

PAPER – 1 : FINANCIAL REPORTING

QUESTIONS

Consolidated Financial Statements of Group Companies

- From the following Balance Sheets of a group of companies and the other information provided, draw up the consolidated Balance Sheet as on 31.3.2010.

Balance Sheets as on 31.3.2010

(Rs. in Lakh)

	A	B	C		A	B	C
Share capital (in shares of Rs. 10 each)	300	200	100	Fixed Assets less depreciation	130	150	100
Reserves	50	40	30	Cost of investment in B Ltd.	180	—	—
Profit and loss balance	60	50	40	Cost of investment in C Ltd.	40	—	—
Bills payables	10	—	5	Cost of investment in C Ltd.	—	80	—
Creditors	30	10	10	Stock	50	20	20
B Ltd. balance	—	—	15	Debtors	70	10	20
C Ltd. balance	50	—	—	Bills receivables	—	10	20
				C Ltd. balance	—	10	—
				A Ltd. balance	—	—	30
				Cash and bank balance	<u>30</u>	<u>20</u>	<u>10</u>
	<u>500</u>	<u>300</u>	<u>200</u>		<u>500</u>	<u>300</u>	<u>200</u>

- A Ltd. holds 1,60,000 shares and 30,000 shares respectively in B Ltd. and C Ltd.; B Ltd. holds 60,000 shares in C Ltd. These investments were made on 1.7.2009 on which date the provision was as follows:

	B Ltd.	C Ltd.
Reserves	20	10
Profit and loss account	30	16

- In December, 2009 B Ltd. invoiced goods to A Ltd. for Rs. 40 lakhs at cost plus 25%. The closing stock of A Ltd. includes such goods valued at Rs. 5 lakhs.
- A Ltd. proposes dividend at 10%.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

- C Ltd. sold to B Ltd. an equipment costing Rs. 24 lakhs at a profit of 25% on selling price on 1.1.2010. Depreciation at 10% per annum was provided by B Ltd. on this equipment.
 - Bills payables of C Ltd. represent acceptances given to B Ltd. out of which B Ltd. had discounted bills worth Rs. 3 lakhs.
2. Consolidated balance sheet of Mohan Ltd. group and its associate Sohan Ltd. as on 31/03/10 before adjustment for equity method are given below:

Liabilities	Group Rs. 000	Sohan Ltd. Rs. 000	Assets	Group Rs. 000	Sohan Ltd. Rs. 000
Equity Share Capital (Rs. 10)	900	300	Sundry Assets	2,200	630
Capital Reserve	25	-	Investment in Sohan Ltd.	150	
P & L A/c	500	200			
Minority Interest	150	-			
Sundry Liabilities	675	100			
Proposed Dividend					
	<u>100</u>	<u>30</u>			
	<u>2,350</u>	<u>630</u>		<u>2,350</u>	<u>630</u>

Mohan Ltd. acquired 30% ordinary equity shares of Sohan Ltd. on 01/04/08 for Rs. 1,50,000. The balance of A Ltd. profit and loss account on that date was Rs. 1,80,000.

Mohan Ltd. is preparing consolidated financial statements of the group as on 31.3.2010 as per equity method. You are required to:

- (i) Compute goodwill, if any, arising on acquisition of Sohan Ltd. shares;
- (ii) Show how Mohan Ltd. will reflect the value of investment in Sohan Ltd. in the consolidated financial statements?

PAPER- 1 : FINANCIAL REPORTING

Corporate Restructuring

3. The following are the Balance sheets (as at 31.3.2010) of A Ltd. and B Ltd.:

Liabilities	A Ltd. Rs.	B. Ltd. Rs.	Assets	A Ltd. Rs.	B. Ltd. Rs.
Share Capital			Fixed Assets	50,00,000	30,00,000
Equity Shares of Rs.10 each	36,00,000	18,00,000	Investments	5,00,000	5,00,000
10% Preference shares of Rs.100 each	12,00,000	-	Current Assets		
12% Preference shares of Rs.100 each	-	6,00,000	Stock	18,00,000	12,00,000
Reserve and Surplus			Debtors	15,00,000	12,00,000
Statutory Reserve	1,00,000	1,00,000	Bills receivable	50,000	10,000
General Reserve	25,00,000	17,00,000	Cash at Bank	1,50,000	90,000
Secured Loan					
15% Debentures	5,00,000	-			
12% Debentures	-	5,00,000			
Current Liabilities					
Sundry creditors	10,80,000	12,80,000			
Bills payable	<u>20,000</u>	<u>20,000</u>			
	<u>90,00,000</u>	<u>60,00,000</u>		<u>90,00,000</u>	<u>60,00,000</u>

Contingent liabilities for bills receivable discounted Rs.20,000.

(A) The following additional information is provided to you:

	A Ltd. Rs.	B Ltd. Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Rate of Income-tax	40%	40%
Preference dividend	1,20,000	72,000
Equity dividend	3,60,000	2,70,000
Balance profit transferred to Reserve account.		

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

- (B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.
- (C) A Ltd proposes to absorb business of B Ltd. as on 31.3.2010. The agreed terms for absorption are:
- (i) 12% Preference shareholders of B Ltd. will receive 10% Preference shares of A Ltd. sufficient to increase their present income by 20%.
 - (ii) The Equity shareholders of B Ltd. will receive equity shares of A Ltd. on the following terms:
 - (a) The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of A Ltd. based on the results of 2009-10 of both the Companies.
 - (b) The market price of Equity shares of A Ltd. is Rs.40 per share.
 - (c) The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.
 - (d) In addition to Equity shares, 10% Preference shares of A Ltd. will be issued to the equity shareholders of B Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2009-2010.
 - (iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 15% debentures in A Ltd. issued at a discount of 10%.
 - (iv) Rs.16,000 is to be paid by A Ltd. to B Ltd. for liquidation expenses. Sundry Creditors of B Ltd. include Rs.20,000 due to A Ltd. Bills receivable discounted by A Ltd. were all accepted by B Ltd.
 - (v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.
 - (vi) Statutory reserve has to be maintained for two more years.
 - (vii) For the next two years no increase in the rate of equity dividend is anticipated.
 - (viii) Liquidation expense is to be considered as part of purchase consideration.

You are required to find out the purchase consideration and prepare the Balance Sheet of A Ltd. as at 31.3.2010 after absorption.

4. Paradise Limited which had experienced trading difficulties, decided to reorganize its finances. On March 31, 2010, a final Trial Balance extracted from the books of the company showed the following position:

PAPER- 1 : FINANCIAL REPORTING

	<i>Dr.</i>	<i>Cr.</i>
	<i>Rs.</i>	<i>Rs.</i>
Share Capital, Authorized and issued:		
1,500 6% Cumulative Preference Shares of Rs 100 each		1,50,000
2,000 Equity Shares of Rs. 100 each		2,00,000
Capital Reserve		36,000
Profit and Loss Account	1,10,375	
Preliminary Expenses	7,250	
Goodwill at Cost	50,000	
Trade Creditors		42,500
Debtors	30,200	
Bank Overdraft		51,000
Leasehold Property at Cost	80,000	
Provision for Depreciation on Leasehold Property		30,000
Plant and Machinery at Cost	2,10,000	
Provision for Depreciation on Plant and Machinery		57,500
Stock-in-Trade	<u>79,175</u>	
	<u>5,67,000</u>	<u>5,67,000</u>

- (a) The approval of the Court was obtained for the following scheme for reduction of Capital.
- (b) The Preference Shares to be reduced to Rs. 75 per share.
- (c) The Equity Shares to be reduced to Rs. 12.50 per share
- (d) One Rs. 12.50 Equity Share to be issued for each Rs. 100 of Gross Preference Dividend Arrears, the Preference Dividend had not been paid for three years.
- (e) The balance in Capital Reserve Account to be utilized.
- (f) Plant and Machinery to be written down to Rs. 75,000.
- (g) The Profit and Loss Account balance and all intangible assets to be written off.

At the same time as the resolution to reduce capital was passed, another resolution was approved restoring the total Authorised Capital to Rs. 3,50,000 consisting of 1,500 6% Cumulative Preference Shares of Rs. 75 each and the balance in Equity Shares of Rs. 12.50. As soon as the above resolutions had been passed 5,000 Equity Shares were issued at par, for cash, payable in full as application money. The same were fully subscribed and paid.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

You are required:

- (i) To show the Journal entries necessary to record the above transactions in the Company's books, and
 - (ii) To prepare the Balance Sheet of the Company, after completion of the reconstruction scheme.
5. The following was the balance sheet of Kanika Ltd. as at 31st March, 2010.

<i>Liabilities</i>	<i>(Rs. in lakhs)</i>
10% Redeemable preference shares of Rs. 10 each, fully paid up	2,500
Equity shares of Rs. 10 each fully paid up	8,000
Capital redemption reserve	1,000
Securities premium	800
General reserve	7,100
Profit and loss account	300
9% Debentures	5,000
Sundry creditors	3,300
Sundry provisions	<u>2,000</u>
	<u>30,000</u>
<i>Assets</i>	<i>(Rs. in lakhs)</i>
Fixed assets	16,000
Investments	4,100
Cash at bank	1,650
Other current assets	<u>8,250</u>
	<u>30,000</u>

On 1st April, 2010 the company redeemed all its preference shares at a premium of 10% and bought back 25% of its equity shares @ Rs. 20 per share. In order to make cash available, the company sold all the investments for Rs. 4,500 lakhs and raised a bank loan amounting to Rs. 1,000 lakhs on the security of the company's plant.

Pass journal entries for all the above mentioned transactions including cash transactions and prepare the company's balance sheet immediately thereafter. The amount of securities premium has been utilized to the maximum extent allowed by law.

Valuation

6. Following information is furnished in respect of Som Dutt Ltd.
1. Share capital: 2,00,000 equity shares of Rs. 10 each fully paid.

PAPER- 1 : FINANCIAL REPORTING

2. Profits after tax, dividends declared and retained earnings.

<i>Year</i>	<i>Profit after tax</i>	<i>Dividend declared</i>	<i>Retained earnings</i>
	<i>(Rs.)</i>	<i>(Rs.)</i>	<i>(Rs.)</i>
2009	7,00,000	3,40,000	3,70,000
2008	6,00,000	3,00,000	3,00,000
2007	4,00,000	2,60,000	1,40,000

3. Normal rate of return expected by shareholders in the market is 10%

4. The normal earnings of similar companies in the chemicals industry is 15%.

You are required to calculate the value of shares under earnings capitalization method.

7. Negotiation is going on for transfer of Value Ltd. on the basis of the balance sheet and the additional information as given below.

Balance sheet of Value Ltd. as on 31st March, 2010

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital (Rs. 10 fully paid up)	10,00,000	Goodwill	1,00,000
Reserves and surplus	4,00,000	Land and building	3,00,000
Sundry creditors	3,00,000	Plant and machinery	8,00,000
		Investment	1,00,000
		Stock	2,00,000
		Debtors	1,50,000
		Cash and bank	<u>50,000</u>
	<u>17,00,000</u>		<u>17,00,000</u>

Profit before tax for 2009-10 amounted to Rs. 6,00,000 including Rs. 10,000 as interest on investment. However, an additional amount of Rs. 50,000 p.a. shall be required to be spend for smooth running of the business.

Market values of land and buildings and plant and machinery are estimated at Rs. 9,00,000 and Rs. 10,00,000 respectively. In order to match the above figures, further depreciation to the extent of Rs. 40,000 should be taken into consideration. Income tax rate may be taken at 50%. Return on capital at the rate of 20% before tax may be considered normal for this business at the present stage.

Average trading capital employed is required to be considered for the purpose of calculation of goodwill. It has been agreed that 4 years purchase of super profit shall be taken as the value of goodwill for the purpose of the deal.

You are requested to compute the value of goodwill of the company.

8. From the following information, determine the possible value of brand under potential earning model:

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

	<i>Rs. In lakhs</i>
(i) Profit Before Tax (PBT)	6,500
(ii) Income Taxes	1,500
(iii) Tangible fixed assets	10,000
(iii) Identifiable intangible other than brand	5,000
(iv) Expected normal return on tangible fixed assets	3,000
(v) Appropriate capitalization factor for intangibles	25%

Inflation Accounting

9. (a) What are the limitations of historical accounting in a period of inflation?
 (b) Calculate the Cost of Sale Adjustment (COSA) from the following under Current cost accounting (CCA) Method:

<i>Particulars</i>	<i>Historical cost (Rs.)</i>	<i>Index No.</i>
Opening stock	1,00,000	100
Purchases	<u>3,60,000</u>	120 Average
	4,60,000	
Less: Closing stock	<u>1,68,000</u>	140
Cost of sales	<u>2,92,000</u>	

Value Added

10. (a) Write short note on 'market value Added'.
 (b) Following is an extract of Profit & Loss Account of Chitresh Ltd. for the year ended 31st March, 2010.

Particulars	Rs. 000s
Sales (including Excise Duty Recoveries)	1,454
Other Income	<u>26</u>
Total	<u>1,480</u>
Materials	1,060
Excise Duty	124
Salaries, Wages & Employee Benefits	38
Other Expenses	94
Interest & Finance Charges	14
Depreciation	10
Provision for Taxation	62

PAPER- 1 : FINANCIAL REPORTING

Preliminary Expenses written off	10
Transfer to Debenture Redemption Reserve	10
Proposed Dividend	10
Transfer to General Reserve	<u>48</u>
Total	<u>1,480</u>

- Other Expenses include Fees & Commissions to Whole – Time Directors amounting to Rs. 18,000 and Loss on Sale of Fixed Assets of Rs. 6,000.
- Interest and Finance Charges include interest on Long Term Loans of Rs. 8,000; and the balance being on Short-term Borrowings.

Prepare a Value Added Statement for the year ended 31st March, 2010. Also show statement showing application of value added.

Economic Value Added

11. (a) Define the concept of Economic Value Added in brief.
- (b) Prime Commercial Bank has a criterion that it will give loan to companies that have an economic value added greater than zero for the past three years on average. The bank is considering lending money to a small company that has the economic value characteristics shown below. Does that company meet the bank's criterion for a positive economic value added? The data relating to the company is as follows:
- (i) Average operating income after tax equals Rs. 25,00,000 per year for the last three years.
 - (ii) The average total assets of company over the past three years equals Rs. 75,00,000.
 - (iii) The weighted average cost of capital appropriate for the company equals 10% which is applicable to all three years.
 - (iv) The company's average current liabilities over the past three year equals Rs. 15,00,000.

Human Resource Reporting

12. (a) Why Human Resources Asset is not recognized in the Balance sheet?
- (b) Discuss the method of valuation of human resources as suggested by Jaggi and Lau.

Financial Reporting for Financial Institutions

13. Calculate the NAV of a Mutual Fund scheme from the information given below –

Beginning of the year :

Number of Units outstanding 1 Crore of Rs. 10 each

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Investments at Cost Rs. 10 Crores (Market Value Rs. 16 Crores)

Outstanding Liabilities Rs. 5 Crore

Other Information –

1. Another 20 Lakh units were sold during the year at Rs. 24.
 2. No additional investments were made during the year and as at the year-end, 50% of the Investments at year beginning were quoted at 80% of the book value.
 3. 10% of the Investments had witnessed a permanent fall of 10% below cost.
 4. The balance investments were quoted at Rs. 13.60 Crores.
 5. Outstanding liabilities towards Custodian Charges, Salaries and Commission etc. applicable to the Scheme were Rs. 1 Crore.
- (a) For what purposes inspection of records and documents of Merchant Banker is ordered by SEBI?
- (b) Write short notes on:
- (i) Disclosures by a NBFC in its balance sheet.
 - (ii) Closing out by a member broker.
 - (iii) Open ended and close ended schemes of mutual funds.

Corporate Financial Reporting

15. One of the important factors generally considered for awarding shields and plaques in India for 'best presented accounts' is that the information presented in the accounts make useful disclosures. What are actually looked into in this regard?

International Accounting standards, International Financial Reporting Standards, their Interpretations and US GAAPs – An Overview

16. Explain the term “IFRS”. What is the need of convergence of Accounting Standards with IFRS?
17. Hari Co. Ltd. has decided to reconcile its financial statements in line with International Financial Reporting Standards. The statement of financial position of Hari Co. Ltd as at 1st April, 2010 is as follows:

Assets	Rs. '000
Fixed assets	1,200
Intangible assets	400
Financial assets	400
Inventories	600
Trade and other receivables	500
Cash and cash equivalents	100

PAPER- 1 : FINANCIAL REPORTING

	<u>3,200</u>
<i>Liabilities</i>	
Trade and other payables	800
10% Loans from Bank	1,300
Current tax liability	80
Deferred tax liability	<u>20</u>
	<u>2,200</u>
Total assets less liabilities	<u>1,000</u>
<i>Equity</i>	
Issued share capital	600
Retained earnings	<u>400</u>
	<u>1,000</u>

Other information:

- (i) The provision for depreciation was made as per the Indian statutes. Due to reconciliation with the IFRS provisions, the carrying amount of fixed assets needs to be increased by 2,00,000.
- (ii) All financial assets costing Rs. 4,00,000 are classified as available for sale category under IAS 39. The fair value of these assets is calculated as 5,00,000 on 1st April, 2010.
- (iii) A pension liability of 1,00,000 is recognized under IFRS (not provided earlier). However, no tax implication arises due to recognition of this liability.
- (iv) The value of inventories is Rs. 4,00,000 as per IAS 2. The necessary adjustment needs to be done in the book value.
- (v) Unrealized gain Rs. 3,00,000 on unmatured forward foreign exchange contracts (included in receivables) which were not recognized under Indian Accounting Standards are required to be recognized under IFRS.

You are required to prepare reconciled financial statements (in convergence to IFRS), assuming tax rate of 30%. Give necessary working notes.

Financial Instruments

18. (a) ABC bank has a deposit with other banks which are negotiable but the depositor has not negotiated these deposit documents. How will you categorize this deposit as a financial asset?
- (b) In the following derivative contracts, identify the underlying variable:
- (i) Interest Rate Swap
 - (ii) Equity Swap

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

- (iii) Currency Swap (Foreign Exchange Swap)
- (iv) Commodity Swap
- (v) Equity Forward

Share Based Payments

19. On 1.1.2009, Surya Kiran Ltd grants 200 stock options to each of its 300 employees, which will vest at the end of 3rd year, provided the employees are in service at the end of 3rd year. The exercise price per option is Rs. 60 if average annual output per employee is in the range of 100 units to 120 units, Rs. 50 if the same is in the range of 121 units to 130 units, Rs. 40 if the same is above 130 units.

Fair value as on grant date is estimated at Rs. 50 per option if the exercise price is Rs. 60, Rs. 40 per option if the exercise price is Rs. 50, Rs. 30 per option if the exercise price is Rs. 40.

On 31.12.2009, 20 employees have left. Actual average annual output per employee is 115 till date. X Ltd. expects that it is most likely that the average output will be 122 over the 3 years and that further 30 employees will leave during next 2 years.

On 31.12.2010, further 25 employees have left. Actual average annual output per employee is 132 till date. X Ltd. expects that it is most likely that the average output will be above 130 units over the 3 years. It also estimates that a further 10 employees will leave during the 3rd year.

On 31.12.2011, further 15 employees have left. Actual average annual output per employees is only 112 till date.

Compute the amounts to be recognized for each year.

Accounting Standards and Guidance Notes

20. (a) Contractors Ltd. have recognized contract revenue on a contract awarded in the financial year 2009-10. The target date of completion is 5 years. The contract provides for incentives for early completion at the rate of Rs. 1,000 per day subject to a maximum of Rs. 3,00,000. The company has included this amount in contract revenue (in the first year of contract) on the ground that based on the previous experience in similar contracts, it is confident of completing the contract in 4 years. The company's past track record shows that company was able to complete such contracts well in time and earn incentives. Comment on the company's accounting policies.
- (b) The Board of Directors of Gautam Ltd. seeks your advice in the finalization of financial statements for the year ended 31st March, 2010. On a review of financial statements, it is noticed that:
- Sale of goods costing Rs. 54,000 with a profit margin of 10% on selling price is included in the inventory as delivery of goods was postponed at buyer's request.

PAPER- 1 : FINANCIAL REPORTING

Advise the company on changes to be effected in the draft financial statements. Give reasons in support of your advice. There is no necessity to discuss disclosure requirements in this regard.

- (c) Induga Ltd., a venturer, purchased an asset of Rs. 20 lakhs from to jointly controlled entity, written down value of asset in joint venture books was Rs. 24 lakhs. Under proportionate consolidation method, what adjustment Induga Ltd., should do while preparing financial statements, Induga Ltd. has 50% interest in venture.
21. (a) Supriya Ltd. received a grant of Rs.2,500 lakhs during the last accounting year (2008-09) from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However, during the year 2009-10, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS 12.
- (b) The fair value of plan assets at the beginning and end of the year were Rs. 4,000 and Rs. 5,000 respectively. The employer's contribution to the plan during the year as Rs. 500. Benefit payments to retiree were Rs. 400. Calculate the actual return on plan assets.
- (c) Parvesh Ltd. had the following borrowings during a year in respect of capital expansion:

Plant	Cost of Asset (Rs.)	Remarks
Plant P	100 lakhs	No specific borrowings
Plant Q	125 lakhs	Bank loan of Rs. 65 lakhs at 10%
Plant R	175 lakhs	9% Debentures of Rs. 125 lakhs were issued.

In addition to the specific borrowings stated above, the Company had obtained term loans from two banks

- (1) Rs. 100 lakhs at 10% from Corporation Bank and
- (2) Rs. 110 lakhs at 11.50% from State Bank of India, to meet its capital expansion requirements.

Determine the amount of borrowing costs to be capitalized in each of the above Plants, as per AS-16.

22. (a) X Ltd. has its financial year ended 31.3.2009, fifteen Law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the probable outcomes as below:

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Result	Probability	Amount of Loss Rs.
For first ten cases:		
Win	0.6	----
Loss-low damages	0.3	50,000
Loss-high damages	0.1	1,00,000
For remaining five cases:		
Win	0.5	----
Loss-low damages	0.3	60,000
Loss-high damages	0.2	1,00,000

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.

- (b) Pooja Ltd. had 12,00,000 equity shares of Rs. 10 each fully paid up outstanding prior to rights issue. The details of rights issue are as follows:
- One new share for every two shares outstanding.
 - Rights issue price – Rs. 18
 - Last date to exercise rights is 31st December, 2009
 - Fair value of each equity share prior to exercise of rights – Rs 24

The details of net profit earned by the company as follows:

Year ended 31-3-2009 Rs. 40,00,000

Year ended 31-3-2010 Rs. 54,00,000

Calculate EPS to be reported under AS-20.

23. (a) Mr. Raj a relative of key Management personnel received remuneration of Rs. 2,50,000 for his services in the company for the period from 1.4.2009 to 30.6.2009. On 1.7.2009 he left the service.

Should the relative be identified as at the closing date i.e. on 31.3.2010 for the purposes of AS 18?

- (b) Raw materials inventory of a company includes certain material purchased at Rs. 100 per kg. The price of the material is on decline and replacement cost of the inventory at the year end is Rs. 75 per kg. It is possible to convert the material into finished product at conversion cost of Rs. 125.

Find out the value of inventory, if selling price is (i) Rs. 175 and (ii) Rs. 235.

PAPER- 1 : FINANCIAL REPORTING

- (c) On 30.6.2009, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment.

Also, on 30.7.2009, the company paid Rs. 60,000 for property taxes assessed for the calendar year

2009. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30.9.2009.

24. (a) The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

Rs. in lakhs

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

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

- (b) A company enters into three sale agreements for disposing off the assets of three separate components of the business. Can the company report the discontinuing operations on a consolidated basis? Elucidate.
- (c) An Enterprise has incurred expense for purchase of Technical know-how for manufacturing a car. The Enterprise has paid Rs. 5 crores for the use of know-how for a period of 4 years. The Enterprise estimates the production of cars as follows:

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

- (a) How will the Enterprise amortize the Technical know-how Fees as per AS 26?
- (b) Whether this amortization should be directly charged as an expense or should form part of production cost of the cars?
25. (a) X Ltd. purchased a plant for Rs. 50 lakhs from Y Ltd. during 2009-2010 and installed immediately. The price includes excise duty of Rs. 5 lakhs. During 2009-2010, the company produced excisable goods on which the excise authority charged excise duty to the extent of Rs. 4.5 lakhs. Show the necessary Journal Entries explaining the treatment of Cenvat credit. You are also required to indicate

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

the value of plant at which it should be recorded in fixed asset register.

(b) How will you present MAT credit in financial statements?

SUGGESTED ANSWERS / HINTS

**1. Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd.
as at 31st March, 2010**

<i>Liabilities</i>		<i>Amount</i>	<i>Assets</i>	<i>(Rs. in lakhs)</i> <i>Amount</i>	
Share capital		300.00	Fixed Assets		
Minority Interest			A Ltd.	130.00	
B Ltd.	63.08		B Ltd.	150.00	
C Ltd.	<u>16.22</u>	79.30	C Ltd.	<u>100.00</u>	
Capital Reserve		13.40		380.00	
			Less: Unrealized profit	<u>7.80</u>	372.20
Other Reserves		81.60	Stock		
Profit and Loss Account		56.90	A Ltd.	50.00	
Bills Payables			B Ltd.	20.00	
A Ltd.	10.00		C Ltd.	<u>20.00</u>	
B Ltd.	<u>5.00</u>			90.00	
	15.00		Less: Unrealized profit	<u>1.00</u>	89.00
Less: Mutual indebtedness	<u>2.00</u>	13.00	Debtors		
			A Ltd.	70.00	
Creditors			B Ltd.	10.00	
A Ltd.	30.00		C Ltd.	<u>20.00</u>	100.00
B Ltd.	10.00		Cash and Bank Balances		60.00
C Ltd.	<u>10.00</u>	50.00	Bills Receivable		
Current Account Balances			B Ltd.	10.00	
A Ltd.	50		C Ltd.	<u>20.00</u>	
				30.00	
C Ltd.	<u>15</u>		Less: Mutual indebtedness	<u>2.00</u>	28.00
	65				

PAPER- 1 : FINANCIAL REPORTING

Less: Mutual indebtedness (10+ 30)	<u>40</u>	25.00		
Proposed Dividend		<u>30.00</u>		
		<u>649.20</u>		<u>649.20</u>

Working Notes:

		(Rs. in lakhs)		
		Capital Profit	Revenue Reserve	Revenue profit
1.	Analysis of Profits of C Ltd.			
	Reserves on 1.7.2009	10.00		
	Profit and Loss A/c on 1.7.2009	16.00		
	Increase in Reserves		20.00	
	Increase in Profit			<u>24.00</u>
		<u>26.00</u>	<u>20.00</u>	<u>24.00</u>
	Less: Minority Interest (10%)	<u>2.60</u>	<u>2.00</u>	<u>2.40</u>
		<u>23.40</u>	<u>18.00</u>	<u>21.60</u>
	Share of A Ltd.	7.80	6.00	7.20
	Share of B Ltd.	15.60	12.00	14.40
2.	Analysis of Profits of B Ltd.			
	Reserves on 1.7.2009	20.00		
	Profit and Loss A/c on 1.7.2009	30.00		
	Increase in Reserves		20.00	
	Increase in Profit			<u>20.00</u>
		<u>50.00</u>	<u>20.00</u>	<u>20.00</u>
	Share in C Ltd.		<u>12.00</u>	<u>14.40</u>
		<u>50.00</u>	<u>32.00</u>	<u>34.40</u>
	Less: Minority Interest (20%)	<u>10.00</u>	<u>6.40</u>	<u>6.88</u>
	Share of A Ltd.	<u>40.00</u>	<u>25.60</u>	<u>27.52</u>
3.	Cost of Control			
	Investments in B Ltd.			180.00
	Investments in C Ltd.			<u>120.00</u>
				300.00
	Less: Paid up value of investments in B Ltd.	160.00		

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

	in C Ltd.	<u>90.00</u>	250.00	
	Capital Profit			
	in B Ltd.	40.00		
	in C Ltd.	<u>23.40</u>	<u>63.40</u>	<u>313.40</u>
	Capital Reserve			<u>13.40</u>
4.	Minority Interest	B Ltd.	C Ltd.	
	Share Capital	40.00	10.00	
	Capital Profit	10.00	2.60	
	Revenue Reserves	6.40	2.00	
	Revenue Profits	<u>6.88</u>	<u>2.40</u>	
		63.28	17.00	
	Less: Unrealized profit on stock (20% of 1)	.20		
	Unrealized profit on equipment (10% of 7.8)		<u>.78</u>	
		<u>63.08</u>	<u>16.22</u>	
5.	Unrealized Profit on equipment sale			
	Cost	24.00		
	Profit	<u>8.00</u>		
	Selling Price	<u>32.00</u>		
	$\text{Unrealized profit} = 8 - 8 \times \frac{10}{100} \times \frac{3}{12} = 8.00 - 0.20 = 7.80$			
6.	Profit and Loss Account – A Ltd.			
	Balance	60.00		
	Less: Proposed Dividend	<u>30.00</u>		
		30.00		
	Share in B Ltd.	27.52		
	Share in C Ltd.	<u>7.20</u>		
		64.72		
	Less: Unrealized profit on equipment (90% of 7.8)	<u>7.02</u>		
		57.70		
	Less: Unrealized profit on stock $\left(5 \times \frac{25}{125} \times 80\%\right)$	.80		
		<u>56.90</u>		
7.	Reserves – A Ltd.			
	A Ltd.	50.00		
	Share in B Ltd.	25.60		
	Share in C Ltd.	<u>6.00</u>		
		<u>81.60</u>		

PAPER- 1 : FINANCIAL REPORTING

2.

Rs.' 000

Application of equity method

Closing equity = 30% of (300 + 200 + 30) = 159

Equity at the time of acquisition of shares = 30% of (300 + 180) = 144

Goodwill = 150 – 144 = 6

Post-acquisition profit = 30% of (200 + 30 – 180) = 15

Consolidated Balance sheet of Mohan Ltd. group

As at 31st March, 2010

Liabilities	Rs.000	Assets	Rs.000
Share Capital (Rs. 10)	900	Sundry Assets	2,200
Capital Reserve	25	Investment in Sohan Ltd. [including goodwill 6]	165
P & L A/c (500 + 15)	515		
Minority Interest	150		
Sundry Liabilities	675		
Proposed Dividend	<u>100</u>		
	<u>2,365</u>		<u>2,365</u>

3. (i) **Computation of Purchase Consideration**

	Rs.
<i>For Preference Shareholders</i>	
Present Income of Preference Shareholders of B Ltd.	72,000
Add : Required 20% increase	<u>14,400</u>
	<u>86,400</u>
10% Preference Shares to be issued of Rs. 8,64,000 (86,400/10x 100)	
<i>For Equity Shareholders</i>	
Valuation of Equity Shares of B Ltd. = Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of A Ltd. x 60/100)	
= 1,80,000 x (Rs.2 x 20x $\frac{60}{100}$) = 1,80,000 x 24 = Rs.43,20,000	
<i>Issue of Equity Shares</i>	
No. of Equity Shares to be issued at 80% of Market Price i.e. 80% of Rs.40 = Rs.32	
$\frac{43,20,000}{32} = 1,35,000$ shares	

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Equity Share Capital = 1,35,000 x Rs.10 =	Rs.13,50,000	
Securities Premium = 1,35,000 x Rs. 22 =	<u>Rs.29,70,000</u>	
	<u>Rs.43,20,000</u>	
<i>Issue of Preference Shares</i>		Rs.
Present Equity Dividend		2,70,000
Less: Expected Equity Dividend from A Ltd.		
(13,50,000 x $\frac{10}{100}$)		<u>1,35,000</u>
		<u>1,35,000</u>
10% Preference Shares to be issued of Rs. 13,50,000 (1,35,000/10x 100)		
Purchase Consideration		
Preference Shares Capital [Rs.8,64,000 + Rs.13,50,000]		22,14,000
Equity Share Capital (1,35,000 shares of Rs.10 each at Rs.32 per share)		43,20,000
Liquidation Expenses (in cash)		<u>16,000</u>
		<u>65,50,000</u>

**(ii) Balance Sheet of A Ltd (after absorption of B Ltd.)
as on 31.3.2010**

<i>Liabilities</i>	<i>Amount Rs.</i>	<i>Assets</i>	<i>Amount Rs.</i>
<i>Share Capital:</i>		<i>Fixed Assets:</i>	
4,95,000 Equity Shares of Rs. 10 each fully paid (1,35,000 shares have been allotted as fully paid up for consideration other than cash)	49,50,000	Goodwill	19,10,000
10% Preference Shares of Rs.100 each fully paid	34,14,000	Other Fixed Assets (60,00,000+36,00,000)	96,00,000
		<i>Investment</i> (5,00,000+5,00,000)	10,00,000
<i>Reserve & Surplus:</i>		<i>Current Assets:</i>	
Statutory Reserve	2,00,000	Stock (18,00,000+10,80,000)	28,80,000
Revaluation Reserve	10,00,000	Debtors (15,00,000+12,00,000-20,000)	26,80,000
General Reserve	25,00,000		
Securities Premium	29,10,000	Bills Receivable	60,000

PAPER- 1 : FINANCIAL REPORTING

<i>Secured Loan:</i>		(50,000+10,000)	
15% Debentures (5,00,000 + 6,00,000)	11,00,000	Cash at Bank (1,50,000 + 90,000-16,000)	2,24,000
<i>Current Liabilities and Provisions:</i>			
Creditors (10,80,000+12,80,000-20,000)	23,40,000	Amalgamation Adjustment A/c	1,00,000
Bills Payable (20,000 + 20,000)	<u>40,000</u>		
	<u>1,84,54,000</u>		<u>1,84,54,000</u>

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

Working Notes:

1. Calculation of EPS & P/E ratio

	<i>A Ltd.</i> Rs.	<i>B Ltd.</i> Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Less: Interest on debentures	<u>75,000</u>	<u>60,000</u>
Profit before tax	14,00,000	7,20,000
Less: Tax @ 40%	<u>5,60,000</u>	<u>2,88,000</u>
	8,40,000	4,32,000
Less: Preference Dividend	<u>1,20,000</u>	<u>72,000</u>
Earnings available for equity shareholders	<u>7,20,000</u>	<u>3,60,000</u>
Number of shares	3,60,000 shares	1,80,000 shares
EPS (Earnings/ No. of shares)	2	2
Market Price	Rs.40	Not given
P/E ratio	40/2 = 20	N.A.

2. Computation of Goodwill/Capital Reserve on absorption

			Rs.
Purchase Consideration			65,50,000
Fixed Assets taken over	30,00,000		
Add: Increase by 20%	<u>6,00,000</u>	36,00,000	
Investments		5,00,000	
Current Assets:			
Stock	12,00,000		
Less: Reduction in value by 10%	<u>1,20,000</u>		
	10,80,000		

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Debtors	12,00,000		
B/R	10,000		
Cash at Bank	<u>90,000</u>	<u>23,80,000</u>	
		64,80,000	
Less: Outside Liabilities:			
12% Debentures at premium	5,40,000		
Sundry Creditors	12,80,000		
Bills Payable	<u>20,000</u>	<u>18,40,000</u>	<u>46,40,000</u>
Goodwill			<u>19,10,000</u>

3. Journal Entries in the Books of A Ltd.

<i>Particulars</i>	<i>Dr. (Rs.)</i>	<i>Cr. (Rs.)</i>
1. Fixed Assets A/c	Dr. 10,00,000	
To Revaluation Reserve		10,00,000
(Being Revaluation of Fixed assets at 20% above book value)		
2. Business Purchase A/c	Dr. 65,50,000	
To Liquidator of B Ltd.		65,50,000
(Being purchase consideration payable for the business taken over from B Ltd.)		
3. Fixed Assets A/c	Dr. 36,00,000	
Investment A/c	Dr. 5,00,000	
Stock A/c	Dr. 10,80,000	
Debtors A/c	Dr. 12,00,000	
Bills Receivable A/c	Dr. 10,000	
Cash at Bank A/c	Dr. 90,000	
Goodwill A/c (Balancing figure)	Dr. 19,10,000	
To 12% Debentures in B Ltd.		5,40,000
To Creditors		12,80,000
To Bills Payable		20,000
To Business Purchase A/c		65,50,000
(Being incorporation of different assets and liabilities of B Ltd. taken over at agreed values and balance debited to goodwill account)		

PAPER- 1 : FINANCIAL REPORTING

4.	Liquidator of B Ltd.	Dr.	65,50,000	
	To Equity Share Capital A/c			13,50,000
	To Securities Premium A/c			29,70,000
	To Preference Share Capital A/c			22,14,000
	To Bank A/c			16,000
	(Being discharge of consideration for B Ltd's business)			
5.	12% Debentures in B Ltd.	Dr.	5,40,000	
	Discount on issue of Debentures	Dr.	60,000	
	To 15% Debentures			6,00,000
	(Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of B Ltd. debentures)			
6.	Sundry Creditors A/c	Dr.	20,000	
	To Sundry Debtors A/c			20,000
	(Being cancellation of Mutual owing)			
7.	Amalgamation Adjustment A/c	Dr.	1,00,000	
	To Statutory Reserve A/c			1,00,000
	(Being statutory reserve account is maintained under statutory requirements)			
8.	Securities Premium A/c	Dr.	60,000	
	To Discount on issue of Debentures A/c			60,000
	(Being discount on issue of Debentures written off out of securities premium)			

4. (i)

Journal of Paradise Ltd.

		Dr.	Cr.
		Rs.	Rs.
6% Cumulative Preference Share Capital (Rs. 100 each) A/c	Dr.	1,50,000	
To 6% Cumulative Pref. Share Capital (Rs. 75 each) A/c			1,12,500
To Capital Reduction A/c			37,500
(1,500 6% Preference Shares converted into equal			

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

number of 6% Cum. Pref. Shares of Rs. 75 each; balance of the amount transferred to Capital Reduction Account vide Scheme of Reconstruction confirmed by the Court Order dated)			
Equity Share Capital (Rs. 100 each) A/c To Equity Share Capital (Rs. 12.50 each) A/c To Capital Reduction A/c (2,000 Equity Shares of Rs. 100 each reduced to equity Share of Rs. 12.50 each; the balance transferred to Capital Reduction Account vide Reconstruction Scheme confirmed by the Court Order dated.....)	Dr.	2,00,000	25,000 1,75,000
Capital Reduction A/c To Equity Share Capital A/c (Allotment of 270 Equity Shares of Rs. 12.50 each to preference shareholders in settlement of their claim for arrears of dividend @ 1/8 of amount due, Rs. 27,000, vide Scheme of Reconstruction confirmed by the Court Order dated.....)	Dr.	3,375	3,375
Capital Reserve A/c To Capital Reduction A/c (Balance of capital reserve transferred to Capital Reduction Account vide Scheme of Capital Reconstruction dated.....)	Dr.	36,000	36,000
Capital Reduction A/c To Plant & Machinery A/c (The net amount of Plant & Machinery reduced to Rs.75,000 vide Scheme of reconstruction confirmed by the Court Order dated)	Dr.	77,500	77,500
Capital Reduction A/c To Profit & Loss A/c To Preliminary Expenses To Goodwill (Debit balance of profit and loss account, preliminary expenses and goodwill written off against Capital Reduction Account vide Scheme of Capital Reconstruction confirmed by Court Order dated)	Dr.	1,67,625	1,10,375 7,250 50,000
Bank A/c	Dr.	62,500	

PAPER- 1 : FINANCIAL REPORTING

To Share Application & Allotment A/c (Application & allotment money received on 5,000 Equity Share @ Rs. 12.50 per share)			62,500
Share Application and Allotment A/c To Equity Share Capital A/c (Allotment of 5,000 equity share of Rs. 12.50 each vide Board Resolution dated.....)	Dr.	62,500	62,500

(ii) **Balance Sheet of Paradise Ltd. as on March 31, 2010**

Liabilities	Rs.	Assets		Rs.
<i>Share Capital</i>		<i>Fixed Assets</i>		
Authorised Capital:		Goodwill	50,000	
19,000 Equity Shares of		Less: Written off	<u>50,000</u>	
Rs. 12.50 each	2,37,500	Plant & Machinery		
1,500 6% Cum. Preference		as cost	2,10,000	-
shares of Rs. 75 each	<u>1,12,500</u>	Less: Written off	<u>77,500</u>	
<i>Issued, subscribed &</i>			1,32,500	
<i>paid-up capital:</i>		Less: Provision for		
7,270 Equity Shares of		Depreciation	<u>57,500</u>	75,000
Rs. 12.50 each fully paid	90,875	Lease-hold	80,000	
(270 Shares of Rs. 12.50		Property		
each issued for consideration		Less: Provision for		
other than cash)		Depreciation	<u>30,000</u>	50,000
1,500 6% Cum. Preference	1,12,500	Investments		Nil
Share of Rs. 75 each fully paid		<i>Current Assets &</i>		
<i>Capital Reserve</i>	Nil	<i>Loans & Advances</i>		
<i>Secured Loans</i>	Nil	Stock in trade		79,175
<i>Unsecured Loans,</i>	-	Sundry Debtors		30,200
<i>Current Liabilities &</i>		Cash at Bank		<u>11,500</u>
<i>Provisions</i>				<u>2,45,875</u>
Sundry Creditors	<u>42,500</u>			
	<u>2,45,875</u>			

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

5. Journal entries in the books of Kanika Ltd.

	Particulars		Rs. in Lakhs	
			Debit	Credit
1.	Bank A/c Dr. To Investment A/c To Profit and Loss A/c (Being sale of investments and profit thereon)		4,500	4,100 400
2	Bank A/c Dr. To Bank loan A/c (Being loan taken from bank)		1,000	1,000
3.	10% Redeemable preference share capital A/c Dr. Premium on redemption of preference shareholder A/c Dr. To Preference shareholders A/c (Being redemption of preference shares)		2,500 250	2,750
4.	Preference shareholders A/c Dr. To Bank A/c (Being payment of amount due to preference shareholders)		2,750	2,750
5.	Securities premium A/c Dr. To Premium on redemption of preference shares (Being use of securities premium to provide premium on redemption of preference shares)		250	250
6.	Equity shares bought back A/c Dr. To Bank A/c (Being buy back of equity shares)		4,000	4,000
7.	Equity share capital A/c Dr. Securities premium A/c [800-250] Dr. General reserves A/c Dr. [(200x20) – 2000 – 550] To Equity shares bought back A/c (Being buy back of equity shares)		2000 550 1,450	4,000

PAPER- 1 : FINANCIAL REPORTING

8.	General reserves A/c	Dr.	4,500	
	To Capital redemption reserve (2,000+2,500)			4,500
	(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed and equity shares bought back)			

Balance sheet of Kanika Ltd. as on 01.04.2010

<i>Liabilities</i>	<i>Rs. in lakhs</i>	<i>Assets</i>	<i>Rs. in Lakhs</i>
<i>Share capital</i>		<i>Fixed assets</i>	16,000
Issued, subscribed and paid up Equity shares of Rs. 10 each	6,000	<i>Current asset, loans and advances</i>	
<i>Reserves and surplus</i>		Cash at bank	400
Capital redemption reserve (1000 + 4500)	5,500	Other current assets	8,250
General reserves	1,150		
Profit and loss A/c (300 + 400)	700		
<i>Secured loans</i>			
9% Debentures	5,000		
Bank loan (Secured on plant)	1,000		
<i>Current liabilities and provisions</i>			
Sundry creditors	3,300		
Provisions	<u>2,000</u>		
	<u>24,650</u>		<u>24,650</u>

Working Notes:

- Cash at bank as on 1.4.2010
Rs.[1,650+4,500+1,000-2,750-4,000=400]
- Balance of general reserve as on 1.4.2010
Rs.[7,100-1,450-4,500=1,150]

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

6. Valuation of shares under earnings capitalization method.

Future Maintainable Profit (FMP)

Particulars		2009 (Rs.)	2008 (Rs.)	2007 (Rs.)
(a)	Profit after tax	7,00,000	6,00,000	4,00,000
(b)	Weights	3	2	1
(c)	Weighted profits	21,00,000	12,00,000	4,00,000

FMP = Weighted average of past profits [profits show an increasing trend]
 = 37,00,000 divided by 6 = Rs. 6,16,667

Ascertainment of value of business by capitalizing Future Maintainable Profit at normal rate of return

$$\begin{aligned}
 \text{Value of business} &= \frac{\text{Future maintainable profit}}{\text{Normal rate of return}} \\
 &= \frac{\text{Rs. 6,16,667}}{15\%} \\
 &= \text{Rs. 41,11,113 (approx.)}
 \end{aligned}$$

Value per share

$$\begin{aligned}
 \text{Value per share} &= \frac{\text{Value of business}}{\text{Number of shares outstanding}} \\
 &= \frac{\text{Rs. 41,11,113}}{2,00,000} \\
 &= \text{Rs. 20.56 (approx.)}
 \end{aligned}$$

7. Valuation of goodwill (Super profits method)

Average capital employed	Rs.18,50,000
Normal rate of return after tax [50% of 20%]	10%
Normal profits	Rs.1,85,000
Future maintainable profit [W.N.1]	Rs.2,30,000
Super profits	Rs.45,000
Number of years of purchase	4 years
Goodwill	Rs.1,80,000

Working Notes:

1. Computation of future maintainable profits

PAPER- 1 : FINANCIAL REPORTING

<i>Particulars</i>	<i>Rs.</i>
Profit before tax	6,00,000
Less: Income from investments	(10,000)
Less: Additional expenses for smooth running of business	(50,000)
Less: Additional depreciation	<u>(40,000)</u>
Adjusted maintainable profit before tax	5,00,000
Less: Provision for taxation*	<u>(2,70,000)</u>
Future maintainable profit	<u>2,30,000</u>

*Provision for taxation

Particulars	Rs.
Maintainable operational profit before tax	5,00,000
Add: Depreciation (not allowable)	<u>40,000</u>
Taxable income	<u>5,40,000</u>
Tax @ 50%	<u>2,70,000</u>

2. Average capital employed for 2009-10

	Rs.	Rs.
a. Closing capital employed on 31.03.10		
Land and buildings	9,00,000	
Plant and machinery	10,00,000	
Stock	2,00,000	
Debtors	1,50,000	
Bank	<u>50,000</u>	23,00,000
b. Less: Outside liabilities		
Creditors		<u>(3,00,000)</u>
		20,00,000
c. Less: Half of current year profit*		<u>(1,50,000)</u>
d. Average capital employed		<u>18,50,000</u>

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

*Half of current year profit

Particulars	Rs.
i. Profit before tax for 2009-10	6,00,000
ii. Tax @ 50%	<u>3,00,000</u>
iii. Net Profit	<u>3,00,000</u>
iv. Half of the profit	1,50,000

Note: Half of the total profits have been considered, (without adjusting for investment income) on the assumption that income from investments has not been reinvested. Further such income (cash) is part of closing working capital used in business.

Assumptions:

- Investments are assumed to be non-trade investments.
- All items of income and expenses except to the extent adjusted above are assumed to be taxable.
- It is assumed that additional depreciation (on revaluation) is not deductible for calculating provision for taxation.

8. Calculation of Possible Value of Brand

	(Rs. in lakhs)
Profit after Tax	5,000
Less: Profit allocated to tangible fixed assets	<u>3,000</u>
Profit relating to intangible assets including Brand	<u>2,000</u>
Capitalization factor 25%	
Capitalized value of intangibles including brand $[\frac{2,000}{25} \times 100]$	8,000
Less: Identified intangibles other than brand	<u>5,000</u>
Brand Value	<u>3,000</u>

9. (a) Historical accounting suffers from a major limitation. It is well known that the purchasing power of rupee has been persistently shrinking due to inflationary trends observed in the economy since late fifties. Thus Historical cost based accounting overstates the profit by undercharging depreciation and materials cost. Depreciation is undercharged since it is based on the historical cost of fixed assets instead of their current cost. Similar is the case of materials cost as the stocks purchased at historical costs are matched against revenues expressed at current prices. Again, historical cost based accounting reflects assets at their historical cost instead of

PAPER- 1 : FINANCIAL REPORTING

current cost. It results in understatement of the net worth of an enterprise. Historical cost based accounting thus fails to serve the primary purpose of the financial statements. It presents a distorted view of the profitability by overstating it and of intrinsic worth by understating it.

(b) Calculation of Cost of Sales Adjustment (COSA)

$$\text{COSA} = (C - O) - Ia \left[\frac{C}{Ic} - \frac{O}{Io} \right]$$

Where, C = Historical cost of closing stock

O = Historical cost of opening stock

Ia = Average Index number for the period

Ic = Index number appropriate to closing stock

Io = Index number appropriate to opening stock

$$\text{COSA} = (1,68,000 - 1,00,000) - 120 \left[\frac{1,68,000}{140} - \frac{1,00,000}{100} \right] = \text{Rs. } 44,000$$

Alternatively, COSA can also be calculated as follows:

	Rs.
Opening stock at Average Index (1,00,000 x 120/100)	1,20,000
Add : Purchases at Average Index	<u>3,60,000</u>
	4,80,000
Less: Closing stock at Average Index (1,68,000 x 120/140)	<u>1,44,000</u>
Current cost of sales	<u>3,36,000</u>

$$\begin{aligned}\text{COSA} &= \text{Current cost of sales} - \text{Historical cost of sales} \\ &= \text{Rs. } 3,36,000 - \text{Rs. } 2,92,000 = \text{Rs. } 44,000\end{aligned}$$

10. (a) Market Value Added is the market value of capital employed in the firm less the book value of capital employed. Market value added is calculated by summing up the paid up value of equity and preference share capital, Retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt. Market value added measures cumulatively the performance of corporate entity. A High market value added means that the company has created substantial wealth for shareholders. On the other hand negative MVA means that the value of management's actions and investments are less than the value of the capital contributed to the company by the capital market or that the wealth and value has been destroyed.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

(b) Value added Statement of Chitresh Ltd for the year ended 31st March, 2010

<i>Particulars</i>	<i>Rs. 000</i>	<i>Rs. 000</i>	
VALUE ADDED			
Sales		1,454	
Less: Cost of bought in materials and services			
Materials	1,060		
Other Expenses [94 – (18 + 6)]	70		
Short-term Interest (14 – 8)	<u>6</u>	<u>1,136</u>	
Value Added by manufacturing and trading activities		318	
Add: Other Income		<u>26</u>	
Total Value Added		<u>344</u>	
APPLICATION OF VALUE ADDED			%
To Employees:			
Salaries, Wages and Benefits (38+18)		56	<u>16.3</u>
To Government:			
Excise Duty		124	36.0
Income Tax		<u>62</u>	<u>18.1</u>
		<u>186</u>	<u>54.1</u>
To Finance Providers:			
Interest on Long Term Loans		8	2.3
Dividend on Equity		<u>10</u>	<u>2.9</u>
		<u>18</u>	<u>5.2</u>
To Entity's needs -			
Meeting Loss on Sale of Fixed Assets		6	1.7
Preliminary Expenses w/off		10	2.9
Depreciation		10	2.9
Transfer to Reserves (Debenture Redemption & General Reserve)		<u>58</u>	<u>16.9</u>
		<u>84</u>	<u>24.4</u>
Total application		344	100.0

11. (a) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. Though the term "Economic Profit" was very much there since the inception of "Economics", Stern Stewart & Co., of USA has got a registered Trade Mark for this by the name "EVA", an acronym for Economic Value Added.

PAPER- 1 : FINANCIAL REPORTING

EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

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

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

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVA is not enough it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

(b) Computation of Economic Value Added

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

NOPAT = Net Operating Profit after Tax

COCE = Cost of Capital Employed

Particulars	Rs.
a. Net operating profit after taxes	25,00,000
b. Less: Cost of Capital (WN 2)	<u>6,00,000</u>
c. Economic Value Added	<u>19,00,000</u>

Decision: The company qualifies for the loan because the economic value added is greater than zero.

Working Notes:

1. Capital Employed

Particulars	Rs.
Average total assets	75,00,000

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Less: Average current liabilities	<u>15,00,000</u>
Total capital employed	<u>60,00,000</u>

2. **Cost of capital** = Capital employed x Weighted average cost of capital
= Rs. 60,00,000 x 10% = Rs. 6,00,000

12. (a) 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.
- (b) Jaggi and Lau suggested a model for valuation of human resources. According to them, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:
- (i) Ascertain the number of employees in each rank.
 - (ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.
 - (iii) Ascertain the economic value of an employee in a specified rank during each time period.
 - (iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.
- Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as basis of valuation. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

PAPER- 1 : FINANCIAL REPORTING

13. Units as at the end of the year (units in crores)

Number of Units at beginning of the year	1.00
Add: Units issued during the year	<u>0.20</u>
Units as at the end of the year (A)	<u>1.20</u>

Net Asset Value (NAV) of the Scheme (Rs. in crores)

Market Value of Investments (50% x Rs.10 Crores) x 80%	4.00
10% x Rs.10 Crores – (10% below Cost)	.90
Balance Investments (at Market Price)	<u>13.60</u>
Total Market Value	18.50
Less: Mutual Fund Scheme Liabilities	<u>1.00</u>
Net Asset Value of the Scheme (B)	<u>17.50</u>

NAV per Unit = B ÷ A = Rs. 17.50 Crores ÷ 1.2 Crore units = Rs. 14.58

14. (a) SEBI has the right to appoint one or more persons as inspecting authority to undertake inspection of the books of account, records and documents of the merchant banker for any of the following purposes:

- (i) To see that books of account are being maintained in the required manner;
- (ii) To ensure that provisions of SEBI Act, rules and regulations are complied with;
- (iii) To investigate into complaints received from investors, other merchant bankers, or any other person on any matter having a bearing on the activities of merchant banker;
- (iv) To investigate suo moto in the interest of securities business or investors' interest into the affairs of merchant bankers.

- (b) (i) (a) Every NBFC shall, separately disclose in its balance sheet the provisions made as per requirements above without netting them from the income or against the value of assets.
- (b) The provisions shall be distinctly indicated under separate heads of accounts as provisions for bad and doubtful debts and provisions for depreciation in investments.
- (c) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC.
- (d) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general Provisions and loss reserves may be written back without making adjustment against them.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

- (ii) In case of purchases on behalf of clients, Member brokers shall be at liberty to close out the transactions by selling the securities, in case the client fails to make the full payment to the Member Broker for the execution of the contract within two days of contract note having been delivered for cash shares and seven days for specified shares or before pay-in day (as fixed by Stock Exchange for the concerned settlement period), whichever is earlier; unless the client already has an equivalent credit with the Member. The loss incurred in this regard, if any, will be met from the margin money of that client.

In case of sales on behalf of clients, Member broker shall be at liberty to close out the contract by effecting purchases if the client fails to deliver the securities sold with valid transfer documents within 48 hours of the contract note having been delivered or before delivery day (as fixed by Stock Exchange authorities for the concerned settlement period), whichever is earlier. Loss on the transaction, if any, will be deductible from the margin money of that client.

- (iii) Open ended funds can issue and redeem units any time during the life of the scheme while close ended funds cannot issue new units except in case of bonus or rights issue. Hence, unit capital of open ended funds can fluctuate on daily basis while that is not the case for close ended schemes. New investors can join the scheme by directly applying to the mutual fund at applicable net asset value related prices in case of open ended schemes while that is not the case in close ended schemes. New investors can buy the units from secondary market only.

15. A financial report of an enterprise is arguably the most important medium of dissemination of such information. With a view to promote better standards in the presentation of information in the financial report, the Institute of Chartered Accountants of India has been holding an annual competition for the ICAI Awards for Excellence in Financial Reporting.

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

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

PAPER- 1 : FINANCIAL REPORTING

6. Inclusion of one or more bits of information like value added statement, break up of operations, organization chart, location of factories / branches, human resource accounting, inflation adjusted accounts, social accounts etc.
16. The term IFRS refers to the International Financial Reporting Standards issued by International Accounting Standard Board (IASB). IFRS is a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.

International Financial Reporting Standards (IFRS) are the globally accepted accounting standards adopted by International Accounting Standard Board (IASB) earlier known International Accounting Standard Committee (IASC).

IFRSs being principle-based standards have distinct advantage that the transactions can not be manipulated easily to achieve a particular accounting.

In general, convergence of Accounting Standards (AS) with International Financial Reporting Standards (IFRS) means to achieve harmony with IFRS. The term convergence can be considered as "to design and maintain national accounting standards in a way that financial statements prepared in accordance with rational AS are in convergence with IFRS". IAS I require financial statements to comply with all requirements of IFRS. This does not mean that IFRS should be adopted word by word. The local standard setters can add disclosure requirements or can remove some requirements which do not create non compliance with IFRS. Thus, convergence with IFRS means adoption of IFRS with exceptions wherever necessary. Today IFRS is being used in more than 100 countries and it is expected that by 2014, all major countries will have adopted IFRS to some extent, so it is imperative that India shall also adopt IFRS to ensure harmony in preparation and presentation of Financial Statements

17.

Assets	Previous GAAPs	Adjustment due to transition to IFRS	IFRS
	Rs. '000	Rs.'000	Rs.'000
Fixed assets	1,200	200	1,400
Intangible assets	400		400
Financial assets	400	100	500
Inventories	600	(200)	400
Trade and other receivables	500	300	800
Cash and cash equivalents	<u>100</u>		<u>100</u>
	<u>3,200</u>		<u>3,600</u>
<i>Liabilities</i>			
Trade and other payables	800		800
10% Loans from Bank	1,300		1,300
Current tax liability	80		80

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Deferred tax liability	20	90	110
Pension liability	<u>Nil</u>	<u>100</u>	<u>100</u>
(A)	<u>2,200</u>		<u>2,390</u>
Equity			
Issued share capital	600		600
Retained earnings	400	140	540
Revaluation reserves	<u>Nil</u>	<u>70</u>	<u>70</u>
(B)	<u>1,000</u>		<u>1,210</u>
Total (A+B)	<u>3,200</u>		<u>3,600</u>

Working Notes:

1. Journal entries

(i) Fixed assets	Dr.	2,00,000	
To Retained earnings			2,00,000
(ii) Financial Assets	Dr.	1,00,000	
To Revaluation reserve			1,00,000
(iii) Retained earnings	Dr.	1,00,000	
To Pension liability			1,00,000
(iv) Retained earnings	Dr.	2,00,000	
To Inventories			2,00,000
(v) Trade and other receivables	Dr.	3,00,000	
To Retained earnings			3,00,000

2. Ledgers Accounts

Revaluation Reserve

To Deferred Tax Liability	30,000	By Financial Assets	1,00,000
To Balance c/d	<u>70,000</u>		
	<u>1,00,000</u>		<u>1,00,000</u>

Retained Earnings

To Pension Liability	1,00,000	By Fixed Assets	2,00,000
To Inventories	2,00,000	By Trade and other receivables	3,00,000
To Deferred Tax Liability	60,000		

PAPER- 1 : FINANCIAL REPORTING

To	Balance c/d	<u>1,40,000</u>		<u>5,00,000</u>
		<u>5,00,000</u>		<u>5,00,000</u>

Deferred Tax Liability

To	Balance c/d	90,000	By	Revaluation Reserve	30,000
		<u>90,000</u>	By	Retained Earnings	<u>60,000</u>
					<u>90,000</u>

18. (a) It should be loans and receivables. In case the entity has the intention to sell the instrument in the near term, it should be classified as held for trading.

(b)

<i>Type of Contract</i>	<i>Main Pricing-Settlement Variable (Underlying Variable)</i>
Interest Rate Swap	Interest rates
Equity Swap	Equity prices (equity of another entity)
Currency Swap (Foreign Exchange Swap)	Currency rates
Commodity Swap	Commodity prices
Equity Forward	Equity prices (equity of another entity)

19. It should be noted that remaining in service for 3 years and achieving a particular level of average output are vesting conditions which are not market conditions. Their distribution of possible outcomes is not taken into account in arriving at a single fair value. However, since the achieving a particular level of average output affects the exercise price and thus the fair value per option, the enterprise estimates/re-estimates the most likely outcome and takes the corresponding fair value as on the grant date.

Their outcomes are taken into account in estimating/re-estimating the number of employees and the number of options expected to vest.

Particulars	31.12.09	31.12.10	31.12.11
A Number of employees expected to satisfy vesting conditions	250 [300-20-30]	245 [300-20-25-10]	240 [300-20-25-15] [Actuals]
B Expected/Most likely average annual output per employee	122	Above 130	112
C Fair value per option as on grant date, based on	40	30	50

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

	most likely outcome			
D	Fair value of options expected to vest (A x C x 200 options per employee)	20,00,000	14,70,000	24,00,000
E	Cumulative fair value to be recognized till date	6,66,667 [20,00,000x1/3]	9,80,000 [14,70,000x2/3]	24,00,000 [24,00,000x3/3]
F	Cumulative fair value already recognized	0	6,66,667	9,80,000
G	Expense to be recognized for the period (E-F)	6,66,667	3,13,333	14,20,000

20. (a) The Company's accounting policy is not in accordance with AS 7 (Revised) "Construction Contracts". Past track record is not the criteria for recognition of incentive payments receivable for early completion of contract. According to AS 7 (Revised) incentives payments can be included in contract revenue only when
- the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
 - the amount of the incentive payment can be measured reliably.
- The contract is not sufficiently advanced as it is in the first year and its normal time is 4-5 years. Hence, the recognition criteria are not met and it is inappropriate to include incentive payments receivable in the current year is part of contract revenue.
- (b) According to AS 9 "Revenue Recognition", when delivery is postponed at buyer's request, revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery. Thus, Rs. 54,000 should be excluded from inventory, and the amount of Rs. 60,000 should be included in sales with corresponding increase in debtors balance if the above conditions are fulfilled.
- (c) Induga Ltd. (Venturer) should not recognize its share of loss arising to joint venture from the purchase of asset from the jointly controlled entity until the asset is sold to third party provided recoverable amount of asset is not less than 24 lakhs.
21. (a) As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". The

PAPER- 1 : FINANCIAL REPORTING

amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2009-10

- (b) The actual return is computed as follows:

	Amount (Rs.)
Fair value of plan assets (beginning of year)	4,000
Add: Employer Contribution	500
Add: Actual Return	?
Less: Benefit Payments	<u>400</u>
Fair value of plan assets (end of year)	<u>5,000</u>

The following formula may be used to derive the actual return:

Actual return = Fair value of asset (end of year) – fair value of assets (beginning of the year) – employer contributions + benefit payments

Actual return = Rs. 5,000 – Rs. 4,000 – Rs. 500 + Rs. 400 = Rs. 900

- (c) (1) Computation of actual borrowing costs incurred during the year

Sources	Loan amount (Rs. in lakhs)	Interest rate	Interest amount (Rs. in lakhs)
Bank Loan	65.00	10%	6.50
9% Debentures	125.00	9%	11.25
Term Loan from Corporation Bank	100.00	10%	10.00
Term Loan from State Bank of India	110.00	11.5%	12.65
Total	400.00		40.40
Specific Borrowings included in above	190.00		17.75
(2) Weighted Average Capitalization Rate for General Borrowings = $\frac{\text{Total Interest} - \text{Interest on Specific borrowings}}{\text{Total Borrowings} - \text{Specific borrowings}}$ $= \frac{(40.40 - 17.75)}{(400 - 190)} = 22.65/210 = 10.79\% \text{ (approx.)}$			
(3) Capitalization of Borrowing Costs under AS-16 will be as under:			

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Plant	Borrowing	Loan Amount	Interest Rate	Interest Amount	Cost of Asset	
P	General	100	10.79%	10.79		110.79
Q	Specific	65	10.00%	6.50	71.50	
	General	60	10.79%	6.47	<u>66.47</u>	137.97
R	Specific	125	9.00%	11.25	136.25	
	General	<u>50</u>	10.79	<u>5.39</u>	<u>55.39</u>	<u>191.64</u>
	Total	400		40.40		440.40

Note: The amount of borrowing costs capitalized should not exceed the actual interest cost.

22. (a) In this case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing the cases is 40% and 50% respectively. According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', we make a provision if the loss is probable. As the loss does not appear to be probable and the probability or 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 of contingent liability will be made. Amount may be calculated as under:

$$\begin{aligned}
 \text{Expected loss in first ten cases} &= [\text{Rs. } 50,000 \times 0.3 + \text{Rs. } 1,00,000 \times 0.1] \times 10 \\
 &= [\text{Rs. } 15,000 + 10,000] \times 10 \\
 &= \text{Rs. } 25,000 \times 10 = \text{Rs. } 2,50,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Expected loss in remaining five cases} &= [\text{Rs. } 60,000 \times 0.3 + \text{Rs. } 1,00,000 \times 0.2] \times 5 \\
 &= [\text{Rs. } 18,000 + \text{Rs. } 20,000] \times 5 \\
 &= \text{Rs. } 38,000 \times 5 = \text{Rs. } 1,90,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Total contingent liability} &= \text{Rs. } 2,50,000 + \text{Rs. } 1,90,000 \\
 &= \text{Rs. } 4,40,000.
 \end{aligned}$$

(b) Calculation of theoretical ex-rights fair value per share

$$\begin{aligned}
 &= \frac{(12,00,000 \text{ shares} \times \text{Rs. } 24) + (6,00,000 \text{ shares} \times \text{Rs. } 18)}{12,00,000 \text{ shares} + 6,00,000 \text{ shares}} \\
 &= \frac{\text{Rs. } 2,88,00,000 + \text{Rs. } 1,08,00,000}{18,00,000 \text{ shares}} = 22
 \end{aligned}$$

Calculation of adjustment factor

PAPER- 1 : FINANCIAL REPORTING

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{\text{Rs. 24}}{\text{Rs. 22}} = 1.091$$

Calculation of EPS for the year ended 31.3.2009

$$\text{EPS originally reported} = \frac{\text{Rs. 40,00,000}}{12,00,000 \text{ shares}} = \text{Rs. 3.33}$$

$$\text{EPS restated for rights issue} = \frac{\text{Rs. 40,00,000}}{12,00,000 \text{ shares} \times 1.091} = \frac{40,00,000}{13,09,200} = \text{Rs. 3.05}$$

Calculation of EPS for the year ended 31.3.2010

$$= \frac{\text{Rs. 54,00,000}}{(12,00,000 \times 1.091 \times 9/12) + (18,00,000 \times 3/12)} = \frac{54,00,000}{9,81,900 + 4,50,000} = 3.77$$

23. (a) According to para 10 of AS 18 on Related Party Disclosures, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Hence, Mr. Raj, a relative of key management personnel should be identified as relative as at the closing date i.e. on 31.3.2010.
- (b) As per para 24 of AS 2 "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.
- (i) When selling price of the finished product is Rs.175, the raw material should be valued at Rs.75 per kg because the selling price of the finished product is less than Rs.225 (i.e. 100 + 125) per kg.
- (ii) When selling price of the finished product is Rs.235, the raw material should be valued at Rs.100 per kg because the selling price of the finished product is not less than Rs.225 (i.e. 100 + 125) per kg.
- (c) According to Para 10 of AS 25 "Interim Financial Reporting", If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2009, Asmitha Ltd., would report the entire Rs.2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since Rs.60,000 Property Tax payment relates to entire calendar

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

year 2009, Rs.30,000 would be reported as an expense for six months ended on 30th September, 2009 while remaining Rs.30,000 would be reported as prepaid expenses.

24. (a) As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

- (i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or
- (ii) Its segment result whether profit or loss is 10% or more of:
 - (1) The combined result of all segments in profit; or
 - (2) The combined result of all segments in loss, whichever is greater in absolute amount; or
- (iii) Its segment assets are 10% or more of the total assets of all segments.

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

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

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

(b) As per Para 31 of AS-24, disclosure is to be presented separately for each discontinuing operation. Hence, reporting on an aggregated basis not permitted.

(c) Intangible Asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services for rental to other or for administrative purposes.

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life.

PAPER- 1 : FINANCIAL REPORTING

Year	No. of cars	Amortisation charge (p.a.)	
1	25,000	50,00,000	$\left[\frac{500,00,000}{2,50,000} \right] \times 25,000$
2	50,000	100,00,000	$\left[\frac{500,00,000}{2,50,000} \right] \times 50,000$
3	75,000	150,00,000	$\left[\frac{500,00,000}{2,50,000} \right] \times 75,000$
4	1,00,000	200,00,000	$\left[\frac{500,00,000}{2,50,000} \right] \times 1,00,000$

The amortization will form part of production cost

25. (a) (i) Journal Entries

(a) Capitalization of asset

		(Rs. in lakhs)	
<i>During 2009-10</i>		<i>Debit</i>	<i>Credit</i>
Plant and Machinery A/c	Dr.	45	
Cenvat credit receivable on capital goods A/c		2.5	
Cenvat credit deferred A/c		2.5	
To Bank A/c or Y Ltd.			50

(b) Excise duty on excisable goods produced.

		(Rs. in lakhs)	
		<i>Debit</i>	<i>Credit</i>
Excise duty A/c	Dr.	2.5	
To Cenvat credit receivable on capital goods A/c			2.5
[Being set off available to the extent of 50%]			

(ii) Value of plant to be recorded in Fixed Asset Register

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

As per Guidance Note on “Accounting treatment for CENVAT”, fixed assets have to be capitalized net of refundable amounts.

The plant and machinery will be recorded at Rs. 45 lacs (50 lacs – 5 lacs) in the fixed asset register.

(b) Balance Sheet

Where a company recognizes MAT credit as an asset on the basis of the considerations specified in the Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961, the same should be presented under the head ‘Loans and Advances’ since, there being a convincing evidence of realization of the asset, it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as ‘MAT credit entitlement’.

In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the ‘Provision for Taxation’ on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head ‘Loans and Advances’ if it continues to meet the considerations stated in paragraph 11 of the Guidance Note.

Profit and Loss Account

According to paragraph 6 of Accounting Standards Interpretation (ASI) ‘Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961’, issued by the Institute of Chartered Accountants of India, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss account in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as a separate line item therein.

PAPER- 1 : FINANCIAL REPORTING

APPENDIX – I

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR NOVEMBER, 2010 EXAMINATION

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2010. Students may kindly take it into consideration while preparing for the examination.

Final Examination Paper 1 : Financial Reporting

I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards (including limited revisions) – AS 1 to AS 32*.

II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserves created on Revaluation of Fixed Assets.
2. Guidance Note on Accrual Basis of Accounting.
3. Guidance Note on Accounting Treatment for Excise Duty.
4. Guidance Note on Accounting for Depreciation in Companies.
5. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus Shares.
6. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
7. Guidance Note on Accounting for Corporate Dividend Tax.
8. Guidance Note on Accounting for Employee Share-based Payments.
9. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
10. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25
11. Guidance Note on Applicability of Accounting Standard (AS) 20, Earnings Per Share.
12. Guidance Note on Remuneration paid to key management personnel – whether a related party transaction.
13. Guidance Note on Applicability of AS 25 to Interim Financial Results.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

14. Guidance Note on Turnover in case of Contractors.

***Note**

1. Students are expected to have thorough knowledge of the Accounting Standards (AS 1 to AS 29) and Guidance Notes on various aspects issued by ICAI. As far as AS 30, 31 and 32 are concerned, in view of the complexities involved, the questions involving conceptual issues (not involving application issues) may be asked. Since a separate topic of 'Financial Instruments' is included in the curriculum, simple practical problems based on AS 30, 31 and 32 may be asked.
2. Official Announcements and Notifications (in relation to syllabus) issued till 30th April, 2010 will be applicable for November, 2010 examination.

APPENDIX – II

Companies (Accounting Standards) Amendment Rules, 2009 – Amendments in Annexure

NOTIFICATION NO. G.S.R.225 (E)

DATED 31-3-2009

In exercise of the powers conferred by clause (a) of sub-section (1) of section 642 read with sub-section (1) of section 21A and sub-section (3C) of section 211 of the Companies Act, 1956 (1 of 1956), the Central Government in consultation with the National Advisory Committee on Accounting Standards, hereby makes the following rules to amend the Companies (Accounting Standards) Rules, 2006, namely:-

1. (1) These rules may be called the Companies (Accounting Standards) Amendment Rules, 2009.
(2) They shall come into force on the date of their publication in the Official Gazette.
2. In the Companies (Accounting Standard) Rules, 2006, in the Annexure, under the heading "B. ACCOUNTING STANDARDS", in the sub-heading "Accounting Standard (AS) 11" relating to "The Effects of Changes in Foreign Exchange Rates", after paragraph 45, the following shall be inserted, namely:-

"46. In respect of accounting periods commencing on or after 7th December, 2006 and ending on or before 31st March, 2011, at the option of the enterprise (such option to be irrevocable and to be exercised retrospectively for such accounting period, from the date this transitional provision comes into force or the first date on which the concerned foreign currency monetary item is acquired, whichever is later and applied to all such foreign currency monetary items), exchange differences arising on reporting of long-term foreign currency monetary items at

PAPER- 1 : FINANCIAL REPORTING

rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/liability but not beyond 31st March, 2011, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with paragraph 15. For the purposes of exercise of this option, an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of 12 months or more at the date of origination of the asset or liability. Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, previously recognized in the profit and loss account before the exercise of the option shall be reversed insofar as it relates to the acquisition of a depreciable capital asset by addition or deduction from the cost of the asset and in other cases by transfer to "Foreign Currency Monetary Item Translation Difference Account" in both cases, by debit or credit, as the case may be, to the general reserve. If the option stated in this paragraph is exercised, disclosure shall be made of the fact of such exercise of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized."

GN(A) 24 (Issued 2006)

**GUIDANCE NOTE ON MEASUREMENT OF INCOME TAX EXPENSE FOR
INTERIM FINANCIAL REPORTING IN THE CONTEXT OF AS 25**

(The following is the text of the Guidance Note on Measurement of Income-tax Expense for Interim Financial Reporting in the context of AS 25, issued by the Council of the Institute of Chartered Accountants of India.)

1. Accounting Standard (AS) 25, 'Interim Financial Reporting', issued by the Council of the Institute of Chartered Accountants of India (ICAI), prescribes the minimum content of an interim financial report and the principles for recognition and measurement in complete or condensed financial statements for an interim period. AS 25 became mandatory in respect of accounting periods commencing on or after 1st April, 2002. In accordance with the Accounting Standards Interpretation (ASI) 27, 'Applicability of AS 25 to Interim Financial Results', the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in the interim financial results presented under Clause 41 of the Listing Agreement entered into between stock exchanges and the listed enterprises. This Guidance Note deals with the measurement of income tax expense for the purpose of inclusion in the interim financial reports.

2. The general principles for recognition and measurement have been laid down in AS 25 as below:

"27. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.

28. Requiring that an enterprise apply the same accounting policies in its interim financial statements as in its annual financial statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an enterprise's reporting should not affect the measurement of its annual results, paragraph 27 acknowledges that an interim period is a part of a financial year. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements."

PAPER- 1 : FINANCIAL REPORTING

3. Paragraph 29(c) of AS 25 illustrates the application of the general principles for recognition and measurement of tax expense in interim periods, as below:

“29.....

(c) income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.”

4. Appendix 3 to AS 25 illustrates the general recognition and measurement principles for the preparation of interim financial reports. Paragraphs 8 to 16 of the Appendix provide guidance on the computation of income-tax expense for the interim period, which are reproduced in Appendix A to this Guidance Note for ready reference. Paragraph 8 of the Appendix states as below:

“8. Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.”

5. The various steps involved in the measurement of income tax expense for the purpose of interim financial reports are as below:

(i) An enterprise will first have to estimate its annual accounting income. For this purpose, an enterprise would have to take into account all probable events and transactions that are expected to occur during the financial year. Such an estimate would involve, e.g., estimating on prudent basis, the depreciation on expected expenditure on acquisition of fixed assets, profits from sale of fixed assets/investments, etc. Such future events and transactions should be taken into account only if there is a reasonable certainty that the same would take place during the financial year.

(ii) The enterprise should next estimate its tax liability for the financial year. For this purpose, the enterprise will have to estimate taxable income for the year. By applying the enacted or the substantively enacted tax rate on the taxable income, an estimate of the current tax for the year is arrived at. The estimates of tax liability would have to be based on the estimated deductions, allowances, etc., that would be available to the enterprise, provided there is a reasonable certainty for the same. The enterprise would also have to estimate the deferred tax assets/liabilities by applying the principles of Accounting Standard (AS) 22, ‘Accounting for Taxes on Income’, issued by the Institute of Chartered Accountants of India. Special considerations may have to be applied in certain cases as below:

(a) Where brought forward losses exist from the previous financial year (when deferred tax asset was not recognised on considerations of prudence as per AS

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

22): In such a situation, for estimating the current tax liability, the brought forward losses would have to be deducted from the estimated annual accounting income as explained in paragraph 16 of Appendix 3 to AS 25 (reproduced in Appendix A to this Guidance Note). Since such carried forward losses will get set-off during the year, these would not have any tax consequence in future periods.

- (b) Where brought forward losses exist (when deferred tax asset was recognised on the considerations of prudence as per AS 22): In such a situation, current tax would be computed in the same manner as explained in (a) above. However, in the determination of deferred tax, the tax expense arising from the reversal of the deferred tax asset recognised previously, to the extent of reversal of deferred tax asset in the current year, would also be considered.
 - (iii) The enterprise would now have to calculate the weighted average annual effective tax rate. This tax rate would be determined by dividing the estimated tax expense as arrived at step (ii) above by the estimated annual accounting income as arrived at step (i) above. Where different tax rates are applicable to different portions of the estimated annual accounting income, e.g., normal tax rate and a different tax rate for capital gains, the weighted average annual effective tax rate would have to be calculated separately for such portions of estimated annual accounting income.
 - (iv) The weighted average annual effective tax rate arrived at step (iii) would be applied to the accounting income for the interim period for determining the income tax expense to be recognised in the interim financial reports.
6. Accounting for interim period income-tax expense as suggested above is based on the approach prescribed in AS 25 that the interim period is part of the whole accounting year (often referred to as the 'integral approach') and, therefore, the said expense should be worked out on the basis of the estimated weighted average annual effective income-tax rate. According to this approach, the said rate is determined on the basis of the taxable income for the whole year, and applied to the accounting income for the interim period in order to determine the amount of tax expense for that interim period. This is in contrast to accounting for certain other expenses such as depreciation which is based on the approach prescribed in AS 25 that the interim period should be considered on stand-alone basis (often referred to as the 'discrete approach') because expenses such as depreciation are worked out on the basis of the period for which a fixed asset was available for use. The aforesaid treatments are, however, consistent with the requirement contained in paragraph 27 of AS 25 that an enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.
7. Appendix B contains examples of computing weighted average annual effective tax rate.

PAPER- 1 : FINANCIAL REPORTING

Appendix A

EXTRACTS FROM APPENDIX 3 TO ACCOUNTING STANDARD (AS) 25, INTERIM FINANCIAL REPORTING

Measuring Income Tax Expense for Interim Period

8. Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

9. This is consistent with the basic concept set out in paragraph 27 that the same accounting recognition and measurement principles should be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Therefore, interim period income tax expense is calculated by applying, to an interim period's pre-tax income, the tax rate that would be applicable to expected total annual earnings, that is, the estimated average effective annual income tax rate. That estimated average annual income tax rate would reflect the tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 27 of this Statement. Paragraph 16(d) requires disclosure of a significant change in estimate.

10. To the extent practicable, a separate estimated average annual effective income tax rate is determined for each governing taxation law and applied individually to the interim period pre-tax income under such laws. Similarly, if different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across such governing taxation laws or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

11. As illustration, an enterprise reports quarterly, earns Rs. 150 lakhs pre-tax profit in the first quarter but expects to incur losses of Rs 50 lakhs in each of the three remaining quarters (thus having zero income for the year), and is governed by taxation laws according to which its estimated average annual income tax rate is expected to be 35 per cent. The following table shows the amount of income tax expense that is reported in each quarter:

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

(Amount in Rs. lakhs)

	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter	Annual
Tax Expense	52.5	(17.5)	(17.5)	(17.5)	0

Difference in Financial Reporting Year and Tax Year

12. If the financial reporting year and the income tax year differ, income tax expense for the interim periods of that financial reporting year is measured using separate weighted average estimated effective tax rates for each of the income tax years applied to the portion of pre-tax income earned in each of those income tax years.

13. To illustrate, an enterprise's financial reporting year ends 30 September and it reports quarterly. Its year as per taxation laws ends 31 March. For the financial year that begins 1 October, Year 1 ends 30 September of Year 2, the enterprise earns Rs 100 lakhs pre-tax each quarter. The estimated weighted average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2.

(Amount in Rs. lakhs)

	Quarter Ending 31 Dec. Year 1	Quarter Ending 31 Mar. Year 1	Quarter Ending 30 June Year 2	Quarter Ending 30 Sep. Year 2	Year Ending 30 Sep. Year 2
Tax Expense	30	30	40	40	140

Tax Deductions/Exemptions

14. Tax statutes may provide deductions/exemptions in computation of income for determining tax payable. Anticipated tax benefits of this type for the full year are generally reflected in

PAPER- 1 : FINANCIAL REPORTING

computing the estimated annual effective income tax rate, because these deductions/exemptions are calculated on an annual basis under the usual provisions of tax statutes. On the other hand, tax benefits that relate to a one-time event are recognised in computing income tax expense in that interim period, in the same way that special tax rates applicable to particular categories of income are not blended into a single effective annual tax rate.

Tax Loss Carry forwards

15. A deferred tax asset should be recognised in respect of carry forward tax losses to the extent that it is virtually certain, supported by convincing evidence, that future taxable income will be available against which the deferred tax assets can be realised. The criteria are to be applied at the end of each interim period and, if they are met, the effect of the tax loss carry forward is reflected in the computation of the estimated average annual effective income tax rate.

16. To illustrate, an enterprise that reports quarterly has an operating loss carryforward of Rs 100 lakhs for income tax purposes at the start of the current financial year for which a deferred tax asset has not been recognised. The enterprise earns Rs 100 lakhs in the first quarter of the current year and expects to earn Rs 100 lakhs in each of the three remaining quarters. Excluding the loss carryforward, the estimated average annual income tax rate is expected to be 40 per cent. The estimated payment of the annual tax on Rs. 400 lakhs of earnings for the current year would be Rs. 120 lakhs $\{(Rs. 400 \text{ lakhs} - Rs. 100 \text{ lakhs}) \times 40\%\}$. Considering the loss carryforward, the estimated average annual effective income tax rate would be 30% $\{(Rs. 120 \text{ lakhs}/Rs. 400 \text{ lakhs}) \times 100\}$. This average annual effective income tax rate would be applied to earnings of each quarter. Accordingly, tax expense would be as follows:

(Amount in Rs. lakhs)

	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter	Annual
Tax Expense	30.00	30.00	30.00	30.00	120.00

Appendix B

Examples of Computation of Weighted Average Annual Effective Tax Rate

Example 1: When deferred tax asset was not recognised for carried forward losses from earlier accounting periods.

	Quarter I	Quarter II	Quarter III	Quarter IV	Total
	Rs.	Rs.	Rs.	Rs.	Rs.
Estimated Pre-tax Income (after considering estimated depreciation on the probable acquisition of fixed assets during the year)	(25)	175	(25)	50	175
Carried forward losses from earlier accounting periods, the deferred tax asset in respect of which was not recognised as it did not meet the requirements of prudence laid down in AS 22. During this year, in view of the expected taxable income, this loss is expected to be set off thereagainst. Therefore, it will not have any tax effect on future periods.					(25)
Additional estimated depreciation as per tax laws as compared to the accounting depreciation after considering depreciation on probable capital expenditure on acquisition of fixed assets during the year.					(50)
Estimated taxable income on which tax payable.					100
Applicable tax rate (say)					30%
Estimated current tax expense for the year.					30

PAPER- 1 : FINANCIAL REPORTING

Estimated deferred tax expense for the year (50x30/100)					15
Weighted Average Annual Effective Tax Rate (current tax)					$\frac{30}{175} \times 100 = 17.14\%$
Weighted Average Annual Effective Tax Rate (deferred tax)_					$\frac{15}{175} \times 100 = 8.57\%$
Tax expense for the interim period	(4.29)	30	(4.29)	8.57	29.99
Current tax	<u>(2.14)</u>	<u>15</u>	<u>(2.14)</u>	<u>4.29</u>	<u>15.01</u>
Deferred tax	(6.43)	<u>45</u>	(6.43)	<u>12.86</u>	<u>45.00</u>
Total					

- (a) The above calculation needs to be done for every interim period for which recognition and measurement of tax expense is required.
- (b) It is presumed that there are no other differences between accounting income and taxable income.

Example 2: When deferred tax asset was recognised for carried forward losses from earlier accounting periods.

	Quarter I	Quarter II	Quarter III	Quarter IV	Total
	Rs.	Rs.	Rs.	Rs.	Rs.
Estimated Pre-tax Income (after considering estimated depreciation on the probable acquisition of fixed assets during the year)	(25)	175	(25)	50	175
Carried forward losses from earlier accounting periods, the deferred tax asset in respect of which was recognised on the basis of considerations of AS 22. During this year, in view of the expected taxable income, this loss is expected to be set off thereagainst. This will result in reversal of the deferred tax asset					(25)

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

in the current year.					
Additional estimated depreciation as per tax laws as compared to the accounting depreciation after considering depreciation on probable capital expenditure on acquisition of fixed assets during the year.					(50)
Estimated taxable income on which tax payable.					100
Applicable tax rate (say)					30%
Estimated current tax expense for the year.					30
Estimated deferred tax expense for the year: (i) Deferred tax liability on account of timing difference in depreciation (50x30/100) 15 (ii) Reversal of deferred tax asset (25x30/100) 7.5					22.5
Weighted Average Annual Effective Tax Rate (Current tax)					$\frac{30}{175} \times 100 = 17.14\%$
Weighted Average Annual Effective Tax Rate (Deferred tax)					$\frac{22.5}{175} \times 100 = 12.86\%$
Tax expense for the interim period	(4.29)	30.0	(4.29)	8.57	29.99
Current tax	<u>(3.21)</u>	<u>22.5</u>	<u>(3.21)</u>	<u>6.43</u>	<u>22.51</u>
Deferred tax	<u>(7.50)</u>	<u>52.5</u>	<u>(7.50)</u>	<u>15.00</u>	<u>52.50</u>
Total					

- (a) The above calculation needs to be done for every interim period for which recognition and measurement of tax expense is required.
- (b) It is presumed that there are no other differences between accounting income and taxable income.

PAPER- 1 : FINANCIAL REPORTING

Example 3: *When progressive rates of tax are applicable*

Under the Indian tax system, the tax rates for corporates and firms are not progressive (i.e., based on levels of income), but are flat rates. Therefore, the tax rate to be applied in the interim period would be the normal rate applicable to the entity. However, the calculation of weighted average annual effective tax rate can be illustrated as below where the tax rates are progressive:

Estimated annual income Rs.1 lakh

Assumed Tax Rates:

On first Rs. 40,000 30%

On the balance income 40%

Tax expense: 30% of Rs. 40,000 + 40% of Rs. 60,000 = Rs. 36,000

Weighted average annual effective tax rate = $\frac{36,000}{1,00,000} \times 100 = 36\%$

Supposing the estimated income of each quarter is Rs. 25,000, the tax expense of Rs. 9,000 (36% of Rs. 25,000) would be recognised in each of the quarterly financial reports.

Example 4:*When different rates of tax are applicable to different portions of the estimated annual accounting income (refer para5(iii))*

Estimated annual income Rs. 1 lakh

(inclusive of Estimated Capital Gains (earned in Quarter II) Rs. 20,000

Assumed Tax Rates:

On Capital Gains 10%

On other income:

First Rs. 40,000 30%

Balance income 40%

Assuming there is no difference between the estimated taxable income and the estimated accounting income,

Tax Expense:

On Capital Gains portion of annual income:

10% of Rs. 20,000 Rs. 2,000

On other income: 30% of Rs. 40,000 + 40% of Rs.40,000 Rs.28,000

Total: Rs.30,000

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

Weighted Average Annual Effective Tax Rate:

On Capital Gains portion of annual income: $\frac{2,000}{20,000} \times 100 = 10\%$

On other income: $\frac{28,000}{80,000} \times 100 = 35\%$

Supposing the estimated income of each quarter is Rs.25,000, when income of Rs.25,000 for 2nd Quarter includes capital gains of Rs.20,000, the tax expense for each quarter will be calculated as below:

	<u>Income</u>	<u>Tax Expense</u>	
Quarter I:	Rs. 25,000	35% of Rs. 25,000 =	Rs. 8,750
Quarter II:	Capital Gains: Rs. 20,000	10% of Rs. 20,000 =	Rs. 2,000
	Other: Rs. 5,000	35% of Rs. 5,000 =	<u>Rs. 1,750</u>
Quarter III:	Rs. 25,000	35% of Rs. 25,000 =	Rs. 8,750
Quarter IV:	Rs. 25,000	35% of Rs. 25,000 =	<u>Rs. 8,750</u>
Total tax expense for the year			<u>Rs. 30,000</u>

GUIDANCE NOTE ON REMUNERATION PAID TO KEY MANAGEMENT PERSONNEL - WHETHER A RELATED PARTY TRANSACTION¹

(The following is the text of the 'Guidance Note on Remuneration paid to key management personnel – whether a related party transaction' issued by the Council of the Institute of Chartered Accountants of India. Pursuant to the issuance of this Guidance Note, Accounting Standards Interpretation (ASI) 23, 'Remuneration paid to key management personnel – whether a related party transaction (Re. AS 18)', stands withdrawn.)

Introduction

¹ This Guidance Note was earlier issued as Accounting Standards Interpretation (ASI) 23, 'Remuneration paid to key management personnel - whether a related party transaction (Re. AS 18)' by the Institute of Chartered Accountants of India (ICAI). While the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006, have incorporated the 'Consensus' part of various ASIs issued by the ICAI, ASI 23 has not been so incorporated as it was felt that it is primarily clarificatory in nature. The Council of the ICAI, has accordingly, decided to withdraw ASI 23, and issue the same as a Guidance Note as it provides appropriate guidance on the subject.

PAPER- 1 : FINANCIAL REPORTING

1. This Guidance Note deals with the issue whether remuneration paid to key management personnel is a related party transaction. Another related issue dealt by this Guidance Note is whether remuneration paid to non-executive directors on the Board of Directors is a related party transaction.
2. Accounting Standard (AS) 18, *Related Party Disclosures*, defines “related party transaction” as **“a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.”** Further, paragraph 24 of AS 18 provides as under:

“The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- purchases or sales of goods (finished or unfinished);
 - purchases or sales of fixed assets;
 - rendering or receiving of services;
 - agency arrangements;
 - leasing or hire purchase arrangements;
 - transfer of research and development;
 - licence agreements;
 - finance (including loans and equity contributions in cash or in kind);
 - guarantees and collaterals; and
 - management contracts including for deputation of employees.”
3. As per the definition of the expression ‘related party transaction’, the transaction should be between related parties to qualify as a related party transaction. Since key management personnel are related parties under AS 18, remuneration paid to key management personnel is a related party transaction requiring disclosures under AS 18. Further, in case non-executive directors on the Board of Directors are not related parties, remuneration paid to them is not considered a related party transaction.

Recommendation

Remuneration paid to key management personnel should be considered as a related party transaction requiring disclosures under AS 18. In case non-executive directors on the Board of Directors are not related parties, remuneration paid to them should not be considered a related party transaction.

GUIDANCE NOTE ON APPLICABILITY OF ACCOUNTING STANDARD (AS) 20, EARNINGS PER SHARE¹

(The following is the text of the 'Guidance Note on the Applicability of Accounting Standard (AS) 20, Earnings Per Share', issued by the Council of the Institute of Chartered Accountants of India. Pursuant to the issuance of this Guidance Note, Accounting Standards Interpretation (ASI) 12 – 'Applicability of AS 20 (Re. AS 20)', stands withdrawn.)

Introduction

1. This Guidance Note deals with the issue whether companies which are required to give information under Part IV of Schedule VI to the Companies Act, 1956, should calculate and disclose earnings per share in accordance with Accounting Standard (AS) 20, *Earnings Per Share*.
2. AS 20 came into effect in respect of accounting periods commencing on or after 1-4-2001 and is mandatory in nature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. AS 20 does not mandate an enterprise, which has neither equity shares nor potential equity shares which are so listed, to calculate and disclose earnings per share, but, if that enterprise discloses earnings per share for complying with the requirements of any statute or otherwise, it should calculate and disclose earnings per share in accordance with AS 20.

Recommendation

3. Since Part IV of Schedule VI to the Companies Act, 1956, requires, among other things, disclosure of earnings per share, every company which provides information under Part IV of Schedule VI to the Companies Act, 1956, should calculate and disclose earnings per share in accordance with AS 20, whether or not its equity shares or potential equity shares are listed on a recognised stock exchange in India.

¹ This Guidance Note was earlier issued as Accounting Standards Interpretation (ASI) 12, 'Applicability of AS 20 (Re. AS 20)' by the Institute of Chartered Accountants of India (ICAI). While the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006, have incorporated the 'Consensus' part of various ASIs issued by the ICAI, ASI 12 has not been so incorporated as it was felt that it is primarily clarificatory in nature. The Council of the ICAI, has accordingly, decided to withdraw ASI 12, and issue the same as a Guidance Note as it provides appropriate guidance on the subject.

PAPER- 1 : FINANCIAL REPORTING

GUIDANCE NOTE ON APPLICABILITY OF AS 25 TO INTERIM FINANCIAL RESULTS¹

(The following is the text of the 'Guidance Note on Applicability of AS 25 to Interim Financial Results', issued by the Council of the Institute of Chartered Accountants of India. Pursuant to the issuance of this Guidance Note, Accounting Standards Interpretation (ASI) 27 - 'Applicability of AS 25 to Interim Financial Results (Re. AS 25)', stands withdrawn.)

Introduction

1. This Guidance Note deals with the issue whether Accounting Standard (AS) 25, *Interim Financial Reporting*, is applicable to interim financial results presented by an enterprise pursuant to the requirements of a statute/regulator, for example, quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises.
2. Accounting Standard (AS) 25, *Interim Financial Reporting*, issued by the Council of the Institute of Chartered Accountants of India, came into effect in respect of accounting periods commencing on or after 1-4-2002. If any enterprise is required or elects to prepare and present an interim financial report, it should comply with this Standard (applicability paragraph).
3. AS 25 further provides as follows:
 - “1. ***This Statement does not mandate which enterprises should be required to present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Statement.***
 2. A statute governing an enterprise or a regulator may require an enterprise to prepare and present certain information at an interim date which may be different in form and/or content as required by this Statement. In such a case, the recognition and measurement principles as laid down in this Statement are applied in respect of such information, unless otherwise specified in the statute or by the regulator.”

¹ This Guidance Note was earlier issued as Accounting Standards Interpretation (ASI) 27, 'Applicability of AS 25 to Interim Financial Results (Re. AS 25)' by the Institute of Chartered Accountants of India (ICAI). While the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006, have incorporated the 'Consensus' part of various ASIs issued by ICAI, ASI 27 has not been so incorporated as it was felt that it was not relevant to the requirements of the Companies Act, 1956. The Council of the ICAI, accordingly, has decided to withdraw ASI 27 and issue the same as a Guidance Note as it provides appropriate guidance on the subject.

FINAL (NEW) EXAMINATION : NOVEMBER, 2010

“4. The following terms are used in this Statement with the meanings specified:

.....

Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements (as described in this Statement) for an interim period.”

Recommendation

4. The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an ‘interim financial report’ as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of ‘interim financial report’ as per AS 25) presented by an enterprise. For example, quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises do not meet the definition of ‘interim financial report’ as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

GUIDANCE NOTE ON TURNOVER IN CASE OF CONTRACTORS¹

(The following is the text of the ‘Guidance Note on Turnover in case of Contractors’, issued by the Council of the Institute of Chartered Accountants of India. Pursuant to the issuance of this Guidance Note, Accounting Standards Interpretation (ASI) 29 – ‘Turnover in case of Contractors (Re. AS 7)’, stands withdrawn.)

Introduction

1. This Guidance Note deals with the issue whether the revenue recognised in the financial statements of contractors as per the requirements of Accounting Standard (AS) 7, *Construction Contracts* (revised 2002), can be considered as ‘turnover’.

¹ This Guidance Note was earlier issued as Accounting Standards Interpretation (ASI) 29, ‘Turnover in case of Contractors (Re. AS 7)’ by the Institute of Chartered Accountants of India (ICAI). While the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006, have incorporated the ‘Consensus’ part of various ASIs issued by the ICAI, ASI 29 has not been so incorporated as it was felt that it is primarily clarificatory in nature. The Council of the ICAI, has accordingly, decided to withdraw ASI 29, and issue the same as a Guidance Note as it provides appropriate guidance on the subject.

PAPER- 1 : FINANCIAL REPORTING

2. AS 7 (revised 2002) deals, *inter alia*, with revenue recognition in respect of construction contracts in the financial statements of contractors. It requires recognition of revenue by reference to the stage of completion of a contract (referred to as 'percentage of completion method'). This method results in reporting of revenue which can be attributed to the proportion of work completed. Under this method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting period in which the work is performed.
3. The paragraph dealing with the 'Objective' of AS 7 (revised 2002) provides as follows:

"Objective

The objective of this Statement is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Statement uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria."

From the above, it may be noted that AS 7 (revised 2002) deals, *inter alia*, with the allocation of contract revenue to the accounting periods in which construction work is performed.

4. Further, paragraphs 21 and 31 of AS 7 (revised 2002) provide as follows:

"21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35."

"31. When the outcome of a construction contract cannot be estimated reliably:

- (a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and***
- (b) contract costs should be recognised as an expense in the period in which they are incurred.***

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.”

From the above, it may be noted that the recognition of revenue as per AS 7 (revised 2002) may be inclusive of profit (as per paragraph 21 reproduced above) or exclusive of profit (as per paragraph 31 reproduced above) depending on whether the outcome of the construction contract can be estimated reliably or not. When the outcome of the construction contract can be estimated reliably, the revenue is recognised inclusive of profit and when the same cannot be estimated reliably, it is recognised exclusive of profit. However, in either case it is considered as revenue as per AS 7 (revised 2002).

5. 'Revenue' is a wider term. For example, within the meaning of Accounting Standard (AS) 9, *Revenue Recognition*, the term 'revenue' includes revenue from sales transactions, rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends. The term 'turnover' is used in relation to the source of revenue that arises from the principal revenue generating activity of an enterprise. In case of a contractor, the construction activity is its principal revenue generating activity. Hence, the revenue recognised in the statement of profit and loss of a contractor in accordance with the principles laid down in AS 7 (revised 2002), by whatever nomenclature described in the financial statements, is considered as 'turnover'.

Recommendation

6. The amount of contract revenue recognised as revenue in the statement of profit and loss as per the requirements of AS 7 (revised 2002), should be considered as 'turnover'.