives 90% only as 10% is kept as 'Retention Money'. Thus, S Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sale price.

Depending on the past experience of recovering the balance 10% from the steel plants, S Ltd. can make a provision for sales income which is not likely to be realized.

20. The policy of the company of crediting the excess of sale proceeds of fixed assets over their original cost to capital reserve is not appropriate. The appropriate treatment would be to credit the entire excess of sale proceeds over the net book value of the fixed assets concerned to the profit and loss account. The following arguments are relevant: (a) AS 10 does not prescribe a different treatment for gains representing the excess of sale proceeds over the original cost – it requires the entire gain to be taken to the profit and loss account (b) As per Part II of Schedule VI to the Companies Act, 1956, requires that the profit and loss account should clearly disclose the result of working of the company during the period and also disclose every material feature, including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature. It is noted that the above requirements do not make any distinction between what are often referred to as capital profits and other profits – all credits relating to the working of the company during the period are required to be recognised in the profit and loss account. Schedule VI specifically requires that profit on investments should be recognized in the profit and loss account (except to the extent the same has been adjusted against any previous provision or reserve) even if they have been held for long-term, as in the case of fixed assets. Therefore the entire amount of excess of sale proceeds over the net book value of the assets concerned should be recognized in the profit and loss account (c) Section 293, to which a reference has been made by the company, does not explain the term 'capital reserve'. This, however, does not have any bearing on the opinion.
21. (a) Different items will be translated at different exchange rates as follows:

<i>Exchange Rate of Opening Date</i>	<i>Exchange Rate of Closing Date</i>	<i>Average Exchange Rate</i>	<i>Specific Exchange Rate</i>
1. Opening stock	1. Creditors	1. Salaries and Wages	1. Fixed Assets
	2. Closing stock	2. Purchases	2. Equity Share Capital
	3. Loans and Borrowings	3. Sales	
	4. Sundry Debtors		
	5. Provision for tax		

The Head Office A/c will be translated at the value appearing in the Branch A/c of the Indian Parent Company.

The difference due to translation, known as exchange difference, will be shown in the Profit and Loss A/c of the current year.

(b)

Hind Export Ltd.

	<i>Rs.</i>
Debtors on the date of transaction (2,00,000 × Rs. 48.38)	96,76,000
Debtors on the balance sheet date (2,00,000 × Rs. 48.50)	<u>97,00,000</u>
Exchange difference gain on balance sheet date	<u>24,000</u>
Amount received on the due date (2,00,000 × Rs. 48.43)	96,86,000
Therefore exchange difference loss on the date of receipt (Rs. 97,00,000 – Rs. 96,86,000)	<u>14,000</u>

22. The diminution in the value of investments is required to be provided for based on the investors assessment of the investee company and its potential to generate enough returns in future to justify the carrying value of the investments. The capital reduction and consequent reduction in the face value of shares would not on its own result in a diminution in value in the books of the investor but would nevertheless be a strong indicator for making a diminution provision, though this could be mitigated if it is expected that the investee company has a bright future. If a diminution provision is required the same would have to be adjusted against current results and past amalgamation or capital reserve cannot be used for the purpose.

23. (a) This is a case of Government grant received relating to specific fixed assets. There are two methods for dealing this grant in accounts.

Method 1 – Grant can be shown as an outright deduction from the gross value of the asset. In this method, the depreciation will be Rs. 40,000 based on SLM (assumed) i.e., 10% of (Rs. 7,00,000 – Rs. 3,00,000). In this method the grant is recognized in the profit and loss statement over the useful life of depreciable asset by way of a reduced depreciation charge.

Method 2 – The grant related to depreciable asset is treated as deferred income and recognized in the profit and loss statement on a systematic and rational basis over the useful life of asset.

(i)

Profit and Loss Account (Extract)

	<i>Rs.</i>	<i>Rs.</i>
Depreciation	70,000	
Less: Proportionate deferred Government grant for the year	<u>30,000</u>	40,000

(ii)

Balance Sheet (Extract)

<i>Liabilities</i>		<i>Assets</i>	
Share Capital	XXX	Fixed Assets	
Reserve and Surplus	XXX	Gross	7,00,000
Deferred Govt. Grant	2,70,000	Less: Depreciation	<u>70,000</u>
Loan	XXX		6,30,000

- (b) The Government grant to be received can be shown either as income or as deduction from training expense. As the grant has not been received till the year end, it has to be shown as receivable.

- (c) The grant amount received should be credited to profit and loss account in the current year, i.e., 2005-2006.

24. Computation of Weighted Average Borrowing Cost for X Ltd.

Step 1 : Computation of total products of all borrowings

	<i>Nature of Borrowing</i>	<i>Date</i>	<i>Cumulative Amount</i>	<i>Number of months</i>	<i>Product</i>
1	18% Bank Loan	01.04.2004	1,000	3	3,000
2	16% Term Loan	01.07.2004	4,000	3	12,000
3	14% Debentures	01.10.2004	6,000	<u>6</u>	<u>36,000</u>
				<u>12</u>	<u>51,000</u>

Step II : Computation of Weighted Average Borrowings (Product/months)

Total products as in Step 1	51,000	
Number of months	12	
Average borrowing	4,250	(51,000/12)

Step III : Identifying borrowing cost incurred by the company: This is given as 680

Step IV : Determining capitalisation rate: $\text{Borrowing Cost/Weighted Average Borrowings} \times 100$

This works out to $680/4,250 \times 100$: 16%.

Step V : Capitalisation of borrowing cost:

<i>Assets</i>	<i>Expenditure</i>	<i>Cost at 16% for Number of months</i>	<i>Borrowing cost to be capitalised</i>
Factory Shed	2,500	12	400.00
Plant 1	1,500	9	180.00
Plant 2	<u>1,000</u>	7	<u>93.33</u>
Total	<u>5,000</u>		<u>673.33</u>

In this connection, it is worthwhile to note the Interpretation 1 issued by the ICAI. An extract from this is reproduced below:

It has been clarified that primarily “substantial period of time” depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time, unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially to get ready for its intended use or sale should be considered. Assets that generally take substantial period of time include assets which are a part of major capital expansion.

25. (a) In sum, inter-segment assets and liabilities cannot be netted off.

The Standard requires that all inter segment receivables/payables are captured and recorded and then eliminated only through the ‘Elimination’ column of the Segmental disclosure. A practical difficulty is that these balances would keep on increasing year after year as they are not cash settled. It is important therefore that inter segment assets/liabilities are cash settled, else the balance should remain outstanding as in the case of any third party debtor or creditor.

(b) Paragraph 7 of AS 18, reads as under: “No disclosure is required in consolidated financial statements, in respect of intra-group transactions” in as much as the transactions themselves would get eliminated in the consolidation process. It is also unnecessary because Consolidated Financial Statement presents information about the holding and its subsidiary as a single reporting enterprise.

26. In the books of the lessee

- The leaseback is a finance lease since it covers almost all of the remaining useful life of the asset.
- The PV of the MLP = $(3.79 \times 15,000) + (0.62 \times 6,000) = \text{Rs. } 60,570$
- A finance lease is capitalized at fair value or PV of MLP if that is lower than fair value. Since in the given case, the PV is much higher than the fair value of the asset, Rs. 60,000, the asset will be capitalized at its fair value of Rs. 60,000.
- The new carrying value of the asset (Rs. 60,000) less the residual value (Rs. 6,000) will be equally depreciated over the next 5 years (Rs. 10,800 each year).
- The profit on lease back Rs. 10,000 will not be recognized immediately but taken credit of in the next 5 years in proportion to the depreciation charge. In this case, each year Rs. 2,000 will be released to the credit of the Profit and Loss Account over the next 5 years.
- The interest charge will be determined in accordance with the reducing balance method (IRR method).

In the books of the lessor

As far as the lessor is concerned, he makes an investment of Rs. 60,000 in respect of which he receives Rs. 75,000 over the next 5 years and a residual value of Rs. 5,000. This gives him an IRR of 9.8%, which will be recognized as follows:

<i>Principal outstanding</i>	<i>MLPs</i>	<i>Income @ 9.98%</i>	<i>Principal redeemed</i>
60,000	15,000	5,988	9,012
50,988	15,000	5,089	9,911
41,077	15,000	4,099	10,901
30,176	15,000	3,012	11,988
18,188	<u>20,000</u>	<u>1,812</u>	<u>18,188</u>
	<u>80,000</u>	<u>20,000</u>	<u>60,000</u>

The principal outstanding will appear as a recoverable amount in the balance sheet of the lessor.

27. Paragraph 24 of AS-20 states as follows:

“In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported.”

	31st March, 2005	31st March, 2004
(a) Net profit (Rs. in lakhs)	1,150	850
(b) Share capital (Nos. in lakhs)	200	100
(c) Adjusted share capital to give bonus effect	200	200
(d) EPS per share	5.75	4.25

- 28. (a)** Adjustments to opening balances, consequent to applying uniform accounting policies, should be adjusted in the opening balance of reserves and in the case of inadequacy of reserves to the accumulated losses. The same position will apply in the case of unrealized profits/losses arising from intra-group transactions of earlier years, which should be adjusted against opening balance of reserves and in the case of inadequacy of reserves to the accumulated losses.

- (b) In case of tax free companies, no deferred tax liability is recognised in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability (or asset) is created in respect of timing difference that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method. Of the Rs. 100 million, Rs. 40 million will reverse in the tax holiday period. Therefore, deferred tax liability will be created on Rs. 60 million at the tax rate of 35%, i.e., Rs. 21 million. In the second year, the entire Rs. 200 million will reverse only after the tax holiday period; therefore, deferred tax charge in the profit and loss account will be Rs. 70 million ($200 \times 35\%$) and deferred tax liability in the balance sheet will be Rs. 91 million ($70 + 21$).
29. (a) The change made by the company is focused on outsourcing of services, in respect of one single process – in a sequence of processes. The net effect of this change is closure of one facility relating to a process.

This has been done by the company with a view to achieving productivity improvements and savings in costs.

Such a change does not meet definition criteria in paragraph 3(a) of AS 24 – namely, disposing of substantially in its entirety, such as by selling a component of the enterprise in a single transaction. The change is merely a cost-saving endeavour. Hence, this change over is not a discontinuing operation.

- (b) The estimated payment of the annual tax on Rs. 400 lakhs of earnings for the current year would be Rs. 120 lakhs $\{(Rs. 400 \text{ lakhs} - Rs. 100 \text{ lakhs}) \times 40\%\}$. Considering the loss carry forward, the estimated average annual effective income-tax rate would be 30% $\{(Rs. 120 \text{ lakhs}/Rs. 400 \text{ lakhs}) \times 100\}$. This average annual effective income-tax rate would be applied to earnings of each quarter. Accordingly, tax expense would be as follows:

	<i>(Amount in Rs. lakhs)</i>				
	<i>1st Quarter</i>	<i>2nd Quarter</i>	<i>3rd Quarter</i>	<i>4th Quarter</i>	<i>Annual</i>
Tax expense	30	30	30	30	120

- (c) As per para 36 of AS 25 revenues received seasonally/occasionally should be recognized as they occur and not be anticipated/deferred. Hence, entire 100 crores to be recognized in October to December, 2005, quarterly statement.
30. Based on the revised estimate, total sales is 2,05,000, the first year charge should be a proportion of 25,000/2,05,000 on Rs. 5 crores, second year will be 35,000/2,05,000, and so on unless the estimates are again revised. If these estimates cannot be determined reliably it would be preferable to charge them off on a straight line basis, otherwise, as can be seen from the above example, significant amortisation amount is inappropriately postponed to later years. As already mentioned above, there will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method. In the given case, amortisation expense will be included as cost of inventory.

31. Step 1 : Calculation and allocation of impairment loss for the year ended 31.3.2005

	<i>(Amount Rs. in lakhs)</i>		
<i>End of 2005</i>	<i>Goodwill</i>	<i>Identifiable Asset</i>	<i>Total</i>
(a) Historical cost	200	400	600
(b) Accumulated /Amortisation for the period 1.4.2001 to 31.3.2005	160*	106	266
(c) Carrying amount (a–b)	40	294	334
(d) Recoverable amount as on 31.3.2005			272
(e) Impairment loss			62

(f)	Impairment loss allocated first to goodwill and balance to other assets	(40)	(22)	(62)
(g)	Carrying amount after impairment loss (c–f)	Nil	272	272

*Amortisation period 5 years as per AS-14.

Step 2 : Reversal of impairment loss as on 31.3.2007.

		(Amount Rs. in lakhs)		
		Goodwill	Identifiable Asset	Total
(a)	Carrying amount of asset at the end of 2007 after recognizing impairment loss in 2005 and depreciation for 2 years.	Nil	223	223
(b)	Carrying amount of asset in 2007 had there been no impairment loss in 2005	Nil	240	240
(c)	Recoverable amount as on 31.3.2007			342
(d)	Excess of recoverable amount over carrying amount (c–a)			119
(e)	Impairment loss that can be reversed (240 – 223)			17

- 32 (a)** Paragraph 31 of AS 27 states that “many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in Accounting Standard (AS 21), Consolidated Financial Statements (CFS).” In addition, paragraphs 41 to 45, deal with elimination of unrealized profits and certain unrealized losses on transactions between a venturer and a JV, do not require elimination of entire transactions or balances in respect of transactions between a venturer and JV. However, any realized profits on such transactions need to be eliminated.

In the case of services rendered by a venturer to a JV, or vice-versa, any excess of the charges for such services, over the cost of such services, would need to be recognized only to the extent of the share of the other venturers. In case there is no cost to the services rendered, the entire amount charged for such services is considered as the profit on the transaction, which needs to be recognized only to the extent of the share of the other venturers.

Example: A Ltd. a venturer in B Ltd. (the JV), holding a 60% equity interest in B Ltd. has rented office space from a third party for a rent of Rs. 1 lakh per month, and sublets the property to B Ltd. for a rent of Rs. 5 lakhs per month. The profit on this transaction, of Rs. 4 lakhs, can be recognised only to the extent of the share of other venturers, i.e., 40%. Therefore, profits on this transaction can be recognized only to the extent of Rs. 1.6 lakhs (40% of Rs. 4 lakhs).

However, if A Ltd. does not incur any cost in respect of the property, the entire rental income received from B Ltd. Would be considered as profit on the transaction, and can be recognized to the extent of Rs. 2 lakhs (40% of Rs. 5 lakhs).

- (b)** Paragraph 10 of AS 27 states that, “The contractual arrangement may identify one venturer as the operator or manager of the JV. The operator does not control the JV but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangements and delegated to the operator.”

Paragraph 49 of AS 27 states as follows, “One or more venturers may act as the operator or manager of the JV. Operators are usually paid a management fees for such duties. The fees are accounted for by the JV as an expense.”

On the above basis, all the three companies of the Wall Group should apply the proportionate consolidation method, to the extent of their own holding.

- 33. (a)** At the end of the year, there is no present obligation arising out of a past obligating event and hence no provision should be made in respect of the expected rebate. The obligating event occurs when the customer makes the payment within the due date, which entitles the customer to a rebate. The Company's contention is not correct since cash rebate for prompt payment are matched with the saving of interest that is effected to the enterprise due to early receipt from customers and cannot be matched with sales.
- (b)** The construction of the oil rig creates an obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil since extraction of oil has not commenced as of the balance sheet date. An outflow of resources embodying economic benefits in settlement is probable. A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.
- (c)** It is present obligation as a result of a past obligating event: The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. An outflow of resources embodying economic benefits in settlement is probable because a proportion of goods are returned for refund.

A provision should be recognized for the best estimate of the costs of refunds since recognition criteria in AS 29 is satisfied.