

PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Valuation of Shares

- The balance sheet of Major Ltd. has been given to you for the purpose of valuation of shares:

Balance Sheet of Major Ltd. as on 31st December, 2009

Liabilities	Rs.	Rs.	Fixed Assets:	Rs.
Share Capital:			Goodwill	50,000
Equity Shares of Rs.10 each	5,00,000		Machinery	2,30,000
Less: Call in arrear (Rs.2 on final call)	<u>10,000</u>	4,90,000	Factory shed	3,00,000
			Vehicles	60,000
8% preference shares of Rs.10 each, fully paid		2,00,000	Furniture	25,000
Reserve and Surplus:			Investments	1,00,000
General Reserve		2,00,000	Current Assets:	
Profit and Loss Account		1,40,000	Stock in trade	2,10,000
Current Liabilities:			Sundry Debtors	3,50,000
Bank Loan		1,00,000	Cash at Bank	50,000
Sundry Creditors		<u>2,70,000</u>	Preliminary Expenses	25,000
		<u>14,00,000</u>		<u>14,00,000</u>

Additional Information:

- Fixed Assets are worth 20% above their actual book value. Depreciation on appreciated value of fixed assets to be ignored for valuation of goodwill.
- Of the investments 80% is non-trading and the balance is trading. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.
- For the purpose of valuation of shares, Goodwill is to be considered on the basis of 4 years' purchase of the super-profits based on average profit of the last 3 years. Profits are as follows:

	Rs.
2007	1,90,000
2008	2,00,000
2009	2,10,000

In a similar business return on capital employed is 15%. In 2007 new furniture costing Rs.10,000 was purchased but wrongly charged to revenue. (No effect has been yet been given for rectifying the same). Depreciation is charged on furniture @ 10%. Find out the value of each fully-paid and partly-paid equity share, assuming tax rate of 50%.

Valuation of Goodwill

2. The Balance Sheets of X Ltd. are as follows:

	(Rs. in lakhs)	
	As at 31.3.2006	As at 31.3.2007
Liabilities		
Share Capital	1,000.0	1,000.0
General Reserve	800.0	850.0
Profit and Loss Account	120.0	175.0
Term Loans	370.0	330.0
Sundry Creditors	70.0	90.0
Provision for Tax	22.5	25.0
Proposed Dividend	<u>200.0</u>	<u>250.0</u>
	<u>2,582.5</u>	<u>2,720.0</u>
Assets		
Fixed Assets and Investments (Non-trade)	1,600.0	1,800.0
Stock	550.0	600.0
Debtors	340.0	220.0
Cash and Bank	<u>92.5</u>	<u>100.0</u>
	<u>2,582.5</u>	<u>2,720.0</u>

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.2006 Rs. 2,200 lakhs and on 31.3.2007 Rs. 2,532.8 lakhs.
2. Current cost of stock on 31.3.2006 Rs. 670 lakhs and on 31.3.2007 Rs. 750 lakhs.
3. Non-trade investments in 10% government securities Rs. 490 lakhs.
4. Debtors include foreign exchange debtors amounting to \$ 70,000 recorded at the rate of \$ 1 = Rs. 17.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
5. Creditors include foreign exchange creditors amounting to \$ 1,20,000 recorded at the rate of \$ 1 = Rs. 16.50 but the closing exchange rate was \$ 1 = Rs. 21.50.
6. Profit included Rs. 120 lakhs being government subsidy which is not likely to recur.
7. Rs. 247 lakhs being the last instalment of R and D cost were written off the profit and loss account. This expenditure is not likely to recur.
8. Tax rate during 2006-07 was 50% effective future tax rate is estimated at 40%.
9. Normal rate of return is expected at 15%.

Based on the information furnished, Mr. Iral, a director contends that the company does not have any goodwill. Examine his contention.

Valuation of Business

3. Xeta Ltd. plans to take over Beta Ltd. Independent Cash Flow forecasts of both companies are as follows:

Year	1	2	3	4	5
Xeta Ltd. (Rs. In lakhs)	2,00	2,25	2,50	2,70	2,85
Beta Ltd. (Rs. In lakhs)	50	65	80	95	110

Year	6	7	8	9	10
Xeta Ltd. (Rs. In lakhs)	3,10	3,50	6,00	6,10	6,50
Beta Ltd. (Rs. In lakhs)	1,20	1,30	1,50	1,70	1,80

Following further information is available from the latest Balance Sheet of Beta Ltd.

Assets:		Rs. in lakhs
Fixed Assets		5,00
Stock		1,15
Debtors		<u>50</u>
		6,65
Less: Liabilities		
Sundry creditors	1,65	
Long term loan	<u>2,00</u>	<u>(3,65)</u>
Net assets		<u>3,00</u>

Xeta Ltd. finds that fixed assets of book value Rs.75 lakhs will not be used which will fetch Rs.50 lakhs on immediate disposal. Moreover, stock will fetch Rs.140 lakhs and debtors Rs.48 lakhs immediately. But Xeta Ltd. has to payoff the liabilities immediately. Also it has to pay Rs.110 lakhs to workers of Beta Ltd. whose service cannot be used. It appears that after merger Xeta Ltd. has to invest Rs.210 lakhs for renovation of the plant and machinery at the end of 1st year and Rs.50 lakhs for modernization at the end of 2nd year after merger.

Forecast of cash flows of Xeta Ltd. after merger.

Year	1	2	3	4	5
Cash flows (Rs. In lakhs)	2,40	2,80	3,50	4,00	4,10

Year	6	7	8	9	10
Cash flows (Rs. In lakhs)	4,80	5,50	8,00	8,80	9,50

Determine the maximum value of Beta Ltd. which its management should ask from Xeta Ltd. You may use 20% discount rate.

Acquisition of Business

4. A company was incorporated on 1st July, 2008 to take over the business of Mr. M as and from 1st April, 2008. Mr. M's Balance Sheet, as at that date was as under:

Liabilities	Rs.	Assets	Rs.
Trade Creditors	36,000	Building	80,000
Capital	1,94,000	Furniture and Fittings	10,000
		Debtors	90,000
		Stock	30,000
		Bank	20,000
	<u>2,30,000</u>		<u>2,30,000</u>

Debtors and Bank balances are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue M with 10,000 equity shares of Rs.10 each, Rs.8 per share paid up and cash of Rs.56,000.

The company issued to the public for cash 20,000 equity shares of Rs.10 each on which by 31st March, 2009 Rs.8 per share was called and paid up except in the case of 1,000 shares on which the third call of Rs.2 per share had not been realized. In the case of 2,000 shares, the entire face value of the shares had been realized. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following were shown by the books of accounts of the company on 31st March, 2009:

	Rs.
Discount (including Rs.1,000 allowed on vendor's debtors)	6,000
Preliminary expenses	10,000
Directors' fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2009 was Rs.52,000. Depreciation at 10% on Furniture and Fittings and at 5% on Building is to be provided. Collections from debtors belonging to the vendor were Rs.60,000 in the period.

Kindly prepare the Trading and Profit & Loss Account for the period ended 31st March, 2009 of the limited company and its Balance Sheet as at that date.

Internal Reconstruction of a Company

5. The following is the Balance Sheet as at 31st December, 2008 of Ginni Ltd.

Liabilities	Rs.	Assets	Rs.
Subscribed capital:		Fixed Assets (including goodwill of Rs.1,00,000)	10,80,000
3,000 Cumulative Preference shares of Rs.100 each fully paid up	3,00,000	Investments	20,000
7,500 Equity share of Rs.100 each fully paid up	7,50,000	Stock in Trade	2,00,000
Securities Premium	12,000	Trade Debtors	1,54,500
Preference Shares		Bank Balances	62,500
General Reserve	80,000		
Trade Creditors	<u>3,75,000</u>		
	<u>15,17,000</u>		<u>15,17,000</u>

Contingent liability:

Preference Dividends in arrears Rs.66,000.

The Board of Directors of the Company decided upon the following scheme of reconstructions:

- The preference shares are to be converted into 13% unsecured debentures of Rs.100 each in regard to 80% of the dues (including arrears of dividends) and for the balance equity shares of Rs.50 paid up would be issued. The authorized capital of the company permitted the issue of additional shares.
- Equity shares would be reduced to share of Rs.50 each paid up.
- All equity holders agree to pay the balance in cash.
- Goodwill has lost its value and is to be written off fully. Investment are to reflect their market value of Rs.30,000. Obsolete items in stock of Rs.50,000 are to be written off. Bad debts to the extent of 5% of the total debtors would be provided for. Fixed assets to be written down by Rs.1,50,000.

The scheme was duly approved and put into effect.

The company carried on trading for six months and after writing off depreciation at 20% p.a. on the revised value of fixed assets, made a net profit of Rs.80,000. The half-yearly working resulted in an increase of Sunday Debtors by Rs.60,000. Stock by Rs.80,000 and cash by Rs.40,000.

Show the journal entries (without narration) necessary in the Company's books to give effect to the scheme and draw the Balance sheet as at 30th June, 2009.

Amalgamation of Companies

6. Following are the Balance Sheet of companies as at 31.12.2008:

Liabilities	D Ltd. Rs.	V Ltd. Rs.	Assets	D Ltd. Rs.	V Ltd. Rs.
Equity share capital (Rs. 100)	8,00,000	6,00,000	Goodwill	6,00,000	—
General Reserve	4,00,000	3,00,000	Fixed Assets	5,00,000	8,00,000
Investment Allowance			Investments	2,00,000	4,00,000
Reserve	—	4,00,000	Current Assets	4,00,000	3,00,000
Sundry Creditors	<u>5,00,000</u>	<u>2,00,000</u>			
	<u>17,00,000</u>	<u>15,00,000</u>		<u>17,00,000</u>	<u>15,00,000</u>

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

- Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 2002- 2007 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2011 reserve of Rs. 2,00,000 for utilization.
- Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.
- The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.
- Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.
- Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.
- Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

Holding Company Accounts

7. Astha Ltd. acquired 80% of both classes of shares in Birat Ltd. on 1.4.2007. The draft Balance Sheets of two companies on 31st March, 2008 were as follows:

(Rs. in 000's)					
Liabilities	Astha Ltd.	Birat Ltd.	Assets	Astha Ltd.	Birat Ltd.
Share Capital:					
Equity shares of Rs.10 each, full paid up	3,000	600	Plant & machinery	2,060	600
14% Preference shares of Rs.100 each, fully paid up	-	400	Furniture & fixtures	600	540
General reserve	1,900	40	Investments in equity shares of Birat Ltd.	1,920	-
Profit and loss account	1,600	720	in preference shares of Birat Ltd.	320	-
Creditors	300	320	Stock	680	404
			Debtors	560	316
			Cash at bank	<u>660</u>	<u>220</u>
	<u>6,800</u>	<u>2,080</u>		<u>6,800</u>	<u>2,080</u>

Note:

Contingent liability – Astha Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – Rs.1,55,000.

Additional Information:

- General reserve balance of Birat Ltd. was the same as on 1.4.2007.
- The balance in Profit and Loss A/c of Birat Ltd. on 1.4.2007 was Rs.3,20,000, out of which dividend of 16% p.a. on the Equity capital of Rs.6,00,000 was paid for the year 2006-07.
- The dividend in respect of preference shares of Birat Ltd. for the year 2007-08 was still payable as on 31.3.2008.
- Astha Ltd. credited its Profit and Loss A/c for the dividend received by it from Birat Ltd. for the year 2006-07.
- Sundry creditors of Astha Ltd. included an amount of Rs.1,20,000 for purchases from Birat Ltd., on which the later company made a loss of Rs.10,000.

- (vi) Half of the above goods were still with the closing stock of Astha Ltd. as at 31.3.2008.
- (vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%. There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.
- (viii) The directors of Astha Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31st March, 2008, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer.

Corporate Restructuring

8. The Balance Sheet of Z Ltd. as at 31st March, 2008 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

	(All amounts in crores of Rupees)		
	S Division	W Division	Total
Fixed Assets:			
Cost	875	249	
Less: Depreciation	<u>360</u>	<u>81</u>	
Written-down value	<u>515</u>	<u>168</u>	683
Investments			97
Net Current assets:			
Current Assets	445	585	
Less: Current Liabilities	<u>270</u>	<u>93</u>	
	<u>175</u>	<u>492</u>	<u>667</u>
			<u>1,447</u>
Financed by:			
Loan funds		15	417
Own funds:			
Equity share capital: shares of Rs. 10 each			345
Reserves and surplus			<u>685</u>
			<u>1,447</u>

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2007 and 30th September, 2008.

On 1st April, 2008 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs. 900 crore divided into shares of Rs. 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd. allotting to Z Ltd.'s shareholders its two fully paid equity shares of Rs. 10 each at par for every fully paid equity share of Rs. 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs. 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to:

- (i) Show the journal entries in the books of Z Ltd.
- (ii) Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).

Buy-back of Securities

9. The Balance Sheet of Gunshot Ltd. as on 31.3.2008 is given :

(Rs. in '000)			
Liabilities	Amount	Fixed Assets	Amount
Share Capital :		Fixed Assets	2,700
Equity shares of Rs. 10 each	800	Non-trade Investments	300
Securities Premium	100	Stock	600
General Reserve	780	Sundry Debtors	360
Profit and Loss Account	120	Cash and Bank	160
10% Debenture	2,000		
Creditors	<u>320</u>		<u> </u>
	<u>4,120</u>		<u>4,120</u>

Gunshot Ltd. buy back 16,000 shares of Rs. 20 per share. For this purpose, the Company sold its all non-trade investments for Rs. 3,20,000. Give Journal Entries with full narrations affecting the buy back.

Value Added Statement

10. (a) What are the advantages of preparation of Value Added (VA) statements? Explain in brief.

- (b) The following are the balances in the accounts statements of Addition Ltd. for the year, 2008:

	Rs. in lakhs		Rs. in lakhs
Turnover	2,300	Printing and Stationery	22
Loss on Sale of Machinery	75	Auditor's Remuneration	28
Depreciation on Plant and Machinery	200	Retained Profits (Opening Balance)	994
Dividend to Ordinary Shareholders	146	Retained Profits for the year	288
Debtors	200	Rent, Rates and Taxes	165
Creditors	127	Other Expenses	85
Total Stock of all materials, W.I.P. and finished goods		Ordinary Share Capital issued	1,500
Opening Stock	160	Interest on Borrowings	40
Closing Stock	200	Income Tax for the year	276
Raw Materials purchased	625	Wages and Salaries	327
PF Contribution	28	Employees State Insurance	35

Prepare a value added statement for the company for 2008.

Economic Value Added

11. (a) What is economic value added and how is it calculated? Discuss.
(b) From the following information of Vinod Ltd., compute the economic value added:

Share capital	Rs.2,000 lakhs
Reserve and surplus	Rs.4,000 lakhs
Long-term debt	Rs.400 lakhs
Tax rate	30%
Risk free rate	9%
Market rate of return	16%
Interest	Rs.40 lakhs
Beta factor	1.05
Profit before interest and tax	Rs.2,000 lakhs

Human Resource Accounting

12. (a) Describe the progress made by India so far in the field of human resource accounting.
(b) Why Human Resources Asset is not recognized in the Balance sheet?

Corporate Social Reporting

13. From the following information taken from the books of Srishti Ltd. relating to staff and community benefits, you are required to prepare a statement classifying the various items under the appropriate heads, required under corporate social reporting:

Particulars	Rs. in lakhs
Environmental improvements	36.18
Medical facilities	9.00
Training programmes	18.45
Generation of job opportunities	109.35
Municipal taxes	19.26
Increase in cost of living in the vicinity due to company's operations	29.79
Concessional transport, water-supply etc.	20.25
Generation of business	45.00
Leave encashment and leave travel benefits	93.60
Education facilities for children of staff members	38.88
Subsidised canteen facilities	25.92
Extra work put in by staff and officers for drought relief	33.30

Financial Reporting of Financial Institutions

14. (a) Explain "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.
(b) What do you mean by "Net asset value" (NAV) in case of mutual fund units?
15. (a) Write short note on Capital adequacy requirements of merchant bankers.
(b) Write short note on Books of account required to be maintained by a Stock Broker.

Accounting for Not-for-profit Organizations

16. The Annuity fund of Punjab University accepts an annuity – based gift from an alumnus who specifies that he receives a monthly payment of Rs.25,000 for the remainder of his life. The gift consists of cash of Rs.20 lakh and securities having a market value of Rs.15 lakh at the time of the gift. The investment income of annuity fund for a particular month comes to Rs.38,500.

Draft journal entries in the University's books.

Indian AS, IFRS and US GAAPs

17. State the treatment of the following items with reference to Indian Accounting Standards and IFRS:
- (i) Discontinued operations – definition and measurement
 - (ii) Acquired intangible assets.

Accounting Standards and Guidance Notes

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

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

- (b) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?
- (c) If a sale and lease back transaction results in an operating lease, what provisions will be applicable? Describe in line with AS 19.
- (d) 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?
19. Write short notes on :
- (i) NACAS.
 - (ii) Impairment of asset and its application to inventory.
 - (iii) Treatment of borrowing costs.
 - (iv) Accounting for investment by a holding company in subsidiaries.
 - (v) Concept of Cost v/s Fair value with reference to Indian Accounting Standards.
 - (vi) Restatement of shares as per AS 20.
 - (vii) Provisions of AS 26 relating to retirement and disposal of intangible assets.
 - (viii) Change in accounting estimates.
20. (i) Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with references to AS-9.
- (ii) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

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

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

- (iii) Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2007 for Rs.60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs.41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs.36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs.54 crore per annum and has a carrying amount of Rs.3.46 crore. All such machines put together could fetch a sum of Rs.4.44 crore if disposed. Discuss the applicability of Impairment loss.
- (iv) A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

- 21. (i) Rainbow Limited borrowed an amount of Rs.150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized Rs.19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of Rs.150 crores, an income of Rs.3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.
- (ii) Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2006, 2007 and 2008 for Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for Income-

tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs.7,00,000, Rs.18,00,000 and Rs.23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

- (iii) B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. the cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?

- (iv) The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

22. From the following information, prepare cash flow statement as at 31st December, 2008 by using indirect method according to AS 3:

Balance Sheets					
Liabilities	2007	2008	Assets	2007	2008
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Profit & Loss A/c	4,25,000	5,00,000	Stock	3,40,000	3,50,000
Long Term Loans	5,00,000	5,30,000	Debtors	3,60,000	3,30,000
Creditors	1,75,000	2,00,000	Cash	30,000	35,000
			Bills Receivable	20,000	15,000
	<u>16,00,000</u>	<u>17,30,000</u>		<u>16,00,000</u>	<u>17,30,000</u>

Income Statement for the year ended 31st December, 2008

Sales	20,40,000
Less: Cost of Sales	<u>13,60,000</u>
Gross Profit	6,80,000
Less: Operating Expenses:	
Administrative Expenses	(2,30,000)
Depreciation	<u>(1,10,000)</u>

Operating Profit	3,40,000
Add: Non-Operating Incomes (dividend received)	<u>25,000</u>
	3,65,000
Less: Interest Paid	<u>(70,000)</u>
	2,95,000
Less: Income Tax	<u>1,30,000</u>
Profit after Tax	<u>1,65,000</u>

Statement of Retained Earnings

Opening Balance	4,25,000
Add: Profit	<u>1,65,000</u>
	5,90,000
Less: Dividend paid	<u>90,000</u>
Closing Balance	<u>5,00,000</u>

23. (i) A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.
- (ii) A Ltd., owns 30% of the equity capital of B Ltd. B Ltd. in turn owns 35% of equity capital C Ltd., and 40% of equity capital in D Ltd. You are required to answer the following questions.
- Whether B Ltd. is a related party to A Ltd?
 - Whether C Ltd., is a related party to A Ltd.?
 - Whether C Ltd. and D Ltd. are related parties?
- (iii) A limited company has set up its business in a designated backward area and is entitled to a capital subsidy of 15% under a scheme in force. Accordingly, it received a subsidy of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat it as income and reduce the losses made in the first year of its operations ending with 31st March, 2009. You are asked to advise the accountant, whether his view is in conformity with AS 12.
- (iv) Induga Company has at its financial year ended 31st March, 2009 fifteen law suits outstanding none of the which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

Result	Probability	Amount of loss
	0.6	-
For first ten cases:		
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	-
Lose-low damages	0.3	60,000
Lose-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss

24. (i) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on "mark to market basis". For the financial year ended March, 2009 the investments which were acquired at a cost of Rs.109 crores were reflected in the Balance Sheet at Rs.89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.
- (ii) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.
25. (i) Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2005 for Rs.20 depending upon the employees at the time of vesting of options. The market price of the share is Rs.50. The options will vest at the end of year 1 if the earning of Choice Ltd. increases 16% or it will vest at the end of the year 2 if the average earning of two years increases by 13% or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2006, 4,000 unvested options lapsed on 31.3.2007 and finally 3,500 unvested options lapsed on 31.3.2008.

Following is the earning of Choice Ltd. :

Year	Earning (in %)
Year 1	14%
Year 2	10%
Year 3	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

- (ii) Parikshit Ltd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

The company securitises the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs.1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. the remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

SUGGESTED ANSWERS/HINTS

1.

(i) Capital Employed on 31.12.2009	Rs.	Rs.
Machinery		2,30,000
Factory Shed		3,00,000
Vehicles		60,000
Furniture (25,000+7,290)		32,290
		6,22,290
Add: 20%		1,24,458
		7,46,748
Trade Investments		16,000
Stock in Trade		2,10,000
Sundry Debtors		3,50,000
Cash at Bank		50,000
		13,72,748
Less:		
Bank Loan	1,00,000	
Sundry Creditors	2,70,000	3,70,000
		<u>10,02,748</u>

(ii) Average profits for the last three years

	2007	2008	2009
	Rs.	Rs.	Rs.
Reported Profit (taking the figures given in the question as profit after tax)	1,90,000	2,00,000	2,10,000
Add: furniture purchased charged to revenue (net of tax)	5,000	-	-
	1,95,000	2,00,000	2,10,000
Less: Depreciation on furniture purchased (net of tax)	500	450	405
	1,94,500	1,99,550	2,09,595
Less: Dividend on non-trading investments less tax	4,000	4,000	4,000
	1,90,500	1,95,550	2,05,595
Average Profit			1,97,215

(iii) Calculation of Super Profits

	Rs.
Capital employed	10,02,748
Average profit	1,97,215
Normal profit @ 15% on capital employed	1,50,412
Super profit	46,803
Goodwill at four years' purchase	1,87,212
Valuation of Equity Shares	Rs.
Value of Net Tangible Assets [Refer (i)]	10,02,748
Add Goodwill [Refer (iii)]	1,87,212
Add Non-trade investments	80,000
Add Notional Calls	<u>10,000</u>
	12,79,960
Less: Preference Share Capital	<u>2,00,000</u>
	<u>10,79,960</u>
No. of shares	50,000
Intrinsic value of fully paid share	Rs.21.60
Intrinsic value of partly paid share (Rs.21.60-2.00)	Rs.19.60

2.

(Rs. in lakhs)

(1) Average Capital employed

	As at 31.3.2006	As at 31.3.2007
Current cost of fixed assets other than non trade investments	2,200.0	2,532.8
Current cost of stock	670.0	750.0
Debtors	340.0	222.8
Cash and Bank	<u>92.5</u>	<u>100.0</u>
	3,302.5	3,605.6
Less: Outside Liabilities:		
Term loans	370.0	330.0
Sundry creditors	70.0	96.0
Tax provision	<u>22.5</u>	<u>25.0</u>
	<u>462.5</u>	<u>451.0</u>
Capital Employed	2,840.0	3,154.6
Average Capital Employed at current value = $\frac{2,840.0 + 3,154.6}{2}$		2,997.3

(2) Future maintainable profit

Increase in General Reserve		50
Increase in Profit and Loss Account		55
Proposed Dividend		<u>250</u>
Profit after tax		<u>355</u>
Pre-tax profit = $\frac{355}{1 - 0.5}$		710.00
Less: Non-trading income	49.00	
Exchange loss on creditors [1.2 lakhs × (21.5 – 16.5)]	6.00	
Subsidy	<u>120.00</u>	<u>175.00</u>
		535.00
Add: Exchange gain on debtors [0.7 lakhs × (21.5 – 17.5)]	2.80	
R & D costs	247.00	
Stock adjustment	<u>30.00</u>	<u>279.80</u>
Adjusted pre-tax profit		814.80
Less: Tax @ 40%		<u>325.92</u>
Future maintainable profit		<u>488.88</u>

Valuation of Goodwill

(Rs. in lakhs)

(1) Capitalisation Method

Capitalised value of future maintainable profit $\left(\frac{488.88}{0.15} \right)$	3,259.20
Less: Average Capital Employed	<u>2,997.30</u>
Goodwill	<u>261.90</u>

(2) Super Profit Method

Future Maintainable Profit	488.88
Normal Profit @ 15% on average capital employed	<u>449.60</u>
Goodwill	<u>39.28</u>

Under capitalisation method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes:

(Rs. in lakhs)

(1) Stock adjustment

Difference between current cost and historical cost of closing stock	150.00
Difference between current cost and historical cost of opening stock	<u>120.00</u>
	<u>30.00</u>

(2) Debtors' adjustment

Value of foreign exchange debtors at the closing exchange rate (\$ 70,000 × 21.5)	15.05
Value of foreign exchange debtors at the original exchange rate (\$ 70,000 × 17.5)	<u>12.25</u>
	<u>2.80</u>

(3) Creditors' adjustment

Foreign exchange creditors at the closing exchange rate (\$ 1,20,000 × 21.5)	25.80
Foreign exchange creditors at the original exchange rate (\$ 1,20,000 × 16.5)	<u>19.80</u>
	<u>6.00</u>

3. Maximum value to be quoted

Particulars	Rs. in Lakhs	Rs. in Lakhs
a. Value of merged entities as per discounted cashflows (W.N.1)		502.38
b. Add: Cash to be collected immediately on disposal of assets		
i. Fixed assets	50.00	
ii. Stock	140.00	

iii.	Debtors	<u>48.00</u>	238.00
c.	Less:		
i.	Sundry creditors	165.00	
ii.	Long term loan	200.00	
iii.	Compensation to workers	110.00	
iv.	Renovation of plant and machinery (210×0.8333) [PV]	174.99	
v.	Modernisation of Plant and machinery (50 x 0.6944)	<u>34.72</u>	<u>(684.71)</u>
d.	Maximum value to be quoted (a+b-c)		<u>55.67</u>

So, Beta Ltd. can quote as high as Rs.55,67,000 for take over.

Working Note:

Valuation of Xeta Ltd. in case of merger

Year	Cash flow after merger	Cash flow of Xeta Ltd. before merger	Incremental cash flow	Discount factor @ 20%	Discounted cash flow
(1)	(2)	(3)	(4)= (2)-(3)	(5)	(6) = (4) ×(5)
1	240	200	40	0.8333	33.33
2	280	225	55	0.6944	38.19
3	350	250	100	0.5787	57.87
4	400	270	130	0.4823	62.70
5	410	285	125	0.4019	50.24
6	480	310	170	0.3349	56.93
7	550	350	200	0.2791	55.82
8	800	600	200	0.2326	46.52
9	880	610	270	0.1938	52.33
10	950	650	300	0.1615	<u>48.45</u>
					<u>502.38</u>

4. Trading and Profit and Loss Account for the year ended 31.03.09

Dr.		Rs.	Cr.		Rs.
To	Opening Stock	30,000	By	Sales	4,60,000
To	Purchases	3.20.000	By	Closing Stock	52,000
To	Gross Profit c/d	1,62,000			
		<u>5,12,000</u>			<u>5,12,000</u>

		Pre-Incorporation Rs.	Post-Incorporation Rs.			Pre-Incorporation Rs.	Post-Incorporation Rs.
To	Salaries	12,000	36,000	By	Gross Profit c/d	40,500	1,21,500
To	Directors' fee	-	12,000	By	Commission	-	3,000
To	Discount	1,250	3,750				
To	Depreciation:						
	Building	1,000	3,000				
	Furniture	250	750				
To	Pre-incorporation Profit transferred to Capital Reserve Account	26,000	-				
To	Net Profit	-	69,000				
		<u>40,500</u>	<u>1,24,500</u>			<u>40,500</u>	<u>1,24,500</u>

Note: Apportionment has been made in the Profit and Loss Account between pre-incorporation and post-incorporation period using the following basis.

Item	Base	Ratio
Gross Profit	Time	1 : 3
Salaries	Time	1 : 3
Discount	Time	1 : 3
Directors' Fees		100% to post-incorporation period
Commission		100% to post-incorporation period

Balance Sheet as on 31.3.2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			Fixed Assets		
30,000 equity shares of Rs.10 each Rs.8 called up			Building	80,000	
			Less: Depreciation	<u>4,000</u>	76,000
	2,40,000				

Less: Calls in Arrear (of the above 10,000 shares are allotted pursuant to a contract without payments being received in cash)	<u>2,000</u>	2,38,000			
Share Suspense A/c (400 shares to be issued to the underwriter in consideration of under-writing commission on completion of share issue)		4,000	Furniture & Fittings	10,000	
			Less: Depreciation	<u>1,000</u>	9,000
			Investments		Nil
Reserves and Surplus			Current Assets, Loans and Advances		
Capital Reserve	26,000		(A) Current Assets:		
Less: Goodwill w/o	<u>16,000</u>	10,000	Stock	52,000	
Profit & Loss A/c		69,000	Debtors	1,31,000	
Secured Loans		Nil	Cash	<u>91,000</u>	2,74,000
Unsecured loans		Nil	(B) Loans and Advances		Nil
Current Liabilities and Provisions			Miscellaneous Expenditure		
(A) Current Liabilities:			Preliminary Expenses	10,000	
Sundry Creditors	48,000		Underwriting Commission	<u>4,000</u>	14,000
Calls in Advance	<u>4,000</u>	52,000			
(B) Provisions		Nil			
		<u>3,73,000</u>			<u>3,73,000</u>

Working Notes:

(1) Goodwill on acquisition

Purchase consideration:	Rs.	Rs.
10,000 equity shares of Rs.10 Rs.8 paid up		80,000
Cash		<u>56,000</u>
		1,36,000
Less: Assets taken over		
Building	80,000	
Furniture and Fittings	10,000	
Stock	<u>30,000</u>	1,20,000
Goodwill		<u>16,000</u>

(2) Cash Inflows from public issue of equity shares

	Rs.
20,000 equity shares of Rs.10 each Rs.8 called up	1,60,000
Less: Calls in arrear on 1,000 shares @ Rs.2 per share	<u>2,000</u>
	1,58,000
Add: Calls-in-advance on 2000 shares @ Rs.2	<u>4,000</u>
	<u>1,62,000</u>
(3) Underwriting Commission 2% on face value Rs.2,00,000	4,000

Underwriting Commission becomes due on completion of the job relating to shares underwritten. It appears that the job relating to public issue was not finished till 31st March, 2009. So a Share Suspense Account should be created showing the amount of shares to be issued to the underwriter in discharge of his claim for commission

(4) Cash collection from Company's debtors

Total Debtors Account						
Dr.		Vendor's Debtors	Company's Debtors		Vendor's Debtors	Company's Debtors
		Rs.	Rs.		Rs.	Rs.
To	Balance b/d	90,000	-	By	Discount	1,000
						5,000

To	Sales	4,60,000	By	Cash	60,000	¹ 3,24,000
			By	Balance c/d	29,000	² 1,31,000
		<u>90,000</u>			<u>90,000</u>	<u>4,60,000</u>

Note: Assumed that all sales were on credit.

(5) Cash payment for purchases

Dr.					Cr.
		Rs.			Rs.
To	Cash (Balancing figure)	2,72,000	By	Purchases	3,20,000
To	Balance c/d	48,000			
		<u>3,20,000</u>			<u>3,20,000</u>

Note: Assumed that all purchases were on credit

(6) Summary Cash Book

Dr.					Cr.
		Rs.			Rs.
To	Share Capital A/c	1,62,000	By	Total Creditors A/c:	
To	Total Debtors A/c:			Payment to creditors	2,72,000
	Collection from company's debtors	3,24,000	By	Vendor's A/c:	
	Collection from vendor's debtors	60,000		Purchase consideration	56,000
			By	Preliminary Expenses	10,000
			By	Directors' Fees	12,000
			By	Salaries	48,000
			By	Vendor's A/c (Collection less commission Rs.3,000)	57,000
			By	Balance c/d	91,000
		<u>5,46,000</u>			<u>5,46,000</u>

¹ Balancing figure.

² Total Debtors Rs.1,60,000 minus Vendor's Debtors Rs.29,000

5.

In the books of Ginni Ltd.

Journal Entries

		Debit Rs.	Credit Rs.
Cumulative Preference Share Capital A/c	Dr.	3,00,000	
Capital Reduction A/c	Dr.	66,000	
To Cumulative Preference Shareholders A/c			3,66,000
(Being the cumulative preference shares & arrear dividend transferred to cumulative preference shareholders account in accordance with the resolution of the Board dated.....)			
Cumulative Preference Shareholders A/c	Dr.	3,66,000	
To 13% unsecured debentures A/c			2,92,800
To Equity Share Capital A/c			73,200
(Being the issue of 13% unsecured debentures and 1,464 Equity shares of Rs.100 each issued as Rs.50 paid up as per the Board's resolution dated....)			
Equity Share Capital A/c	Dr.	3,75,000	
To Capital Reduction A/c			3,75,000
(Being the entry for reducing every share of Rs.100 each as Rs.50 paid up 7,500 Equity shares @ 50 per share as per the Board resolution dated....)			
Cash A/c	Dr.	4,48,200	
To Equity Share Capital A/c			4,48,200
(Being the receipt of Cash of Rs.50 each for 8964 being the call made as per Boards resolution dated.....)			
Investments A/c	Dr.	10,000	
Capital Reduction (Balancing figure)	Dr.	2,97,725	
To Goodwill A/c			1,00,000
To Stock A/c			50,000
To Fixed Assets A/c			1,50,000
To Provision for doubtful Debts A/c			7,725
(Being the change in value of assets as per the resolution of the Board dated.....)			
Capital Reduction A/c	Dr.	11,275	
To Capital Reserve A/c			11,275
(Being the transfer of Capital Reduction A/c balance to Capital Reserve)			

Ginni Ltd.
Balance Sheet as at 30th June, 2009

Liabilities	Rs.	Assets	Rs.	Rs.
Subscribed Capital		Fixed Assets	8,30,000	
8,964 Equity Shares of Rs.100 each	8,96,400	Less: depreciation	<u>83,000</u>	7,47,000
Securities premium	12,000	Investments		30,000
Capital Reserve	11,275	Stock in Trade		2,30,000
General Reserve	80,000	Trade Debtors	2,14,500	
Profit and Loss A/c	80,000	Less: Provision for Doubtful debts	<u>7,725</u>	2,06,775
13% unsecured debentures	2,92,800	Bank Balance		5,50,700
Trade Creditors	<u>3,92,000</u>			
	17,64,475			<u>17,64,475</u>

Working Notes:

1. No. of equity shares issued to cumulative preference shareholders	1,464
No. of shares held by Equity shareholders	<u>7,500</u>
Total	<u>8,964</u>
	Rs.
2. Opening Balance on 31.12.2008	62,500
Add: Calls on shares @ 50 per share (8,964 × Rs.50 per share)	<u>4,48,200</u>
Balance on implementation of the scheme	5,10,700
Add: Change in cash balance (as given in the question)	<u>(+)40,000</u>
	<u>5,50,700</u>
3. Creditors Balance = Balancing figure	
Alternative approach: Profit & Loss upto 30.6.2009	80,000
Add: Depreciation (non cash item)	<u>83,000</u>
Cash from operations	<u>(A)1,63,000</u>
Change in Current Assets:	
Debtors	(+)60,000
Stock	(+)80,000

Cash Balance	(+)40,000
Cash Outflow	(B)1,80,000
Increase in creditors	
Excess of (B) over (A)	17,000
Add: Opening Balance	3,75,000
	<u>3,92,000</u>

6. Journal Entries in the Books of D Ltd.

		Dr. Amount Rs.	Cr. Amount Rs.
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd. as on 31st December, 2008

Liabilities	Amount Rs.	Assets	Amount Rs.
Equity Share Capital: 17,036 shares of Rs. 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	Fixed Assets (5,00,000 + 8,50,000) Goodwill (6,00,000 + 1,00,000 + 16,000) Investments (2,00,000 + 1,92,500)	13,50,000 7,16,000
General Reserve	4,00,000	Current Assets (7,00,000 – 50 – 16,000)	3,92,500 6,83,950
Securities Premium	3,38,850	Amalgamation Adjustment Account	<u>2,00,000</u>
Investment Allowance Reserve	2,00,000		
Sundry Creditors	7,00,000		
	<u>33,42,450</u>		<u>33,42,450</u>

Working Notes:

1. Calculation of net asset value of shares

	D Ltd. Rs.	V Ltd. Rs.
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	<u>4,00,000</u>	<u>3,00,000</u>
	16,00,000	15,80,000
Less: Sundry Creditors	<u>5,00,000</u>	<u>2,00,000</u>
Net assets	<u>11,00,000</u>	<u>13,80,000</u>
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investments of V Ltd. are calculated as follows:

	Rs.
Shares in D Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	<u>1,92,500</u>
	<u>3,30,000</u>

2. Calculation of Purchase Consideration

	Rs.
Net assets of V Ltd.	<u>13,80,000</u>
Value of Shares of D Ltd.	<u>137.50</u>
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	<u>1,000</u>
Additional shares to be issued	<u>9,036.36</u>
Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	<u>50</u>
	<u>12,42,500</u>

7. Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd. as at 31st March 2008

		(Rs. in '000s)	
Liabilities	Amount	Assets	Amount
Share capital:		Goodwill (W.N.5)	1,088.0
3,00,000 Equity shares of		Plant and machinery	
Rs. 10 each fully paid up	3,000.0	Astha Ltd.	2,060.0
Minority interest (W.N.4)	360.4	Birat Ltd. (W.N.7)	<u>750.0</u>
General reserves	1,900.0		2,810.0
Profit and loss A/c (W.N.6)	1,894.6	Furniture and fixtures	
Creditors		Astha Ltd.	600.0
Astha Ltd.	300.0	Birat Ltd. (W.N. 8)	<u>432.0</u>
Birat Ltd.	<u>320.0</u>		1,032.0
	620.0	Stock	
Less: Mutual owings	<u>120.0</u>	Astha Ltd.	680.0
	500.0	Birat Ltd.	<u>404.0</u>
			1,084.0
		Add: Unrealised loss	<u>5.0</u>
			1,089.0
		Debtors	
		Astha Ltd.	560.0
		Birat Ltd.	<u>316.0</u>
			876.0
		Less: Mutual owings	<u>120.0</u>
			756.0
		Cash at Bank	
		Astha Ltd.	660.0
		Birat Ltd.	<u>220.0</u>
			<u>880.0</u>
	<u>7,655.0</u>		<u>7,655.0</u>

Contingent liability: Claim against damages lodged by a contractor against Astha Ltd. is pending in a law suit Rs. 155 thousands (W.N. 9).

Working Notes:

1.	Calculation of capital profits (pre-acquisition)	(Rs. in '000s)
	General reserve balance as on 1-04-2007	40.0
	Profit and loss account balance as on 1-04-2007	320.0
	Less: Dividend at 16% p.a. on Rs. 6,00,000 for the year 2006-07	<u>96.0</u>
		<u>224.0</u>
		264.0
	Add: Profit on revaluation of plant and machinery (W.N.7)	<u>200.0</u>
		464.0
	Less: Loss on revaluation of furniture and fixtures (W.N.8)	<u>120.0</u>
		<u>344.0</u>
	Share of Astha Ltd. (80%)	275.2
	Share of Minority Interest (20%)	<u>68.8</u>
2.	Calculation of revenue profits (post-acquisition)	(Rs. in '000s)
	Profits during the year 2007-08 (720.0 – 224.0)	496.0
	Less: Preference dividend for the year 2007-08 @ 14% on Rs.4,00,000	<u>56.0</u>
		440.0
	Less: Under charging of depreciation on plant and machinery due to upward revaluation (Rs.2,00,000 x 25%)	<u>50.0</u>
		390.0
	Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%)	<u>12.0</u>
		<u>402.0</u>
	Share of Astha Ltd. (80%)	321.6
	Share of Minority Interest (20%)	<u>80.4</u>
3.	Calculation of dividend on preference shares of Birat Ltd.	(Rs. in '000s)
	Dividend on preference shares (Rs. 4,00,000 x 14%)	<u>56.0</u>
	Share of Astha Ltd. (80%)	44.8
	Share of Minority Interest (20%)	<u>11.2</u>
		<u>56.0</u>

4.	Calculation of Minority Interest	(Rs. in '000s)
	Equity share capital (20%)	120.0
	Preference share capital (20%)	80.0
	Share of capital profits (W.N. 1)	68.8
	Share of Revenue profit (W.N.2)	80.4
	Share of preference dividend (W.N.3)	<u>11.2</u>
		<u>360.4</u>
5.	Calculation of Cost of Control - Goodwill	(Rs. in '000s)
	Investment by Astha Ltd. in	
	Equity shares of Birat Ltd.	1,920.0
	Less: Dividend received for 2006-07 (600 x 80% 16%)	<u>76.8</u> 1,843.2
	Preference shares	<u>320.0</u>
		2,163.2
	Less:Paid up value of	
	Equity shares (80%)	480.0
	Preference shares (80%)	320.0
	Share in Capital Profit (W.N. 1)	<u>275.2</u> 1,075.2
	Goodwill	<u>1,088.0</u>
6.	Calculation of Consolidated Profit and Loss Account	(Rs. in '000s)
	Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2007	1,600.0
	Add: Revenue profit from Birat Ltd (W.N. 2)	321.6
	Preference dividend of Birat Ltd. (W.N. 3)	44.8
	Share of unrealised loss on stock (Rs. 10,000 x 50%)	<u>5.0</u>
		1,971.4
	Less:Dividend wrongly credited	<u>76.8</u>
		<u>1,894.6</u>
7.	Value of Plant and Machinery of Birat Ltd.	(Rs. in '000s)
	Value as on 1.04.07 (600 x 100/75)	800.0
	Add: Appreciation on revaluation (25%)	<u>200.0</u>
	Revalued figure	1,000.00

Less: Depreciation		
Already charged (800-600)	200.0	
Due to upward revaluation (200 x 25%)	<u>50.0</u>	<u>(250.0)</u>
		<u>750.0</u>

8. Value of Furniture and Fixtures of Birat Ltd.	(Rs. in '000s)
Value as on 1.4.2007 (540 x 100/90)	600.00
Less: Diminution on revaluation (20%)	<u>(120.00)</u>
Revalued Figure	480.0
Less: Depreciation already charged (600 - 540)	60.0
Less: Depreciation written back due to downward revaluation (120 x 10%)	<u>(12.0)</u> <u>(48.0)</u>
	<u>432.0</u>

9. Contingent liability:

As per para 68 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability." Therefore, it would not be correct to ignore the contingent liability.

8. (i) In Z Ltd.'s Books
Journal Entries

		(Rs. in crores)	
	Dr.	Cr.	
	Amount	Amount	
	Rs.	Rs.	
Bank Account (Current Assets)	Dr. 102		
To Investments		97	
To Profit and Loss Account (Reserves and Surplus)		5	
(Sale of investments at a profit of Rs. 5 crore)			
Debentures (Loan Funds)	Dr. 125		
To Bank Account (Current Assets)		125	
(Redemption of debentures at par)			
Current Liabilities	Dr. 93		
Bank Loan (Loan Funds)	Dr. 15		

Provision for Depreciation	Dr.	81	
Reserves and Surplus (Loss on Demerger)	Dr.	645	
To Fixed Assets			249
To Current Assets			585
(Assets and liabilities pertaining to W Division taken out of the books on transfer of the division to Y Ltd.)			

(ii) (a)	Z Ltd.'s Balance Sheet after demerger		
	Rs. in crores		Rs. in crores
Fixed Assets			
Gross Block	875		
Less: Depreciation	<u>360</u>		515
Net Current Assets			
Current Assets	422		
Less: Current Liabilities	<u>270</u>		<u>152</u>
			<u>667</u>
Financed by			
Shareholders' Funds			
Equity Share Capital	345		
Reserves and Surplus	<u>45</u>		390
Loan Funds			<u>277</u>
			<u>667</u>

Working Notes:

	Rs. in crores	Rs. in crores
1. Reserves and Surplus		
Balance as on 31st March, 2008		685
Add: Profit on sale of investments		<u>5</u>
		690
Less: Loss on demerger		<u>645</u>
Balance shown in balance sheet after demerger		<u>45</u>
2. Loan Funds		
Balance as on 31st March, 2008		417
Less: Bank Loan transferred to Y Ltd.	15	
Debentures redeemed	<u>125</u>	<u>140</u>
Balance shown in balance sheet after demerger		<u>277</u>

3. Current Assets

Balance as on 31st March, 2008	445
Add: Cash received from sale of investments	<u>102</u>
	547
Less: Cash paid to redeem debentures	<u>125</u>
Balance shown in balance sheet after demerger	<u>422</u>

(b) Initial Balance Sheet of Y Ltd.

	Rs. in crores	Rs. in crores
Fixed Assets		218
Net Current Assets		
Current Assets	585	
Less: Current Liabilities	<u>93</u>	<u>492</u>
		<u>710</u>
Financed by		
Shareholders' funds:		
Capital (Issued for acquisition of business)		690
Capital Reserve*		5
Loan Funds		<u>15</u>
		<u>710</u>

9. Journal Entries for Buy-back of shares of Gun Shot Ltd.

	Rs.	Rs.
(i) Bank A/c	Dr. 3,20,000	
To Non-trade Investments		3,00,000
To Profit & Loss A/c		20,000
(Being the entry for sale of Non-trade Investments)		
(ii) Shares Buy back A/c (16,000 x Rs. 20)	Dr. 3,20,000	
To Bank A/c		3,20,000
(Being purchase of 16,000 shares @ Rs.20 per share)		

* Capital Reserve has been calculated as

		Rs. in crores
Purchase consideration		690
Less: Assets transferred	710	
Loan funds transferred	<u>(-15)</u>	<u>695</u>
Capital reserve		<u>5</u>

(iii)	Equity Share Capital A/c (16,000 x Rs.10)	Dr.	1,60,000	
	Buy-back Premium (16,000 x Rs.10)	Dr.	1,60,000	
	To Shares Buy-back A/c			3,20,000
	(Being cancellation of shares bought back)			
(iv)	Securities Premium A/c	Dr.	1,00,000	
	General Reserve	Dr.	60,000	
	To Buy-back Premium			1,60,000
	(Being adjustment of buy-back premium)			
(v)	General Reserve	Dr.	1,60,000	
	To Capital Redemption Reserve			1,60,000
	(Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)			

10. (a) Various advantages of preparation of Value Added (VA) Statements are as under:
1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
 2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
 3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
 4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour-intensive company.
 5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
 6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

(b) Value Added Statement		(Rs. in lakhs)
Turnover		2,300
Add: Change in Finished Stock (Closing Stock 200 – Opening Stock 160)		<u>40</u>
		2,340
Less: Bought in Materials and Services:		
Raw Materials Purchased	625	
Printing and Stationery	22	
Auditor's Remuneration	28	
Rent, Rates and Taxes	165	
Other Expenses	<u>85</u>	<u>925</u>
Value Added		<u>1,415</u>
Disposals as follows:		
To Employees:		
Wages and Salaries	327	
Employees State Insurance	35	
PF Contribution	<u>28</u>	390
To Providers of Capital:		
Interest	40	
Dividend	<u>146</u>	186
To Government: Income Tax		276
To Provide for Maintenance:		
Loss on Sale of Machinery	75	
Depreciation	200	
Retained Earnings	<u>288</u>	<u>563</u>
		<u>1,415</u>

11. (a) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically $EVA = OPBT - Tax - (TCE \times COC)$

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

(b)

Vinod Limited

Computation of Economic Value Added

Economic Value Added	Rs. in Lakhs
Net Operating Profit after Tax (Refer Working Note 5)	1,372.00
Add: Interest on Long-term Fund (Refer Working Note 2)	<u>28.00</u>
	1,400.00
Less: Cost of Capital Rs. 6,400 lakhs × 15.77%	
(Refer working notes 3 and 4)	<u>1,009.28</u>
Economic Value Added	<u>390.72</u>

Working Notes:

1. Cost of Equity = Risk free Rate + Beta Factor (Market Rate – Risk Free Rate)

$$9\% + 1.05 (16 - 9) = 9\% + 7.35\% = 16.35\%$$

2. Cost of Debt

Interest Rs.40 lakhs

Less: Tax (30%) Rs.12 lakhs

Interest after Tax Rs.28 lakhs

$$\text{Cost of Debt} = \frac{28}{400} \times 100 = 7\%$$

3. Weighted Average Cost of Capital

Cost of Equity	Rs. 6,000 lakhs × 16.35% (W.N.1)	Rs. 981 lakhs
Cost of Debt	Rs. 400 lakhs × 7% (W.N.2)	Rs. <u>28</u> lakhs
		Rs. <u>1009</u> lakhs

$$WACC = \frac{1,009}{6,400} = 15.77\% \quad (\text{approx.})$$

4. Capital Employed

	Rs. in Lakhs
Share Capital	2,000
Reserves + Surplus	4,000
Long-term Debts	<u>400</u>
	<u>6,400</u>

5. Net operating Profit after Tax

Profit before Interest + Tax	2,000
Interest	<u>40</u>
	<u>1,960</u>
Tax 30% on 1,960 Lakhs	588
Operating Profit after Tax	1,372

12. (a) Human resource accounting can be defined as the process of identifying, measuring and communicating information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.
- (b) Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resources. Human resources are not recognized in balance sheet as there are no measurement criteria for recognition of human resources. Human resource accounting is at developing stage and no accounting principles have been established for valuation of human assets. Costs incurred on human resources are

recognized as expenses in profit and loss account. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information.

13.

Srishti Ltd.

Statement relating to Staff and Community Benefits

		Rs. In lakhs
I.	Social benefits and cost to staff	
A.	Social Benefits to Staff	
	1. Medical Facilities	9.00
	2. Training Programmes	18.45
	3. Concessional Transport and Later Supply	20.25
	4. Leave Enchashments and Leave Travel Benefits	93.60
	5. Educational Facilities for children of staff members	38.88
	6. Subsidized canteen facilities	25.92
	Total	206.10
B. Less:	Social costs to staff	
	Extra work put in by staff and officers for drought relief	33.30
	Net Social benefits to staff (A-B)	172.80
II.	Social benefits for cost to community	
A.	Social Benefits to Community	
	1. Environmental Improvements	36.18
	2. Generation of Job Opportunities	109.35
	3. Municipal Taxes	19.26
	4. Generation of Business	45.00
	Total	209.79
B. Less:	Social costs to community increase in cost of living in the vicinity due to company's operations	29.79
		180.00
	Total Net Social Benefits to staff and community (I +II)	352.80

14. (a) "Non-Performing Asset" as per NBFC Prudential Norms (RBI) directions means:

- (i) An asset, in respect of which, interest has remained past due for six months;
- (ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;

- (iii) A bill which remained overdue for six months;
- (iv) The interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances that remained overdue for a period of six months;
- (v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;
- (vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;
- (vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

- (b) Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV) which is calculated as under:–

$$\frac{\text{Total market value of all Mutual Fund holdings} - \text{All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (Rs. 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

- 15. (a) Capital adequacy requirements have been specified by SEBI under the SEBI (Merchant Bankers) Regulations, 1992.

Regulation 7 specifies that the requirement of capital adequacy shall not be less than the net worth of the person making the application for grant of registration.

The specified net worth in this connection will be computed as under:

	Minimum requirement
Category I: Merchant bankers who carry on activity of the issue management, which will inter alia, consist of preparation of prospectus and other information relating to the issue, determining the financial structure, tie-up of financiers and final allotment and refund of subscriptions and act as advisor, consultant, manager, underwriter,	

portfolio manager etc.	Rs. 5 crores
Category II – Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager	Rs.50 lakhs
Category III – Merchant bankers who act as underwriter, adviser, consultant to the issue.	Rs.20 lakhs
Category IV – Merchant bankers who act only as an advisor or consultant to the issue.	Nil

For the purposes of the regulation, a merchant banker has been defined as any person engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities is as manager, consultant, advisory or rendering corporate advising more in relation to issue management.

(b) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

- (a) Register of transactions (Sauda book)/Daily transaction list;
- (b) Clients ledger;
- (c) General ledger;
- (d) Journals;
- (e) Cash book;
- (f) Bank Pass Book;
- (g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;
- (h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
- (i) Counterfoils or duplicates of contract notes issued to clients;
- (j) Written consent of clients in respect of contracts entered into as principals;
- (k) Margin deposit book;
- (l) Register of accounts of sub-brokers;
- (m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scrip wise client wise list in respect of scripts of specified group, client upla statement, duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of valan balance

sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorising directors and employees and copies of pool account statements.

16. Journal Entries

Particulars	L.F.	Debit Rs.	Credit Rs.
Bank A/c Dr.		20,00,000	
Investments A/c Dr.		15,00,000	
To Annuity Fund A/c			35,00,000
(Being receipt of annuity based gift in the form of cash and marketable securities)			
Bank A/c Dr.		38,500	
To Annuities Payable A/c			25,000
To Annuity Fund A/c			13,500
(Being monthly investment income received from the fund and surplus accruing after meeting the annuity payable, transferred to the fund)			
Annuities Payable A/c Dr.		25,000	
To Bank A/c			25,000
(Being monthly annuity payment made)			

17. Treatment under Indian Accounting Standard and IFRS

		Indian Accounting Standards	IFRS
(i)	Discontinuing operations - definition and measurement	Operations and cash flows that can be clearly distinguished for financial reporting and represent major line of business or geographical area of operations are discontinued operations. Measurement of discontinued operations is based on AS 24.	Definition of discontinued operations under IFRS is similar to Indian Accounting Standards. However, it also includes a subsidiary acquired exclusively with a view to resale. Discontinued operations are measured at lower of carrying amount and fair value less cost to sell.

(ii)	Acquired intangible assets	If recognition criteria are satisfied then it can be capitalized. All intangibles are amortized over useful life with rebuttable presumption of not exceeding 10 years. Revaluations are not permitted.	If recognition criteria are satisfied then it can be capitalized. It is amortized over useful life. Intangibles assigned an indefinite useful life are not amortized but reviewed at least annually for impairment. Revaluations are permitted in rare circumstances.
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18. (a) XYZ Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

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

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

(b) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

- (i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include 'other income'.
- (ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.
- (iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

- (c) As per para 50 and 52 of AS 19, 'if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.

- (d) It is a present obligation as a result of 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 practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.
19. (i) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006. Presently, these rules are called as Companies (Accounting Standards) Amendment Rules, 2008.
- (ii) The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

- (iii) According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset* should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.
- (iv) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

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

- (v) Cost vs. Fair value

Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or

* A qualifying asset is an asset that necessarily takes a substantial period of time¹ to get ready for its intended use or sale.

in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

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

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

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

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

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

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

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

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

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

- (vi) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.
- (vii) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying

amount of the asset and should be recognised as income or expense in the statement of profit and loss.

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

(viii) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

- (a) the period of the change, if the change affects the period only; or
- (b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

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

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

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

assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

- (1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).
 - (2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
 - (3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.
- (iii) As per provisions of Para 91(b) of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.
- (iv) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

21. (i) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-09 should be calculated as follows:

Actual interest for 2008-09 (11% of Rs.150 crores)	Rs.16.50 crores
Less: Income on temporary investment from specific borrowings	Rs. 3.50 crores
Borrowing costs to be capitalized during year 2008-09	<u>Rs. 13.00 crores</u>

(ii) Omega Limited.

Calculation of Deferred Tax Asset/Liability				
Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	21,00,000	23,00,000	NIL	NIL
	<u>48,00,000</u>	<u>48,00,000</u>		

(iii) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

- (i) Whether or not work has commenced on the contract;
- (ii) Stage of completion of contract activity; or
- (iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

(iv) As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

22. Cash Flow Statement for the year ended December 31, 2008

Cash Flows from Operating Activities

Profit before Tax	2.95,000
Add: Depreciation (Non-Cash expense)	1,10,000
Interest (Non-operating expense)	70,000
Less: Non-operating Income	<u>(25,000)</u>
Operating Profit	4,50,000
Add: Decrease in Bills Receivable	5,000
Decrease in Debtors	30,000
Increase in Creditors	25,000
Less: Increase in Stock	<u>(10,000)</u>

Cash flow from operation before tax	5,00,000	
Less: Tax paid	<u>(1,30,000)</u>	
Cash provided by Operating Activities		3,70,000
Cash Flows from Investing Activities		
Purchase of Fixed Assets (10,00,000 + 1,10,000 – 8,50,000)	(2,60,000)	
Dividend on Investments	<u>25,000</u>	
Cash used in Investing Activities		(2,35,000)
Cash Flows from Financing Activities		
Long term loan taken	30,000	
Interest paid	(70,000)	
Dividend Paid	<u>(90,000)</u>	
Income from Financing Activities		<u>(1,30,000)</u>
Net Increase in Cash during the year		5,000
Add: Opening Cash Balance		<u>30,000</u>
Closing Cash Balance		<u>35,000</u>

23. (i) Computation of earnings per share

	Earnings	Shares	Earnings per share
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	÷	<u>(60,000)</u>	
Diluted earnings per share	<u>Rs. 15,00,000</u>	<u>6,40,000</u>	Rs. 2.34 (approx.)

* The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

- (ii) (a) As per AS 18, associates and joint ventures of the reporting enterprise are related parties. Since A Ltd. holds more than 20% of the voting power in B Ltd. by virtue of this it has substantial interest and significant influence in B Ltd. Therefore B Ltd. is an associate and is related party to A Ltd.
- (b) An associate of an associate is not a related party. Only in the case of a holding company a subsidiary of a subsidiary (sub-subsidiary) also becomes a related party.
- (c) C Ltd. and D Ltd. are co-associates. Co-subsidiaries become related parties because of common control. In the case of this common control is missing and therefore they are not related parties.

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

In the given case the subsidy is given with reference to the total investment in the unit located in the backward area by way of promoter's contribution, the amount should be treated as capital reserve and not income.

- (iv) As per AS 29, Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under:

$$\begin{aligned}
 \text{Expected loss in first ten cases} &= \text{Rs.90,000} \times 0.3 + \text{Rs.1,60,000} \times 0.1 \\
 &= \text{Rs.43,000} \times 10 \\
 &= \text{Rs.4,30,000} \\
 \text{Expected loss in remaining five cases} &= \text{Rs.60,000} \times 0.3 + \text{Rs.95,000} \times 0.2
 \end{aligned}$$

	=	Rs.37,000 × 5
	=	Rs.1,85,000
Total Contingent Liability	=	Rs.4,30,000 + Rs.1,85,000= Rs.6,15,000

24. (i) The Guidance note on "Accounting for Investments in Financial Statements of Mutual Funds" provides that Investments should be marked to market on balance sheet date with provision for depreciation, if any, in the value of investments debited to revenue account. The provision so created should be shown as a deduction from the value of investments in the Balance Sheet. The Guidance notes further states that the depreciation or appreciation should be worked out on individual basis or by category of investment but not on an overall basis. Keeping in view 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the Guidance Note states that the gross value of depreciation on investments should be reflected in the revenue account rather than the same being netted off with the appreciation in the value of other investments. Thus the claim of Amigo Mutual Fund Ltd. is not correct.

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

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

25. (i) Journal Entries

Date	Particulars		Rs.	Rs.
31.3.2006	Employees compensation Expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of Rs. 30 each, amortised on straight line basis over vesting years- Refer W.N.)			
	Profit and Loss A/c	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being compensation expenses charged to P & L A/c)			

31.3.2007	Employees compensation expenses A/c To ESOS outstanding A/c (Being compensation expense recognized in respect of the ESOP)	Dr.	3,95,000	3,95,000
31.3.2007	Profit and Loss A/c To Employees compensation expenses A/c (Being compensation expense charged to P & L A/c)	Dr.	3,95,000	3,95,000
30.3.2008	Employees compensation expenses A/c To ESOS outstanding A/c (Being compensation expense recognized in respect of the ESOP)	Dr.	8,05,000	8,05,000
30.3.2008	Bank A/c (85,000 X Rs.20) ESOS outstanding A/c [(26,25,000/87,500)x85,000] To Equity share capital 600XRs. 10 To Securities premium A/c (85,000 X Rs.40) (Being 85,000 options exercised at an exercise price of Rs. 50 each)	Dr. Dr.	17,00,000 25,50,000	8,50,000 34,00,000
	Profit and Loss A/c To Employees compensation expenses A/c (Being compensation expenses charged to P & L A/c)	Dr.	8,05,000	8,05,000
	ESOS outstanding A/c To General Reserve A/c (Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)	Dr.	75,000	75,000

Working Note:

Particulars	Year 1 (31.3.2006)	Year 2 (31.3.2007)	Year 3 (31.3.2008)
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expenses accrued @ Rs.30 (50-20)	<u>Rs. 28,50,000</u>	<u>Rs. 27,30,000</u>	Rs.26,25,000
Compensation expenses of the year	28,50,000 x 1/2 = Rs.14,25,000	27,30,000 x 2/3 = Rs.18,20,000	
Compensation expenses recognized previously	<u>Nil</u>	<u>Rs.14,25,000</u>	<u>Rs. 18,20,000</u>
Compensation expenses to be recognized for the year	<u>Rs.14,25,000</u>	<u>Rs. 3,95,000</u>	<u>Rs. 8,05,000</u>

(ii) Journal Entries in the Books of Originator

S.No.	Particulars	L.F.	Debit Rs.	Credit Rs.
1.	Bank A/c	Dr.	1,00,000	
	To Loans (Cost of Securitised Component)			90,910
	To Profit on Securitisation			9,090
	(Being securitization of principal amount and right to receive interest at 14% interest rate)			
2.	Servicing Asset A/c	Dr.	3,180	
	Interest Strip A/c	Dr.	5,910	
	To Loans			9,090
	(Being creation of servicing asset and interest strip receivable)			

Working Notes:

1.	Fair value of securitized component of loan		
	Fair value of Loan		1,10,000
	Less: Fair value of servicing asset	3,500	
	Fair value of interest strip	<u>6,500</u>	<u>10,000</u>
			<u>1,00,000</u>

2. Appropriation of carrying amount based on Fair Value

Particulars	Fair Value	% to Fair Value	Proportionate Carrying Amount
	Rs.	Rs.	Rs.
Fair value of securities component of the loan	1,00,000	90.91%	90,910
Fair value of servicing asset	3,500	3.18%	3,180
Fair value of interest strip	6,500	5.91%	5,910
	<u>1,10,000</u>	<u>100.00%</u>	<u>1,00,000</u>

3. Profit on Securitisation	Rs.
Net proceeds from securitisation	1,00,000
Less: Apportioned carrying amount	<u>90,910</u>
	<u>9,090</u>

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR NOVEMBER, 2009
EXAMINATIONS

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2009. Students may kindly take it into consideration while preparing for the examinations.

Final Examination

Paper 1: Advanced Accounting

- I. Statements and Standards
 1. Framework for the Preparation and Presentation of Financial Statements
 2. Accounting Standards – AS 1 to AS 29.
- II. Guidance Notes on Accounting Aspects
 1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
 2. Guarantees and Counter-Guarantees Given by Companies.
 3. Guidance Note on Accrual Basis of Accounting.
 4. Guidance Note on Accounting Treatment for Excise Duty.
 5. Guidance Note on Accounting for Depreciation in Companies.
 6. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
 7. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
 8. Guidance Note on Accounting for Securitisation.
 9. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
 10. Guidance Note on Accounting for Corporate Dividend Tax.
 11. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
 12. Guidance Note on Accounting for Employee Share-based Payments.
 13. Guidance Note on Accounting for Fringe Benefits Tax.
 14. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
 15. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25.