

PAPER – 1 : FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, ANNOUNCEMENTS AND NOTIFICATIONS

A. Applicable for May, 2013 examination

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

The Ministry of Corporate Affairs (MCA) has revised Schedule VI to the Companies Act 1956 on the 28th February, 2011 pertaining to the preparation of Balance Sheet and Profit and Loss Account under the Companies Act, 1956. This revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards), Rules, 2006. The Revised Schedule VI shall come into force for the Balance Sheet and Profit and Loss Account to be prepared for the financial year commencing on or after 1.4.2011.

(ii) Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs

RBI vide notification No. DNBS.CC.PD.No.252/03.10.01/2011-12 dated December 26, 2011 (Amended further by DNBS.CC.PD.No.254/03.10.01/2011-12 dated December 30, 2011) felt necessary that NBFCs should move over to modern techniques of risk measurement to strengthen their capital framework.

The Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and The Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 require the NBFCs to maintain a minimum CRAR based on risk weights assigned to both on and off balance sheet items.

It has been considered necessary to expand the off-balance sheet regulatory framework to introduce greater granularity in the risk weights and credit conversion factors for different types of off balance sheet items. For this purpose, NBFCs will need to calculate the total risk weighted off-balance sheet credit exposure as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. (Refer point D)

For the off-balance sheet items already contracted by NBFCs, the risk weights shall be applicable with effect from the Financial Year beginning April 01, 2012. For all new contracts undertaken including CDS, the new risk weights shall be applicable from the date of the circular.

1. In para 16 (2), Explanation No. (2) may be replaced with the following:

'(2) Off-balance sheet items

A. General

NBFCs will calculate the total risk weighted off-balance sheet credit exposure as the sum of the risk-weighted amount of the market related and non-market related off-

balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure will be calculated by means of a two-step process:

- (a) the notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and
- (b) the resulting credit equivalent amount is multiplied by the risk weight applicable viz; zero percent for exposure to Central Government/State Governments, 20 percent for exposure to banks and 100 percent for others.

B. Non-market-related off- balance sheet items

- i. The credit equivalent amount in relation to a non-market related off-balance sheet item will be determined by multiplying the contracted amount of that particular transaction by the relevant credit conversion factor (CCF).

Sr. No.	Instruments	Credit Conversion Factor
i.	Financial & other guarantees	100
ii.	Share/debenture underwriting obligations	50
iii.	Partly-paid shares/debentures	100
iv.	Bills discounted/rediscounted	100
v.	Lease contracts entered into but yet to be executed	100
vi.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the NBFC.	100
vii.	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain draw down.	100
viii.	Lending of NBFC securities or posting of securities as collateral by NBFC, including instances where these arise out of repo style transactions	100
ix.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of up to one year over one year	20 50
x.	Similar commitments with an original maturity upto one year, or which can be unconditionally cancelled at any time.	0
xi..	Take-out Finance in the books of taking-over institution	
	(i) Unconditional take-out finance	100
	(ii) Conditional take-out finance	50

	Note: As the counter-party exposure will determine the risk weight, it will be 100 percent in respect of all borrowers or zero percent if covered by Government guarantee.	
xii.	Commitment to provide liquidity facility for securitization of standard asset transactions	100
xiii.	Second loss credit enhancement for securitization of standard asset transactions provided by third party	100
xiv.	Other contingent liabilities (To be specified)	50

Note:

- i. Cash margins/deposits shall be deducted before applying the conversion factor
- ii. Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility, the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of NBFC's on-balance sheet credit exposure'.

C. Market Related Off-Balance Sheet Items

- i. NBFCs should take into account all market related off-balance sheet items (OTC derivatives and Securities Financing Transactions such as repo / reverse repo/ CBLO etc.) while calculating the risk weighted off-balance sheet credit exposures.
- ii. The credit risk on market related off-balance sheet items is the cost to an NBFC of replacing the cash flow specified by the contract in the event of counterparty default. This would depend, among other things, upon the maturity of the contract and on the volatility of rates underlying the type of instrument.
- iii. Market related off-balance sheet items would include:
 - a. interest rate contracts - including single currency interest rate swaps, basis swaps, forward rate agreements, and interest rate futures;
 - b. foreign exchange contracts, including contracts involving gold, - includes cross currency swaps (including cross currency interest rate swaps), forward foreign exchange contracts, currency futures, currency options;
 - c. Credit Default Swaps; and
 - d. any other market related contracts specifically allowed by the Reserve Bank which give rise to credit risk.
- iv. Exemption from capital requirements is permitted for -
 - a. foreign exchange (except gold) contracts which have an original maturity of 14 calendar days or less; and

- b. instruments traded on futures and options exchanges which are subject to daily mark-to-market and margin payments.
- v. The exposures to Central Counter Parties (CCPs), on account of derivatives trading and securities financing transactions (e.g. Collateralised Borrowing and Lending Obligations – CBLOs, Repos) outstanding against them will be assigned zero exposure value for counterparty credit risk, as it is presumed that the CCPs' exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures.
- vi. A CCF of 100 per cent will be applied to the corporate securities posted as collaterals with CCPs and the resultant off-balance sheet exposure will be assigned risk weights appropriate to the nature of the CCPs. In the case of Clearing Corporation of India Limited (CCIL), the risk weight will be 20 per cent and for other CCPs, the risk weight will be 50 percent.
- vii. The total credit exposure to counterparty in respect of derivative transactions should be calculated according to the current exposure method as explained below:

D. Current Exposure Method

The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of a) current credit exposure and b) potential future credit exposure of the contract.

- a) Current credit exposure is defined as the sum of the gross positive mark-to-market value of all contracts with respect to a single counterparty (positive and negative marked-to-market values of various contracts with the same counterparty should not be netted). The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market.
- b) Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts, irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument.

Credit Conversion Factors for interest rate related, exchange rate related and gold related derivatives		
Credit Conversion Factors (%)		
	Interest Rate Contracts	Exchange Rate Contracts & Gold
One year or less	0.50	2.00
Over one year to five years	1.00	10.00
Over five years	3.00	15.00

- i. For contracts with multiple exchanges of principal, the add-on factors are to be multiplied by the number of remaining payments in the contract.
- ii. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. However, in the case of interest rate contracts which have residual maturities of more than one year and meet the above criteria, the CCF or add-on factor is subject to a floor of 1.0 per cent.
- iii. No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.
- iv. Potential future exposures should be based on 'effective' rather than 'apparent notional amounts'. In the event that the 'stated notional amount' is leveraged or enhanced by the structure of the transaction, the 'effective notional amount' must be used for determining potential future exposure. For example, a stated notional amount of USD 1 million with payments based on an internal rate of two times the lending rate of the NBFC would have an effective notional amount of USD 2 million.

E. Credit conversion factors for Credit Default Swaps(CDS)*:

NBFCs are only permitted to buy credit protection to hedge their credit risk on corporate bonds they hold. The bonds may be held in current category or permanent category. The capital charge for these exposures will be as under: (i) For corporate bonds held in current category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, the credit protection will be permitted to be recognised to a maximum of 80% of the exposure hedged. Therefore, the NBFC will continue to maintain capital charge for the corporate bond to the extent of 20% of the applicable capital charge. This can be achieved by taking the exposure value at 20% of the market value of the bond and then multiplying that with the risk weight of the 2 issuing entity. In addition to this, the bought CDS position will attract a capital charge for counterparty risk which will be calculated by applying a credit conversion factor of 100 percent and a risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

- (ii) For corporate bonds held in permanent category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, NBFCs can

* As amended further by notification no. DNBS.PD.No.239/ CGM (US) 2011 and DNBS.PD.No. 240/CGM (US) 2011 both dated December 30, 2011

recognise full credit protection for the underlying asset and no capital will be required to be maintained thereon. The exposure will stand fully substituted by the exposure to the protection seller and attract risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

2. In the notes to the table under 'Explanations: On balance sheet items' in para 16(2), the note no.4 may be deleted.

(Source: www.rbi.org.in)

(iii) Amendment to para 46 of Accounting Standard 11 of the Companies (Accounting Standards) Rules, 2006

Ministry of Corporate Affairs vide its notification number G.S.R 913(E), dated 29th December, 2011, has amended the para 46 of AS 11 of the Companies (Accounting Standards) Amendment Rules, 2011. Through this notification, the MCA has extended the option (for the enterprises) to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020 instead of 31st March, 2012.

(iv) Insertion of para 46A in Accounting Standard 11 of the Companies (Accounting Standards) Rules, 2006

Ministry of Corporate Affairs vide its notification number G.S.R 914(E), dated 29th December, 2011, inserted under-mentioned para 46A in AS 11 of the Companies (Accounting Standards) Rules, 2006, now known as Companies (Accounting Standards) (Second Amendment) Rules, 2011.

"46A. (1) In respect of accounting periods commencing on or after the 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital assets, can be added to or deducted from the cost of the assets and shall be depreciated over the balance life of the assets, 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 assets or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15 of the said rules.

(2) To exercise the option referred to in sub-paragraph (1), an asset or liability shall be designated as long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of twelve months or more at the date of origination of the asset or the liability.

Provided that the option exercised by the enterprise shall disclose the fact 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.”

Note: The principal regulations were published in the Gazette of India Extraordinary, Part II, Section 3, Sub Section (i) vide G.S.R 739(E), dated the 7th December, 2006 and amended vide notification number G.S.R. 212(E), dated the 27th March, 2008 and subsequently amended by No. G.S.R. 225(E) dated 31st March, 2009 and No. G.S.R. 378(E), dated 11th May, 2011.

- (v) **Clarification on Para 46A of notification number G.S.R. 914(E) dated 29.12.2011 on Accounting Standard 11 relating to "The effects of Changes in Foreign Exchange Rates"**

The Ministry has received several representations from industry associations that Para 6 of AS 11 and Para 4(e) of AS 16 are posing problems in proper implementation of Para 46A of AS 11 inserted vide notification 914(E) dated 29.12.2011. In order to resolve the problems faced by industry, MCA had further clarified vide Circular No. 25/2012 dated 09.08.2012 that Para 6 of AS 11 and Para 4(e) of the AS 16 shall not apply to a company which is applying clause Para 46A of AS 11.

(Source: www.mca.gov.in)

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

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

per the roadmap issued by MCA, the Indian Accounting Standard (Ind AS) 39, *Financial Instruments: Recognition and Measurement*, will apply.

- (ii) for entities other than those covered under paragraph 2(i) above, the status of AS 30 will continue as clarified in paragraph 1 above.
- 3. The abovementioned clarifications would also be relevant to the existing AS 31, *Financial Instruments: Presentation* and AS 32, *Financial Instruments: Disclosures* as well as for Ind AS 32, *Financial Instruments: Presentation* and Ind AS 107, *Financial Instruments: Disclosures*, after 1st April 2011 onwards.

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

B. Not applicable for May, 2013 examination

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

The Ministry of Corporate Affairs (MCA) has hosted 35 Converged Indian Accounting Standards (known as "Ind-AS"), without announcing the applicability date. The issuance of Ind-AS is a significant step towards the implementation of converged standards in India. The MCA will intimate the implementation date later. However, Ind ASs are not made applicable for May, 2013 examination.

(ii) Inflation Accounting

As per the Council's decision, in its 306th meeting, the topic of 'Inflation Accounting' has been excluded from the syllabus of Financial Reporting. Therefore, the chapter on 'Inflation Accounting' is not applicable for May, 2013 examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Applicability of Accounting Standards to various entities

1. (a) State the exemptions/relaxations available to Small and Medium Sized Corporates (SMCs) in complying with the notified Accounting Standards as provided by the Central Government.
- (b) A company was classified as Non-SMC in 2011-12. In 2012-13 it has been classified as SMC. The management desires to avail the exemption or relaxations available for SMCs in 2012-13. However, the accountant of the company does not agree with the same. Comment.

AS 1

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

AS 2

- (b) The closing inventory at cost of a Company amounted to ₹ 9,56,700. The following items were included at cost in the total:
- (i) 350 Shirts, which had cost ₹ 380 each and normally sold for ₹ 750 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.
 - (ii) 700 Trousers, which had cost ₹ 520 each. These too were found to be defective. Selling expenses for the batch totaled ₹ 3,800. They were sold for ₹ 950 each.

What should be the closing inventory value (to the nearest rupee), after considering the above items?

AS 3

- (c) Search Ltd. submits the following information pertaining to the year 2011-12 for the purpose of Cash Flow Statement. Using the data, you are required to find the closing cash and bank balances, given an opening figure thereof ₹ 1.55 million.

	(₹ millions)
Additional shares issued	6.50
CAPEX (Capital expenditure)	9.90
Proceeds from assets sold	1.60
Dividends declared	0.50
Gain from disposal of assets	(1.20)

Net income	3.30
Increase in trade receivable	1.50
Redemption of 4.5% debentures	2.50
Depreciation & Amortization	0.75

AS 4

- (d) A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.2012. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2012. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss in detail.

AS 5

3. (a) Give two examples on each of the following items:
- Change in Accounting Policy
 - Change in Accounting Estimate
 - Extra Ordinary Items
 - Prior Period Items.

AS 6 and Guidance Note on Accounting for Depreciation in Companies

- (b) Topsy Ltd. has two divisions. It provides depreciation for both the divisions on straight line basis as per the rates prescribed by Schedule XIV to the Companies Act. While finalising the accounts for the year ended 31.3.2012, the company wants to change the method to Written Down Value method for one of its divisions as the management thinks that the assets of the said division suffer faster wear and tear. Please advise the company on the above and also state whether the change should be prospective or retrospective?

AS 7

- (c) Speedy Construction Ltd. has recognised contract revenue on a contract awarded in the financial year 2012-13. The target period of completion is 5 years. The contract provides for incentives for early completion at the rate of ₹ 1,000 per day subject to a maximum of ₹ 3,00,000. The company has included this amount in contract revenue 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 policy for recognition of such incentives.

AS 9

- (d) Perfect Ltd. manufactures machinery used in Power Plants. In response to the tenders issued by Power Plants, Perfect Ltd. quotes its price. As per terms of contract, full price of machinery is not released by the power plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. From the past experience, it is observed that Perfect Ltd.

normally performs satisfactorily and fulfills the expectations of the Power Plants. Perfect Ltd. accounts for only 90% of the invoice value as sales revenue and book the balance amount in the year of receipt to the extent of actual receipts only. Comment on the treatment done by the company.

AS 10

4. (a) PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	₹
Material	16,00,000
Direct Expenses	3,00,000
Direct Labour (1/15th of the total labour time was chargeable to the construction)	6,00,000
Total Office & Administrative Expenses (4% is specifically attributable to the construction of a fixed asset)	9,00,000
Depreciation on assets used for the construction of fixed asset	15,000

Calculate the cost of the fixed asset.

AS 11

- (b) Option Ltd. is engaged in the manufacturing of steel. For its steel plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2011, it borrowed US \$1 million from International Funding Agency, USA when exchange rate was 1 \$ = ₹ 52. The funds were used for acquiring machineries on the same date to be used in three different steel plants. The useful life of the machineries is 10 years and their residual value is ₹ 20,00,000.

Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalised even though the company had an option to capitalise it as per notified AS 11 (notification issued by the MCA in 2009).

Now for this new purchase of machinery, Option Ltd. is interested to avail the option of capitalising the same to the cost of asset. Exchange rate on 31st March, 2012 is 1 US \$ = ₹ 51. Assume that on 31st March, 2012, Option Ltd. is not having any old Long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2011.

Can Option Ltd. capitalise the exchange difference to the cost of asset on 31st March, 2012? If yes, then calculate the depreciation amount on machineries as on 31st March, 2012.

Would your answer differ, if Option Ltd. was not a company and was a LLP?

AS 12

- (c) A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non compliance with certain conditions. Pass journal entries for first two years.

AS 13 and AS 16

- (d) Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 2011-12. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹ 50 lakhs. As on 31st March, 2012, since the said project was not complete, the directors of Take Ltd. resolved to capitalize the interest accruing on borrowings amounting to ₹ 4 lakhs and add it to the cost of investments. Comment.

AS 15

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

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹ 18 (10% of ₹ 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:

- (a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.
- (b) The fair value of plan assets on the date is estimated at ₹ 5,100.
- (c) The unamortized past service cost is ₹ 180.
- (d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

AS 16

- (b) Faulad Iron and Steel Ltd. is establishing an integrated steel plant consisting of four phases. It is expected that the full plant will be established over several years but Phase I and Phase II of the Plant will be started as soon as they are completed.

Following is the detail of the work done on different phases of the plant during the current year:

	Phase I ₹	Phase II ₹	Phase III ₹	Phase IV ₹
Cash expenditure	20,00,000	35,00,000	25,00,000	40,00,000
Plants purchased	<u>28,00,000</u>	<u>40,00,000</u>	<u>30,00,000</u>	<u>48,00,000</u>
Total expenditure	<u>48,00,000</u>	<u>75,00,000</u>	<u>55,00,000</u>	<u>88,00,000</u>
Total expenditure of all phases				2,66,00,000
Loan taken @ 16%				2,40,00,000

During current year, Phases I and II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

AS 17

- (c) Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

AS 18

- (d) Kismis Ltd. is a 100% subsidiary of Kaju Ltd. Which of the followings are related party transactions for the purpose of consolidated financial statements?
- Salary paid to employees of Kismis Ltd.
 - Loans given to employees of Kaju Ltd.
 - Inter-company sales between Kaju Ltd. and Kismis Ltd.
 - Loan given by Kismis Ltd. to managing director of Kaju Ltd.
 - Transfer of Asset by Kaju Ltd. to Kismis Ltd.

AS 19

6. (a) Annual lease rent = ₹ 40,000 at the end of each year

Lease period = 5 years

Guaranteed residual value = ₹ 14,000

Fair value at the inception (beginning) of lease = ₹ 1,50,000

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.

Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

AS 20

- (b) Determine the order to include dilutive securities in the computation of weighted average number of shares and calculate the diluted earnings per share on the basis of the following information pertaining to financial year ended 31st March, 2012:

Earnings, i.e., Net profit attributable to equity shareholders	₹ 1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	₹ 75.00

Details of Potential Equity Shares:

Options	1,00,000 with exercise price of ₹ 60
Convertible Preference Shares	8,00,000 shares entitled to a cumulative dividend of ₹ 8 per share. Each preference share is convertible into 2 equity shares.
Attributable tax, e.g. Dividend distribution tax (DDT)	16.2225%
12% Convertible Debentures of ₹ 100 each	Nominal amount ₹ 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

AS 22

- (c) Alpha Ltd. prepares its accounts annually on 31st March. The company has incurred a loss of ₹ 1,00,000 in the year 2010 and made profits of ₹ 50,000 and ₹ 60,000 in year 2011 and year 2012 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 2010, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. It is also assumed that there is no difference between taxable income and accounting income except that set off of loss is allowed in years 2011 and 2012 for tax purposes. Calculate profit (loss) after tax effect as per AS 22, in all the three years.

AS 23

- (d) A Ltd. has invested in the shares of B Ltd. Its share holding in B Ltd. is 25%. For the purpose of reporting in the Consolidated Financial Statements, A Ltd. reports its investment in associate at carrying amount at the end of the financial year. It finds that its share of losses of B Ltd. exceeds the amount at which the investment is

carried. Further in the current year, B Ltd. reports loss. Should A Ltd. recognise the loss for the current year in its separate financial statements?

AS 25

7. (a) How should the following be recognised and measured in the interim financial statements?
- (i) Gratuity and other defined benefit schemes;
 - (ii) Year-end bonus;
 - (iii) Income-tax expense;
 - (iv) Provisions
 - (v) Foreign currency translation gains and losses.

AS 26

- (b) A company acquired for its internal use a software on 28.01.2012 from the USA for US \$ 1,00,000. The exchange rate on that date was ₹ 52 per US \$. The seller allowed trade discount @ 5 %. The other expenditure were:
- (i) Import Duty : 20%
 - (ii) Purchase Tax : 10 %
 - (iii) Entry Tax : 5 % (Recoverable later from tax department)
 - (iv) Installation expenses : ₹ 25,000
 - (v) Profession fees for Clearance from Customs : ₹ 20,000
- Compute the cost of software to be capitalized.

AS 28

- (c) A Ltd. is the sole manufacturer of product X. A particular machine is exclusively used for production of product X. The company had near monopoly of the product. A competitor has recently come out with a cheaper substitute of product X. The company is anticipating significant fall in demand for its product and cash flow from the machine used in production of X is also expected to fall. As per the latest budget estimates, taking the entry of the competitor in consideration, the operating pre-tax cash flows from the machine expected over next 5 years are ₹ 9 lakh, ₹ 8 lakh, ₹ 6 lakh, ₹ 5.5 lakh and ₹ 5 lakh respectively. The expected life of the machine is 10 years. Declining growth rates for future cash flows are estimated from year 6 onwards at 10%, 20%, 30%, 40%, 60% respectively. The disposal value (net of expected cost of disposal) realisable at the end of year 10 is ₹ 1 lakh.
- The machine can be disposed off immediately for ₹ 25 lakh subject to payment of brokerage 2% on disposal value. The carrying amount of the machine on the current date is ₹ 35 lakh.

Taking the risk involved in the use of the machine for production of X in consideration, a pre-tax rate of return of 10% seems to be appropriate.

Determine impairment loss if any and give the journal entries in the books of A Ltd.

AS 29

8. (a) A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal with the same in the annual accounts of the company?

AS 30, 31 and 32

- (b) Identify the host and embedded derivative in the following cases:
- Entity A holds a debenture bond of entity B which is convertible into ordinary shares of entity B at the option of entity A.
 - Sun Ltd. enters into a lease agreement for usage of plant and equipment, rentals in respect of which lease rentals are payable annually. The lease includes a clause that lease rentals payable will be linked to changes in Cost Inflation Index announced u/s 48 of Income tax Act, and contingent rentals will be payable on the basis of Benchmark interest of PLR of SBI.
 - Moon Ltd. enters into a lease agreement for usage of plant and equipment, rentals in respect of which are payable annually. The lease includes a clause that lease rentals payable will be increasing annually by ₹ 1,20,000
 - A floating rate debt - (1) with no cap (2) with a cap on interest and (3) a separate agreement for a cap on interest.
 - Interest rate on a fixed deposit linked to fluctuation of BSE sensex.

Guidance Note on Measurement of Income Tax Expenses for interim Financial Reporting in the Context of AS 25

- (c)

Estimated annual income (inclusive of estimated capital gains of ₹ 20,000 earned in quarter II)	₹ 1,00,000
Assumed tax rates:	
On capital gains	10%
On other income:	
First ₹ 40,000	30%
Balance income	40%

Assuming there is no difference between the estimated taxable income and the estimated accounting income; calculate tax expense and weighted average annual effective tax rate. Also, calculate tax expense for each quarter, when the estimated income of each quarter is ₹ 25,000 and income for 2nd quarter of ₹ 25,000 includes capital gain of ₹ 20,000.

Accounting Standards (as applicable in India), IFRS and US GAAP

9. State the treatment of the following items with reference to Accounting Standards (as applicable in India), IFRS and US GAAP:
- Government grants;
 - Borrowing costs.

Corporate Financial Reporting- Revised Schedule VI

10. (a) Astha Ltd. has FCCBs worth ₹ 100 crore which are due to mature on 31st December 2013. While preparing the financial statements for the year ending 31st March 2013, it is expected that the FCCB holders will not exercise the option of converting the same to equity shares. How should the company classify the FCCBs on 31st March 2013? Will your answer be different if the company expects that FCCB holders will convert their holdings into equity shares of Astha Ltd.?
- (b) Calcus Ltd. provides you the following information:
- Raw material stock holding period: 3 months
 - Work-in-progress holding period: 1 month
 - Finished goods holding period: 5 months
 - Debtors collection period: 5 months

You are requested to compute the operating cycle of Calcus Ltd. What would happen if the trade payables of the Company are paid in 12.5 months—whether these should be classified as current or non-current liability?

Corporate Restructuring –Amalgamation

11. Honey Ltd. agreed to acquire the business of Bunny Ltd. as on 31st March, 2012. On that date, balance sheet of Bunny Ltd. was summarised as follows:

Liabilities	₹	Assets	₹
Share Capital (fully paid shares of ₹ 10 each)	3,00,000	Goodwill	50,000
General Reserve	1,35,000	Land, Buildings and Plant	3,20,000
Profit and Loss Account	55,000	Inventories	84,000
Trade Payables	10,000	Trade Receivables	18,000
	<u>5,00,000</u>	Cash and Bank balances	<u>28,000</u>
			<u>5,00,000</u>

The shareholders in Bunny Ltd. were to receive ₹ 2.50 in cash per share and 3 shares in Honey Ltd. for every two shares held - the shares in Honey Ltd. being considered as worth ₹ 12.50 each.

There were fractions equalling 50 shares of Honey Ltd. for which cash was paid. The directors of Honey Ltd. considered the various assets as on 31.3.12 to be valued as follows:

	₹
Land	1,00,000
Buildings	2,50,000
Plant	3,50,000
Inventories	80,000
Trade receivables	18,000

The cost of liquidation of Bunny Ltd. ultimately was ₹ 5,000. Due to a technical hitch, the transaction could be completed only on 1st October, 2012. Till that date, Bunny Ltd. carried on trading which resulted in a profit of ₹ 20,000 (subject to interest) after providing ₹ 15,000 as depreciation. On October 1, 2012 inventory was ₹ 90,000; Trade receivables were ₹ 25,000 and trade payables were ₹ 15,000. There was no addition to or sale of fixed assets. However, for the purpose of amalgamation, stock on October 1, 2012 was taken at ₹ 86,000 only. It was agreed that the profit will belong to Honey Ltd.

You are required to

- Prepare Realisation Account and the Shareholders Account in the books of Bunny Ltd., and
- Give journal entries in the books of Honey Ltd. as on October, 1, 2012.

Consolidated Financial Statements – Multiple subsidiaries

12. Almighty Limited is a holding company and Beloved Limited and Caring Limited are subsidiaries of Almighty Limited. Their summarized Balance Sheets as on 31.12.2012 are given below:

	Almighty Ltd. ₹	Beloved Ltd. ₹	Caring Ltd. ₹		Almighty Ltd. ₹	Beloved Ltd. ₹	Caring Ltd. ₹
Share Capital	1,00,000	1,00,000	60,000	Fixed Assets	20,000	60,000	43,000
Reserves	48,000	10,000	9,000	Investments			
Profit & Loss Account	16,000	12,000	9,000	Shares in Beloved Ltd.	95,000		
				Shares in Caring Ltd.	13,000	53,000	
Trade Payables	7,000	5,000		Inventories	12,000		

Almighty Ltd.		7,000		Beloved Ltd.	8,000		
Caring Ltd.	3,000			Trade Receivables	26,000	21,000	32,000
				Almighty Ltd.			<u>3,000</u>
	<u>1,74,000</u>	<u>1,34,000</u>	<u>78,000</u>		<u>1,74,000</u>	<u>1,34,000</u>	<u>78,000</u>

The following particulars are given:

- (i) The share capital of all companies is divided into shares of ₹ 10 each.
- (ii) Almighty Ltd. held 8,000 shares of Beloved Ltd. and 1,000 shares of Caring Ltd.
- (iii) Beloved Ltd. held 4,000 shares of Caring Ltd.
- (iv) All these investments were made on 30.6.2012.
- (v) On 31.12.2011, the position was as shown below:

	Beloved Ltd. ₹	Caring Ltd. ₹
Reserve	8,000	7,500
Profit & Loss Account	4,000	3,000
Trade Payables	5,000	1,000
Fixed Assets	60,000	43,000
Inventories	4,000	35,500
Trade Receivables	48,000	33,000

- (vi) 10% dividend is proposed by each company.
- (vii) The whole of inventory of Beloved Ltd. as on 30.6.2012 (₹ 4,000) was later sold to Almighty Ltd. for ₹ 4,400 and remained unsold by Almighty Ltd. as on 31.12.2012.
- (viii) Cash-in-transit from Beloved Ltd. to Almighty Ltd. was ₹ 1,000 as at the close of the year.

You are required to prepare the Consolidated Balance Sheet of the group as on 31.12.2012.

Consolidated Financial Statements - Investment in Associates and Joint Ventures

13. The draft consolidated balance sheet of Helpful Ltd. group as at 31.03.12 is given below:

Liabilities	₹ in 000	Assets	₹ in 000
Share Capital	1,200	Fixed Assets	3,000
Capital Reserve	30	Investment in Need Ltd.	180
Profit & Loss A/c	875	Investment in Desire Ltd.	375

Minority Interest	450	Current Assets	500
Non- current liabilities	900		
Current Liabilities	600		
	4,055		4,055

Helpful Ltd. acquired 25% stake in Need Ltd. for ₹ 1.80 lakh and 40% stake in joint venture Desire Ltd. for ₹ 3.75 lakh on 01.01.2011. Profit & Loss A/c balances of Need Ltd. and Desire Ltd. on that date were ₹ 2 lakh and ₹ 3 lakh respectively.

Summarised balance Sheets of Need Ltd. and Desire Ltd. as at 31.12.2011 are given below:

Liabilities	Need Ltd. ₹ in 000	Desire Ltd. ₹ in 000	Assets	Need Ltd. ₹ in 000	Desire Ltd. ₹ in 000
Share Capital	500	600	Fixed Assets	600	800
Profit & Loss A/c	300	400	Current Assets	400	700
Non-current Liabilities	100	150			
Current Liabilities	100	350			
	1,000	1,500		1,000	1,500

Earnings of Need Ltd. for the first quarter 2012 was ₹ 32,000. There were no changes in long term assets and liabilities. Current assets and liabilities increased during the period by ₹ 27,000 and ₹ 18,000 respectively.

In first quarter of 2012, Desire Ltd. redeemed debentures of ₹ 1 lakh at par (standing in the books as non-current liability) and earned ₹ 40,000. Current assets and liabilities increased during the period by ₹ 38,000 and ₹ 25,000 respectively.

Adjust the draft consolidated balance sheet if necessary.

Accounting and Reporting of Financial Instruments

14. You are required to

- Identify the Equity and Liability components;
- Compute bond liability at the end of each year; and
- Give necessary journal entries from the information given below:

Number, value and period of convertible bonds	4,000 bonds, issued at the beginning of year 1, face value is ₹ 1,000 per bond (3 years validity)
Proceeds received	₹ 40 lacs

Interest rate on the bond	6% p.a. payable annually
Conversion	At the bond holders' discretion, conversion into 250 ordinary shares for each bond of ₹ 1000
Prevailing market rate	9% per annum, for bonds issued without conversion option
Present value factors for 9%	0.917, 0.841, 0.772

Share Based Payments

15. At the beginning of year 1, an enterprise grants 300 stock options to each of its 1,000 employees, conditional upon the employees remaining in the employment of the enterprise for two years. The fair value of the stock options, at the date of grant, is ₹ 10 per option and the exercise price is ₹ 50 per share. The other relevant terms of the grant and assumptions are as below:
- The number of employees expected to complete two years vesting period, at the beginning of the plan, is 900. 50 employees are expected to leave during year 1 and year 2 and, consequently, the options granted to them are expected to be forfeited.
 - Actual forfeitures, during the vesting period, are equal to the expected forfeitures and 900 employees have actually completed two-years vesting period.
 - The profit of the enterprise for the year 1 and year 2, before amortisation of compensation cost on account of ESOPs, is ₹ 25,00,000 and ₹ 28,00,000 respectively.
 - The fair value of shares for these years was ₹ 57 and ₹ 60 respectively.
 - The enterprise has 5,00,000 shares of ₹ 10 each outstanding at the end of year 1 and year 2.

Compute the Basic and Diluted EPS, ignoring tax impacts, for the year 1 and year 2.

Mutual Fund

16. (a) Black Rock Mutual Fund has invested in 2,00,000 shares of Profit Ltd. No quotation is available for last thirty days prior to the valuation date. The P/E ratio of a comparable company, which is regularly traded, is 12. Earning per share of Profit Ltd. is ₹ 20. The Net Asset Value of Profit Ltd. is ₹ 160 and the comparable company is ₹ 200. The current market price of comparable equity share is ₹ 240. A policy is taken to give 40% weightage to net assets value and to reduce from comparable P/E ratio for relatively less liquidity of Profit Ltd. stock.

Required:

- Explain whether the investment in Profit Ltd. will be classified as trade investment, or 'non-trade investment' giving the reason for the stand taken by you.

- (b) What do you think, to be the appropriate criteria for selection of comparable stock?
- (c) How much discounting should be made from comparable P/E ratio for valuing investment in non- traded scrip?
- (d) What should be the value of 2,00,000 equity shares of Profit Ltd.?

NBFC

- (b) Templeton Finance Ltd. is a non-banking finance company. The extracts of its balance sheet are given below:

Liabilities	Amount	Assets	Amount
	₹ in 000		₹ in 000
Paid-up equity capital	100	Leased out assets	800
Free reserves	500	Investment:	
Loans	400	In shares of subsidiaries	
Deposits	400	group companies	100
		In debentures of	
		subsidiaries and group	100
		Cash and bank balances	200
		Deferred expenditure	<u>200</u>
	<u>1,400</u>		<u>1,400</u>

You are required to compute 'Net owned Fund' of Templeton Finance Ltd. as per the NBFC (Deposit Accepting or Holding) Companies Prudential Norms (RBI) Directions 2007.

Valuation of Shares

17. The summarised Balance Sheet of Wifi Ltd. as on 31st March, 2012 is given below:

Liabilities	₹	Assets	₹
Share capital:		Fixed assets:	
Equity shares of ₹ 10 each 6,00,000		Goodwill	40,000
Less: Calls in arrear		Machinery	3,00,000
(₹ 2 for final call) <u>20,000</u>	5,80,000		
7% Preference shares of ₹ 10 each		Freehold	
fully paid	3,00,000	properties	4,50,000
Reserve and surplus:		Vehicles	1,00,000
General reserve	3,50,000	Furniture	50,000
Profit and loss account	1,20,000	Investments	2,00,000

Current liabilities:		Current assets:	
Trade Payables	3,00,000	Inventories	2,50,000
Bank loan	2,00,000	Trade Receivables	4,00,000
		Cash at bank	<u>60,000</u>
	<u>18,50,000</u>		<u>18,50,000</u>

Additional information:

- (i) On 1.4.2009 a new furniture costing ₹ 20,000 was purchased and wrongly charged to revenue. No rectification has yet been made for this. Depreciation charged on furniture is @ 10% on reducing balance system.
- (ii) Fixed assets are worth 15% above their actual book value.
- (iii) Stock is overvalued by ₹ 50,000 and 10% debtors are doubtful.
- (iv) Of the investments, 10% is in the nature of trade and the balance non-trade. Trade investments are to be valued at 10% below cost. A uniform rate of dividend of 10% is earned on all investments.
- (v) For the purpose of valuation of shares, goodwill is to be considered on the basis of 2 years' purchase of super profits based on average profit of last 3 years.

Profits are as follows:

	₹
2009-10	2,50,000
2010-11	2,80,000
2011-12	3,30,000

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

You are required to value each fully paid and partly paid equity share, assuming tax rate of 50%.

Valuation of Brand

18. Rough-use Ltd. has hired a Marketing Consultancy Firm for doing market research and provide data relating to Tyre Industry for the next 10 years. The following were the observations and projections made by the consultancy firm:
 1. The Tyre Industry in the target area i.e. whole of India, is expected to grow at 5% per annum for the next 3 years, and thereafter at 7% per annum over the subsequent seven years.
 2. The market size in terms of unencumbered basic sales of tyres was estimated at ₹ 8,000 crores in the last year, dominated by medium and large players. This

includes roughly 10% of fake brands and locally manufactured tyres. Market share of this segment is expected to increase by 0.5% over the decade.

3. Cheap Chinese Imports accounted for 40% of the business (but 60% of the volume) last year. This is expected to be increase by 0.25% over the next decade.
4. The other large players accounted for roughly 34% of the business value last year, which is expected to go down by 0.5% over the next ten years, due to expansion of Rough-use Ltd.'s product portfolio.
5. The Company is in the process of business process re-engineering, which will start yielding results in 2 years time, and increase its profitability by 3% from its existing 8%.

What is the Brand Value of Rough-use Ltd., under Market Oriented Approach, if the appropriate discount rate is 10%?

Valuation of Intangibles

19. During the financial year 2011-2012, Smart Ltd. had the following transactions:

- (i) On 1st April 2011, Smart Ltd. purchased new asset of Ok Ltd. for ₹ 7,20,000. The fair value of Ok Ltd.'s identifiable net assets was ₹ 3,44,000. Smart Ltd. is of the view that due to popularity of Ok Ltd.'s products, the life of resulting goodwill is unlimited.
- (ii) On May 2011, Smart Ltd., purchased a franchise to operate boating service from the State Government for ₹ 1,20,000 and at an annual fee of 1% of boating revenues. The franchise expires after 5 years. Boating revenues were ₹ 40,000 during financial year 2011-2012. Smart Ltd. projects future revenue of ₹ 80,000 in 2012-2013 and ₹ 1,20,000 per annum for 3 years thereafter.
- (iii) On 5th July 2011, Smart Ltd. was granted a patent that had been applied for by Ok Ltd. During 2011-12, Smart Ltd. incurred legal costs of ₹ 1,02,000 to register the patent and an additional ₹ 1,70,000 to successfully prosecute a patent infringement suit against a competitor. Smart Ltd. expects the patents economic life to be 10 years. Smart Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standard taking a full year amortization in the year of acquisition.

Prepare

- (a) A schedule showing the intangible section in Smart Ltd. balance sheet at 31st March 2012.
- (b) A schedule showing the related expenses that would appear in the Statement of Profit and Loss of Smart Ltd. for 2011-2012.

Value Added Statement

20. (a) From the following data, prepare a Value Added Statement of Merit Ltd., for the year ended 31.3.2012:

Particulars	₹	Particulars	₹
Decrease in Stock	24,000	Sales	40,57,000
Purchases	20,20,000	Other Income	55,000
Wages & Salaries	10,00,000		
Manufacturing & Other Expenses	2,30,000		
Finance Charges	4,69,000		
Depreciation	2,44,000		
Profit Before Taxation	<u>1,25,000</u>		
Total	<u>41,12,000</u>		<u>41,12,000</u>
Particulars		₹	
Profit Before Taxation		1,25,000	
Less: Tax Provisions		(40,000)	
Income Tax Payments (for earlier years)		<u>(3,000)</u>	
Profit After Taxation		<u>82,000</u>	
Appropriations of PAT			
Debenture Redemption Reserve		10,000	
General Reserve		10,000	
Proposed Dividend		35,000	
Balance carried to balance Sheet		<u>27,000</u>	
Total		<u>82,000</u>	

Economic Value Added

(b) The Capital Structure of Define Ltd. is as under:

- 80,00,000, Equity Shares of ₹ 10 each = ₹ 800 lakhs
- 1,00,000, 12% Preference Shares of ₹ 250 each = ₹ 250 lakhs
- 1,00,000, 10% Debentures of ₹ 500 each = ₹ 500 lakhs
- Terms Loan from Bank @ 10% = ₹ 450 lakhs

The Company's Statement of Profit and Loss for the year showed PAT of ₹ 100 lakhs, after appropriating Equity Dividend @ 20%. The Company is in the 40% tax bracket. Treasury Bonds carry 6.5% interest and beta factor for the Company may be taken as 1.5. The long run market rate of return may be taken as 16.5%. Calculate Economic Value Added.

SUGGESTED ANSWERS / HINTS

1. (a) The SMCs are given the following exemptions / relaxations in complying with the notified accounting standards:
 1. AS 3 "Cash flow Statement" and AS 17 "Segment Reporting" are not applicable to SMCs in their entirety.
 2. AS 21 "Consolidated Financial Statements", AS 23 "Accounting for Investment in Associates in Consolidated Financial Statements" and AS 27 "Financial Reporting of Interests in Joint Ventures" are also not applicable to SMCs since the relevant regulations require compliance with them only by certain Non-SMCs.
 3. The SMCs have been given following relaxations as regards AS 15 "Employee Benefits":
 - SMCs need not comply paras 11 to 16 of AS 15 to extent they deal with recognition and measurement of short-term accumulated compensating absences.
 - Discounting the amount payable after 12 months of balance sheet as regards defined contribution plans and termination benefits.
 - Recognition, measurement and disclosure principles in respect of defined benefit plans and other long-term employee benefits plan. However such enterprises should provide and disclose the accrued liability in respect of defined benefit plan and other long-term employee benefit plan as per actuarial valuation based on projected unit credit method and discount rate based on yield on Government bonds.
 4. SMCs need not disclose diluted EPS as per AS 20 "Earnings Per Share".
 5. SMCs need not comply with disclosure requirements regarding operating lease given under sub-paras (b) & (d) of para 46; sub-paras (a), (b) & (e) of para 25; sub-paras (a) & (f) of para 37 and sub-paras (c), (e) & (f) of para 22 of AS 19 regarding disclosure requirements for finance lease by the lessor and lessee respectively.
 6. 'Value in use' has been differently defined for SMCs which provides an alternate to calculate 'value in use' based on a reasonable estimate of future cash flows.
 7. SMCs are exempt from disclosure requirements of paras 66 and 67 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets" regarding provisions and its descriptions.

- (b) As per Rule 5 of the Companies (Accounting Standards) Rules, 2006, an existing company, which was previously not an SMC and subsequently becomes an SMC, shall not be qualified for exemption or relaxation in respect of accounting standards available to an SMC until the company remains an SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions available with the SMCs for the year ended 31st March, 2013.
2. (a) AS 1 "Disclosure of Accounting Policies" recognises prudence as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognized only when realized though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Further, 'accrual' is one of the fundamental accounting assumptions as per AS 1. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be placed in a disadvantageous position for non payment of interest in respect of claim for interest from the due date to date of repayment of loan.

From the aforesaid, it is apparent that the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. Non-provision of the interest from the due date to the date of repayment of loan amounts to violation of accrual basis of accounting.

- (b) Calculation of value of closing inventory:

	₹
Value of closing inventory (given)	9,56,700
Less: Adjustment to bring the stock of shirts at net realizable value (W.N.1)	<u>(8,313)</u>
Revised value of closing inventory as per AS 2	<u>9,48,387</u>

Working Notes:

1. Valuation of Shirts as per AS 2

	₹
Cost price (per shirt)	380
Net realizable value per shirt :	
Selling price of a shirt	₹ 750 × 50% = 375.00
Less : Selling expense	(5% of ₹ 375) = <u>(18.75)</u>

NRV of a shirt	<u>356.25</u>	
As per AS 2, inventories are valued at cost or NRV whichever is less.		<u>(356.25)</u>
Difference of cost and NRV		<u>23.75</u>
Therefore, value of inventory of shirts is to be reduced by ₹ 8,313 (₹ 23.75 x 350 shirts)		

2. Valuation of Trousers as per AS 2

	₹
Cost price (per trouser)	520
NRV per trouser:	
Selling price of a trouser	₹ 950.00
Less: Selling expense of a trouser (₹ 3,800/700)	₹ <u>(5.43)</u>
NRV of a trouser	₹ <u>944.57</u>
As per AS 2, inventories are valued at cost or NRV whichever is less.	520
Since, inventory of trousers is already carried at cost, no further adjustment is required in the total value of closing inventories.	

(c) Search Ltd.

Cash Flow Statement for the year ended 31st March, 2012

	₹ in millions	₹ in millions
Cash flows from operating activities		
Net income	3.30	
Add: Depreciation & amortization	0.75	
Loss from disposal of assets	1.20	
Less: Increase in accounts receivables	<u>(1.50)</u>	
Net cash generated from operating activities		3.75
Cash flows from investing activities		
Capital expenditure	(9.90)	
Proceeds from sale of fixed assets	<u>1.60</u>	
Net cash used in investing activities		(8.30)

Cash flows from financing activities		
Proceeds from issuance of additional shares	6.50	
Dividend declared	(0.50)	
Redemption of 4.5% debentures	<u>(2.50)</u>	
Net cash generated from financing activities		<u>3.50</u>
Net decrease in cash and bank balances		(1.05)
Cash and bank balances at the beginning of the period		<u>1.55</u>
Cash and bank balances at the end of the period (Bal.fig.)		<u>0.50</u>

- (d) As per para 13 of AS 4 "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2012 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 2012.

3. (a) (i) Examples of Changes in Accounting Policy:
- Change of depreciation method from WDV to SLM and vice-versa.
 - Change in cost formula in measuring the cost of inventories.
- (ii) Examples of Changes in Accounting Estimates:
- Estimation of provision for doubtful debts on sundry debtors / trade receivables.
 - Estimation of useful life of fixed assets.
- (iii) Examples of Extraordinary items:
- Loss due to earthquakes / fire / strike.
 - Attachment of property of the enterprise.
- (iv) Examples of Prior period items:
- Applying incorrect rate of depreciation in prior periods.
 - Omission to account for income or expenditure in one or more prior periods.

- (b) According to the Guidance Note on 'Accounting for Depreciation in Companies', a company may adopt more than one method of depreciation. It is also permissible to follow different methods for different types of assets provided the same methods are consistently adopted from year to year in accordance with Section 205(2) of the Companies Act.

According to provisions of AS 5 and AS 6, such a change is permissible only when at least one of the following three conditions is satisfied:

- (i) Such change is required by law;
- (ii) Such change is required for compliance with an accounting standard;
- (iii) Such change will result in more appropriate preparation or presentation of the financial statements of the enterprise.

Here, from the facts given it appears that condition (iii) is satisfied i.e., change will lead to more appropriate presentation (since, WDV method better represents pattern of wear and tear instead of SLM).

According to para 15 of AS 6 'Depreciation Accounting', when such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use i.e. the change should be retrospective. Any difference arising thereon should be charged / credited to the Statement of Profit and Loss in the year of change. Such a change in the method of depreciation is considered as a change in the accounting policy and its effect is quantified and disclosed.

- (c) According to para 14 of AS 7 (Revised), 'Construction Contracts', incentive payments are 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.

In the given case, the contract is not sufficiently advanced as it is in the first year of construction and its normal time for construction is 4 to 5 years.

Further, the past track record is not the criteria for recognition of incentive payments receivable for early completion of the contract.

Since, the recognition criterias are not met, it is inappropriate to recognise incentive payments in the current year as part of contract revenue. Therefore, Speedy Construction Ltd.'s accounting policy to recognise incentive payments in the first year of construction as contract revenue, based on past performance, is not in accordance with AS 7 (Revised).

- (d) As per para 11 of AS 9, 'Revenue Recognition', revenue from sale of goods should be recognised when:

- (i) the seller has transferred the property in the goods to the buyer for a consideration and the transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer and the seller retains no effective control of the goods transferred; and
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the power plants. Since, the invoice raised by Perfect Ltd. is for the full price (though it receives only 90% of the invoice value in the year of sale and 10% is kept as 'Retention Money'), Perfect Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sales price. The company should make a separate provision for the balance 10% amount to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Therefore, the practice adopted of recognising only 90% of sales price as revenue by Perfect Ltd. is not in consonance with AS 9.

4. (a) Calculation of cost of fixed assets

	₹
Material	16,00,000
Direct expenses	3,00,000
Direct labour (1/15 th of ₹ 6,00,000)	40,000
Office and administrative expenses (4% of ₹ 9,00,000)	36,000
Depreciation on assets used for the construction of this asset	<u>15,000</u>
Cost of fixed assets constructed	<u>19,91,000</u>

- (b) Ministry of Corporate Affairs, Government of India, inserted paragraph 46A in notified AS 11 by Notification dated 29th December, 2011, which is relevant for companies. It states that in respect of accounting periods commencing on or after 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 or not (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far 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.

Accordingly, though Option Ltd. had not earlier exercised the option as given by the notification on AS 11, issued in 2009, yet it can avail the option to capitalise the

exchange difference to the cost of machinery by virtue of para 46A inserted in the notified AS 11 in December, 2011.

Exchange difference to be capitalised

Cost of the asset in \$		\$ 10 lakhs
Exchange rate on 1 st April, 2011		₹ 52 = 1\$
Cost of the asset in ₹	(\$ 10 lakhs x ₹ 52)	520 lakhs
Less: Exchange differences as on 31 st March, 2012 (52-51) x \$ 1 million	(Gain)	<u>(10 lakhs)</u>
		510 lakhs
Less: Depreciation for 2011-12	(510 lakhs - 20 lakhs)/10 years	<u>(49 lakhs)</u>
		<u>461 lakhs</u>

Notification number G.S.R 914(E), dated 29th December, 2011, is relevant only for companies. If Option Ltd. is a LLP, then this notification is not applicable and it can not capitalise the exchange difference to the cost of the machinery. The amount recognised to Profit and Loss account would be ₹ 10 lakhs.

(c) **Journal Entries**

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account Dr. To Bank Account (Being fixed asset purchased)		20	20
	Bank Account Dr. To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)		8	8
	Depreciation Account (W.N.1) Dr. To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))		2	2
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)		2	2

2	Fixed Asset Account	Dr.	5	
	To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)			5
	Depreciation Account (W.N.2)	Dr.	3.67	
	To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)			3.67
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)			3.67

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	<u>(8)</u>
	12
Depreciation $\left[\frac{12-4}{4} \right]$	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	20
Less: Government grant received	<u>(8)</u>
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4} \right]$	<u>2</u>
	10
Add: Government grant refundable	<u>5</u>
	15
Depreciation for the second year $\left[\frac{15-4}{3} \right]$	3.67

- (d) As per para 9 of AS 13 "Accounting for Investments", the cost of investment includes acquisition charges such as brokerage, fees and duties. In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. ₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges, therefore, cannot be constituted as cost of investment.

Further, as per para 3 of AS 16 "Borrowing Costs", a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Since, shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments. Therefore, the directors of Take Ltd. cannot capitalise the borrowing cost as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2012.

5. (a) Gain from curtailment is estimated as under

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

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

	₹
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	<u>(5,100)</u>
	300
Less: Unamortised past service cost (90% of ₹ 180)	<u>(162)</u>
Liability to be recognised in the balance sheet	<u>138</u>

- (b) In this case, the total capital expenditure is ₹ 2,66,00,000 while the loan taken is ₹ 2,40,00,000 only. It appears that the balance amount of ₹ 26,00,000 would have been spent by the company from its own resources on which no interest would have been payable. Interest payable on loan of ₹ 2,40,00,000 @ 16% is ₹ 38,40,000. This interest cost is consisting of two components i.e., interest to be expensed and interest to be capitalized.

As Phases I and II have become operational during the year, the interest in proportion to their cost should be treated as expense of the year and interest in respect of Phases III and IV should be capitalized.

	₹
Total cost of Phases I and II (₹ 48,00,000 + ₹ 75, 00,000)	1,23,00,000
Total Cost of Phases III and IV (₹ 55,00,000 + ₹ 88,00,000)	<u>1,43,00,000</u>
Total cost	<u>2,66,00,000</u>
Total loan	2,40,00,000
Proportionate loan used for Phases I and II	
$\left[\frac{2,40,00,000}{2,66,00,000} \times 1,23,00,000 \right]$	1,10,97,744
Proportionate loan used for Phases III and IV	
$\left[\frac{2,40,00,000}{2,66,00,000} \times 1,43,00,000 \right]$	1,29,02,256
Interest on loan used for Phases I and II @ 16%	17,75,639
Interest on loan used for Phases III and IV @ 16%	<u>20,64,361</u>
Total Interest	<u>38,40,000</u>

Interest amounting ₹ 20,64,361 should be capitalized and added to the cost of Phases III and IV, and ₹ 17,75,639 should be treated as expense of the year.

- (c) As per para 5 of AS 17 'Segment Reporting', a business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:
- the nature of the products or services;
 - the nature of the production processes;
 - the type or class of customers for the products or services;
 - the methods used to distribute the products or provide the services; and
 - if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc.

Therefore, it can be said that Microtech Ltd. has two business segments viz- 'Automobile batteries' and 'batteries for Invertors and UPS'.

- (d) As per para 3 of AS 18 'Related Party Disclosures', employees are not considered as Related Party for an entity. Salaries and loans given to employees are in the course of normal dealings of business. Therefore, the first two transactions cannot be considered as related party transactions.

As per para 3(a) of the standard, holding and subsidiary companies are said to be related parties since they are said to be under common control for the purpose of consolidated financial statements. Therefore, 'inter-company sales between holding and subsidiary companies' is a related party transaction. However, as per para 7 of the standard, no disclosure is required for the same in consolidated financial statements.

Since, managing director of Kaju Ltd. directly or indirectly owns an interest in the voting power of the reporting enterprise that gives him control or significant influence over its subsidiary Kismis Ltd., the loan given to him by Kismis Ltd. will be treated as related party transaction.

Since, holding and subsidiary companies are said to be related parties as per para 3(a) of the standard, transfer of asset by holding company Kaju Ltd. to its subsidiary Kismis Ltd. will be considered as related party transaction.

6. (a) In books of Lessee
Journal Entry

		₹	₹
Asset A/c	Dr.	1,49,888	
To Lessor			1,49,888
(Being recognition of finance lease as asset and liability)			

Working Note:

Year	Lease Payments ₹	DF (12.6%)	PV ₹
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880
5	40,000	0.552	22,080
5	14,000	0.552	<u>7,728</u>
			<u>1,49,888</u>

- (b) Manner of determining the order in which dilutive securities should be included in computation of Weighted Average Number of Shares

As per para 42 of AS 20 'Earnings Per Share', in order to maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

Increase in Earnings Attributable to Equity Shareholders on Conversion of Potential Equity Shares

	Increase in Earnings	Increase in no. of Equity Shares	Earnings per Incremental Share
Options Increase in earnings No. of incremental shares issued for no consideration $\{1,00,000 \times (75 - 60) / 75\}$	Nil	20,000	Nil
Convertible Preference Shares Increase in net profit attributable to equity shareholders as adjusted by attributable tax (DDT) $\{(\text{₹ } 8 \times 8,00,000) + 16.2225\% \text{ of } (8 \times 8,00,000)\}$ No. of incremental shares $\{2 \times 8,00,000\}$	₹ 74,38,240	16,00,000	₹ 4.6489
12% Convertible Debentures Increase in net profit $\{\text{₹ } 10,00,00,000 \times 0.12 \times (1 - 0.30)\}$ No. of incremental shares $\{10,00,000 \times 4\}$	₹ 84,00,000	40,00,000	₹ 2.10

It may be noted from the above that options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and convertible preference shares will be considered at the end.

Computation of Diluted Earnings Per Share

	Net Profit Attributable (₹)	No. of Equity Shares	Net profit attributable Per Share (₹)	
As reported	1,00,00,000	20,00,000	5.00	
Options	<u> </u>	<u>20,000</u>		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	<u>84,00,000</u>	<u>40,00,000</u>		
	1,84,00,000	60,20,000	3.06	Dilutive
Convertible Preference Shares	<u>74,38,240</u>	<u>16,00,000</u>		
	<u>2,58,38,240</u>	<u>76,20,000</u>	3.39	Anti-Dilutive

Since, diluted earnings per share is increased while taking the convertible preference shares into account (from ₹ 3.06 to ₹ 3.39), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is ₹ 3.06.

(c)

Statement of Profit and Loss

(for the three years ending 31st March, 2010, 2011, 2012)

(₹ in thousands)

	2010	2011	2012
Profit (loss)	(100)	50	60
Less: Current tax (Refer W.N.)	<u>—</u>	<u>—</u>	<u>(4)</u>
	(100)	50	56
Adjustment of Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year	<u>—</u>	<u>(20)</u>	<u>(20)</u>
Profit (loss) after tax effect	<u>(60)</u>	<u>30</u>	<u>36</u>

Working Note:

Loss of the year 2010, ₹ 100 thousands is set off from the profits of the year 2011 and 2012. After set-off of loss, remaining profit of the year 2012 to the extent of ₹ 10 thousands is taxable @ 40%.

- (d) As per para 18 of AS 23 "Accounting for Investments in Associates", under the equity method, if an investor's share of losses of an associate equals or exceeds

the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value.

Therefore, A Ltd. need not recognise its share of loss for the current year and shall carry the investment at 'Nil' value for the purpose of Consolidated Financial Statements. However, permanent diminution in value, if any, should be adjusted from the carrying amount of the long term investment in Separate Financial Statements of A Ltd.

7. (a) (i) As illustrated in AS 25, 'Interim Financial Reporting', provisions in respect of gratuity and other defined benefit schemes for an interim period are calculated on a year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements, or other significant one-time events.
- (ii) A year-end bonus is anticipated for interim reporting purposes if, and only if,
- (1) the bonus is a legal obligation or an obligation arising from past practice for which the enterprise has no realistic alternative but to make the payments, and
 - (2) a reliable estimate of the obligation can be made.
- (iii) For income-tax expense, apply estimated average annual effective income-tax rate to the pre-tax income of the interim period.
- (iv) An enterprise should apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year.
- (v) Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year end in accordance with the principles as stipulated in AS 11.
- (b) Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	\$ 1,00,000
Less: Trade discount @ 5%	<u>(\$ 5,000)</u>
	<u>\$ 95,000</u>
Cost in ₹ (US \$ 95,000 x ₹ 52)	49,40,000
Add: Import duty on cost @ 20% (₹)	<u>9,88,000</u>
	59,28,000
Add: Purchase tax @ 10% (₹)	5,92,800
Installation expenses (₹)	25,000
Profession fee for clearance from customs (₹)	<u>20,000</u>
Cost of the software to be capitalised (₹)	<u>65,65,800</u>

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset.

- (c) As per paras 57 and 58 of AS 28 'Impairment of Assets', if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss which should be recognised as an expense in the statement of profit and loss immediately.

Impairment Loss

Net Selling Price = Disposal value – Brokerage

= ₹ 25 lakh – 2% of ₹ 25 lakh = ₹ 24.5 lakh

Value in use = ₹ 32.98 lakh (Refer Working Note)

Recoverable value = ₹ 32.98 lakh (Higher of value in use and net selling price)

Carrying amount = ₹ 35 lakh

Impairment loss = ₹ 35 lakh - ₹ 32.98 lakh = ₹ 2.02 lakh.

Journal Entries

	₹ in lakhs	₹ in lakhs
Impairment Loss A/c Dr. To Machine A/c (Being impairment loss recognised)	2.02	2.02
Profit & Loss A/c Dr. To Impairment Loss A/c (Being impairment loss transferred to Profit and Loss Account)	2.02	2.02

Working Note:

Calculation of Value in use

Year	Growth rate	Operating cash flow ₹ 000	Disposal value ₹ 000	Cash flow ₹ 000	DF (10%)	Present Value ₹ 000
1		900		900	0.909	818.10
2		800		800	0.826	660.80
3		600		600	0.751	450.60
4		550		550	0.683	375.65
5		500		500	0.621	310.50
6	-10%	450		450	0.564	253.80
7	-20%	360		360	0.513	184.68

8	-30%	252		252	0.467	117.68
9	-40%	151.20		151.20	0.424	64.11
10	-60%	60.48	100	160.48	0.386	61.95
						<u>3,297.87</u>

8. (a) As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

In the given situation the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

- The debenture bond is the host contract. The option to convert into shares is the embedded derivative.
 - The lease contract is the host contract. The adjustment linked to Cost Inflation Index is the embedded derivative contract.
 - The price adjustment is not a derivative - it does not meet the definition of derivative - there is no underlying.
 - A floating rate debt with no cap - there is no derivative.
 - A floating rate debt with a cap on interest - the cap is the derivative and the debt instrument is the host contract.
 - Separate agreement for a cap on interest - the cap is a derivative because it is based on the interest rate of the underlying instrument
 - Fixed deposit is the host contract and interest payment linked to BSE sensex is the embedded derivative.

- (c) Tax Expense

	₹
Tax on capital gain portion of annual income: 10% of ₹ 20,000	2,000

Tax on other income: 30% of ₹40,000 + 40% of remaining ₹ 40,000	<u>28,000</u>
Total	<u>30,000</u>

Weighted average annual effective tax rate:

$$\text{Rate on capital gain portion of annual income} = \frac{2,000}{20,000} \times 100 = 10\%$$

$$\text{Rate on other income} = \frac{28,000}{80,000} \times 100 = 35\%$$

Tax expense for each quarter:

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

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

Topic	Accounting Standard	IFRS	US GAAP
Government grants	Grants related to fixed assets are shown as deduction from the gross value of the assets concerned. Revenue related government grants are recognized on a systematic basis in the income statement over the periods to match them with the related costs. Grants in the nature of promoter's	Revenue based grants are deferred in the balance sheet and credited to the income statement to match the related expenditure that they are intended to compensate. Capital based grants are deferred and matched with the depreciation on the asset for which the grant	Similar to IFRS, except when conditions are attached to grant. In this case, revenue recognition is delayed until such conditions are met. Long-lived asset contributions recorded as revenue in the period received.

	contribution are credited to capital reserve and treated as a part of shareholder's funds.	arises. Grants related to recognized assets are either presented in the balance sheet as deferred income or amortised. Entities may offset capital grants against asset values.	
Borrowing costs	There is no choice rather to capitalize the borrowing cost.	Permitted as a policy choice for all qualifying assets, but not required.	Required to capitalise the borrowing cost.

10. (a) Revised Schedule VI provides that:

“A liability shall be classified as current when it satisfies any of the following criteria:

- (a) it is expected to be settled in the company's normal operating cycle;
- (b) it is held primarily for the purpose of being traded;
- (c) it is due to be settled within twelve months after the reporting date; or
- (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments and do not affect its classification.”

In the present situation, Astha Ltd. does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date. The position will be same even when the FCCB holders are expected to convert their holdings into equity shares of Astha Ltd. Expectations cannot be called as unconditional rights. Thus, in both the situations, Astha Ltd. should classify the FCCBs as current liabilities as on 31 March 2013.

(b) Operating cycle of Calcus Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period

$$= 3 + 1 + 5 + 5 = 14 \text{ months}$$

Since, the operating cycle of Calcus Ltd. is 14 months, trade payables expected to be paid in 12.5 months should be treated as a current liability.

11. (i) In the books of Bunny Ltd.

Realisation Account

2012		₹	2012		₹
Oct. 1	To Goodwill	50,000	Oct. 1	By Trade Payables	15,000
	To Land, Buildings, Plant, etc.	3,20,000		By Provision for Depreciation	15,000
	To Inventory	90,000		By Honey Ltd. - consideration (W.N.2)	6,37,500
	To Trade Receivables	25,000		By Honey Ltd. (for profit) (W.N.3)	20,000
	To Cash & Bank Balance (W.N.1)	55,000			
	To Shareholders - profit	<u>1,47,500</u>			
		<u>6,87,500</u>			<u>6,87,500</u>

Shareholders Account

2012		₹	2012		₹
Oct. 1	To Cash and Bank A/c	75,625	Oct. 1	By Share Capital A/c	3,00,000
	To Shares in Honey Ltd.	5,61,875		By General Reserve A/c	1,35,000
				By Profit & Loss A/c	55,000
				By Realisation A/c	<u>1,47,500</u>
		<u>6,37,500</u>			<u>6,37,500</u>

(ii) Journal of Honey Ltd.

2012			Dr. (₹)	Cr. (₹)
Oct. 1	Business Purchase Account To Liquidator of Bunny Ltd. (The consideration settled as per agreement dated.... for the purchase of business of Bunny Ltd.)	Dr.	6,37,500	6,37,500
	Land Account	Dr.	1,00,000	
	Buildings Account	Dr.	2,50,000	
	Plant Account	Dr.	3,50,000	
	Inventory Account	Dr.	86,000	
	Trade Receivables Account	Dr.	25,000	
	Bank Account	Dr.	55,000	
	To Provision for depreciation Account			15,000
	To Profit & Loss Suspense Account			20,000

To Trade Payables Account			15,000
To Business Purchase Account			6,37,500
To Capital Reserve Account			1,78,500
(Various assets and liabilities taken over from Bunny Ltd. and profit up to September 30, 2012 being credited to Profit and Loss Suspense Account)			
Liquidator of Bunny Ltd.	Dr.	6,37,500	
To Share Capital Account			4,49,500
To Securities Premium Account			1,12,375
To Cash and Bank Account			75,625
(Allotment of shares at a premium and payment of cash in discharge of consideration for the business taken over)			
Capital Reserve Account	Dr.	5,000	
To Cash and Bank Account			5,000
(Expenses of liquidation)			

Working Notes:

(1) Calculation of cash balance as on 1 st October, 2012	₹	₹
Cash and Bank balances as on April 1, 2012		28,000
Add: Profit earned	20,000	
Depreciation (no cash payment)	15,000	
Increase in Trade Payables	<u>5,000</u>	
	40,000	
Less: Increase in Inventory 6,000		
Increase in Trade Receivables <u>7,000</u>	<u>(13,000)</u>	
Cash profit earned between 1.4.12 to 30.9.12		<u>27,000</u>
		<u>55,000</u>
(2) Calculation of Purchase Consideration	₹	₹
Cash (Rs 2.50 x 30,000 shares)		75,000
Shares [Rs.12.50 x (30,000 x 3/2 - 50)]		5,61,875
Cash for fractions (Rs.12.50 x 50 shares)		<u>625</u>
		<u>6,37,500</u>

- (3) Since, the business of Bunny Ltd. is acquired on 31st March, 2012, the profit of ₹ 20,000 for the period of 1st April, 2012 to 30th September, 2012, should be standing to the credit of Honey Ltd.

12. Consolidated Balance Sheet of Almighty Ltd. and its subsidiaries Beloved Ltd. and Caring Ltd. as on 31st December, 2012

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		1,00,000
(b) Reserves and Surplus	1	60,305
(2) Minority Interest (W.N 5)		37,820
(3) Current Liabilities		
(a) Trade payables		12,000
(b) Other current liabilities	2	10,000
Total		2,20,125
II. Assets		
(1) Non-current assets		
Fixed assets		
i. Tangible assets		1,23,000
ii. Intangible assets	3	5,525
(2) Current assets		
(a) Inventories	4	11,600
(b) Trade receivables		79,000
(c) Cash and cash equivalents	5	1,000
Total		2,20,125

Notes to Accounts

		(₹)	(₹)
1.	Reserves and surplus		
	Reserves - Balance as on 31.12.2012 (given)	48,000	
	Share in		
	Beloved Ltd. [WN 3]	1,200	

	Caring Ltd. [WN 2]	<u>125</u>	49,325
	Profit & Loss Account		
	Balance as on 31.12.2012 (given)	16,000	
	Share in		
	Beloved Ltd. [WN 3]	4,800	
	Caring Ltd. [WN 2]	<u>500</u>	
		21,300	
	Less: Proposed dividend (10% of ₹ 1,00,000)	(10,000)	
	Provision for unrealised profit on stock [80% of (₹ 4,400 – ₹ 4,000)]	<u>(320)</u>	<u>10,980</u>
			<u>60,305</u>
2.	Other current liabilities		
	Proposed Dividend		10,000
3.	Intangible Assets		
	Goodwill (W.N 4)		5,525
4.	Inventories		
	Inventories	12,000	
	Less: Provision for unrealised profit	<u>(400)</u>	11,600
5.	Cash and cash equivalents		
	Cash in transit (8,000 – 7,000)		1,000

Working Notes:

Shareholding Pattern

	Beloved Ltd.	Caring Ltd.
Total Shares	10,000	6,000
Held by Almighty Ltd.	8,000 [80%]	1,000 [1/6 th]
Held by Beloved Ltd.	NA	4,000 [4/6 th]
Minority Holding	20%	1/6 th

(1) Position on 30.06.2012 i.e. date of investment

	Reserves	Profit and Loss Account
Beloved Ltd.	₹	₹
Balance on 31.12.2012	10,000	12,000
Less: Balance on 31.12.2011	<u>(8,000)</u>	<u>(4,000)</u>

Increase during the year	<u>2,000</u>	<u>8,000</u>
Estimated increase for half year	1,000	4,000
Balance on 30.06.2012	9,000 (8,000 + 1,000)	8,000 (4,000 + 4,000)
Caring Ltd.		
Balance on 31.12.2012	9,000	9,000
Balance on 31.12.2011	<u>7,500</u>	<u>3,000</u>
Increase during the year	<u>1,500</u>	<u>6,000</u>
Estimated increase for half year	750	3,000
Balance on 30.06.2012	8,250 (7,500 + 750)	6,000 (3,000 + 3,000)

(2) Analysis of Profits of Caring Ltd.

	<i>Capital Profit</i>	<i>Revenue Reserve</i>	<i>Revenue profit</i>
	₹	₹	₹
Reserves on 30.6.2012 [WN 1]	8,250		
Profit and Loss on 30.6.2012	6,000		
Increase in reserves		750	
Increase in profit			<u>3,000</u>
	14,250	750	3,000
Less: Minority interest (1/6)	<u>(2,375)</u>	<u>(125)</u>	<u>(500)</u>
	<u>11,875</u>	<u>625</u>	<u>2,500</u>
Share of Almighty Ltd. (1/6)	2,375	125	500
Share of Beloved Ltd. (4/6)	9,500	500	2,000

(3) Analysis of Profits of Beloved Ltd.

	<i>Capital Profit</i>	<i>Revenue Reserve</i>	<i>Revenue profit</i>
	₹	₹	₹
Reserves on 30.6.2012	9,000		
Profit and Loss A/c on 30.6.2012	8,000		
Increase in reserves		1,000	
Increase in profit			4,000
Share in Caring Ltd. [W.N.1]		<u>500</u>	<u>2,000</u>

	17,000	1,500	6,000
Less: Minority interest (2/10)	<u>(3,400)</u>	<u>(300)</u>	<u>(1,200)</u>
Share of Almighty Ltd. (8/10)	<u>13,600</u>	<u>1,200</u>	<u>4,800</u>

(4) Cost of control

	₹	₹
Investments in		
Beloved Ltd.	95,000	
Caring Ltd. [13,000 + 53,000]	<u>66,000</u>	1,61,000
Less : Paid up value of investments in		
Beloved Ltd.	80,000	
Caring Ltd.	<u>50,000</u>	(1,30,000)
Capital profits in		
Beloved Ltd. [W.N.3]	13,600	
Caring Ltd. [W.N.2]	<u>11,875</u>	<u>(25,475)</u>
Goodwill		<u>5,525</u>

(5) Minority Interest

	₹	₹
Share Capital:		
Beloved Ltd. [20 %]	20,000	
Caring Ltd. [1/6 th]	<u>10,000</u>	30,000
Share in profits and reserves (Pre and Post acquisition)		
Beloved Ltd.[WN 3]	4,900	
Caring Ltd.[WN 2]	<u>3,000</u>	<u>7,900</u>
		37,900
Less: Provision for unrealized profit (20% of ₹ 400)		<u>(80)</u>
		<u>37,820</u>

Note: The above solution has been done by direct method.

13. Consolidated Balance Sheet as at 31.03.12

Particulars	Note No.	(₹ in 000)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		1,200

(b) Reserves and Surplus		1	994
(2) Minority Interest			450
(3) Non-Current Liabilities (900 + 20)			920
(3) Current Liabilities (600 + 150)			750
	Total		4,314
II. Assets			
(1) Non-current assets			
Fixed assets			
Tangible assets (3,000 + 320)			3,320
Intangible assets	2		20
(2) Non-current Investment in Need Ltd.			208
(3) Current assets (500 + 266)			766
	Total		4,314

Notes to Accounts

		(₹)	(₹)
1.	Reserves and surplus		
	Capital Reserve		30
	Profit & Loss A/c		
	Helpful Ltd. and its subsidiary	875	
	Need Ltd. [25% of (332-200)]	33	
	Desire Ltd. [40% of (440-300)]	<u>56</u>	<u>964</u>
			<u>994</u>
2.	Intangible Assets		
	Goodwill (Need Ltd.)	5	
	Goodwill (Desire Ltd.)	<u>15</u>	20

Working Notes:

- Draft Balance Sheets of Need Ltd. and Desire Ltd. as at 31.03.12 are drawn below:

Liabilities	Need Ltd. ₹ in 000	Desire Ltd. ₹ in 000	Assets	Need Ltd. ₹ in 000	Desire Ltd. ₹ in 000
Share Capital	500	600	Fixed Assets	600	800

Profit & Loss A/c	332	440	Current	450	665
Non-Current Liabilities	100	50	Assets		
Sundry Liabilities	118	375	(Bal. fig.)		
	1,050	1,465		1,050	1,465

2. Closing equity (Need Ltd.) = 25% of (500 + 332) = ₹ 208 thousand

Pre-acquisition equity (Need Ltd.) = 25% of (500 + 200) = ₹ 175 thousand

Goodwill = 180 - 175 = ₹ 5 thousand

Adjustment under equity method for investment in associate Need Ltd.

		₹ in 000	₹ in 000	
Investment in Need Ltd.	Dr.	28		208 - 180
Goodwill	Dr.	5		180 - 175
To Profit and Loss A/c			33	208 - 175

3. Closing equity (Desire Ltd.) = [40% of (600 + 440)] = ₹ 416 thousand

Pre-acquisition equity (Desire Ltd.) = [40% of (600 + 300)] = ₹ 360 thousand

Goodwill = 375 - 360 = ₹ 15 thousand

Adjustment for proportionate consolidation in respect of Investment in Joint Venture- Desire Ltd.

		₹ in 000	₹ in 000	
Investment in Desire Ltd.	Dr.	41		416 - 375
Goodwill	Dr.	15		375 - 360
To Profit and Loss A/c			56	416 - 360
Fixed Assets A/c	Dr.	320		40% of 800
Current Assets A/c	Dr.	266		40% of 665
To Non-current Liabilities			20	40% of 50
To Current Liabilities			150	40% of 375
To Investment in Desire Ltd.			416	40% of 1,040

14. (a) Ascertaining Fair Value of Liability Component

Had the bonds been issued at 9% p.a. the present value would emerge as below:

Present value of ₹ 40 lacs repayable after 3rd year (40 lacs x 0.772)	30,88,000
Present value of interest payable at the end of Year 1 – (2,40,000 x 0.917)	2,20,080

Year 2 – (2,40,000 x 0.841)	2,01,840
Year 3 – (2,40,000 x 0.772)	<u>1,85,280</u>
Liability component (Total of Present value)	<u>36,95,200</u>

(b) Ascertaining Equity Component

Fair Value of Instrument	40,00,000
Less: Liability component	<u>(36,95,200)</u>
Equity component	<u>3,04,800</u>

(c) Initial Recognition at the inception of the Bond

	Debit ₹	Credit ₹
Cash/Bank A/c Dr.	40,00,000	
To Convertible Bond Liability A/c		36,95,200
To Equity A/c		3,04,800

(d) Bond liability at the end of each year

	Year 1	Year 2	Year 3
	₹	₹	₹
Beginning	36,95,200	37,87,768	38,88,668
Add: Interest @ 9%	<u>3,32,568</u>	<u>3,40,900</u>	<u>3,49,980</u>
	40,27,768	41,28,668	42,38,648
Rounding off adjustment	-	-	1,352*
Less: Interest @ 6%	<u>(2,40,000)</u>	<u>(2,40,000)</u>	<u>(2,40,000)</u>
Carrying amount	<u>37,87,768</u>	<u>38,88,668</u>	<u>40,00,000</u>

(e) For recording Finance Charge of each year

Journal Entries

	Debit ₹	Credit ₹
End of Year 1		
Finance Charges A/c Dr.	3,32,568	
To Bonds A/c		92,568
To Cash or Bank A/c		2,40,000

* Rounding off is due to approximation of discounting factor @ 9%.

End of Year 2			
Finance Charges A/c	Dr.	3,40,900	
To Bonds A/c			1,00,900
To Cash or Bank A/c			2,40,000
End of Year 3			
Finance Charges A/c	Dr.	3,51,332*	
To Bonds A/c			1,11,332
To Cash or Bank A/c			2,40,000

15. (a) The stock options granted to employees are not included in the shares outstanding till the employees have exercised their right to obtain shares or stock options, after fulfilling the requisite vesting conditions. Till such time, the stock options so granted are considered as dilutive potential equity shares for the purpose of calculating Diluted EPS. At the end of each year, computations of diluted EPS are based on the actual number of options granted and not yet forfeited.
- (b) For calculating diluted EPS, no adjustment is made to the net profit attributable to equity shareholders as there are no expense or income that would result from conversion of ESOPs to the equity shares.
- (c) For calculating diluted EPS, the enterprise assumes the exercise of dilutive options. The assumed proceeds from these issues are considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value are treated as an issue of equity shares for no consideration.
- (d) As per paragraph 47 of Guidance Note on Accounting for Employee Share Based Payments, the assumed proceeds to be included for computation, mentioned at (c) above, include (i) the exercise price; and (ii) the unamortized compensation cost related to these ESOPs, attributable to future services.
- (e) The enterprise calculates the basic and diluted EPS as below:

Particulars	Year 1	Year 2
Net profit before amortisation of ESOP cost	₹ 25,00,000	₹ 28,00,000
Less: Amortisation of ESOP cost	<u>(₹ 13,50,000)</u>	<u>(₹ 13,50,000)</u>
[(900 employees × 300 options × ₹ 10)/2]		
Net profit attributable to equity shareholders	<u>₹ 11,50,000</u>	<u>₹ 14,50,000</u>

* ₹ 3,49,980 + ₹ 1,352 = ₹ 3,51,332

Number of shares outstanding	5,00,000	5,00,000
Basic EPS	₹ 2.30	₹ 2.90
Number of options outstanding (Options granted less actual forfeitures)	<u>2,85,000</u>	<u>2,70,000</u>
	[(1,000 employees - 50 employees) × 300 options]	[(950 employees - 50 employees) × 300 options]
Unamortised compensation cost per option	₹ 5 [₹ 10 - ₹ 10/2]	₹ 0
Number of dilutive potential equity shares	10,000 [2,85,000 - {(2,85,000 × 50) + (2,85,000 × 5)} / 57]	45,000 [2,70,000 - {(2,70,000 × 50) / 60}]
No. of equity shares used to compute diluted earnings per share	5,10,000	5,45,000
Diluted EPS	₹ 2.255	₹ 2.66

16. (a) A scrip is treated as non-traded, if it is not traded in stock exchange for a period of more than 30 days (Eighth schedule of SEBI (Mutual Funds) Regulations 1996). In the given case, investment in Profit Ltd. will be a 'non-traded investment, as no quotation is available for last thirty days prior the valuation date.

- (b) A comparable stock is generally selected from the same industry. It should be of same size and the return of capital employed should be in the same range.

- (c) The valuation of investment should be linked both to degree of liquidity and also the level of current net assets value. In case the comparable stock is quoted at a discount to net assets value, the same discount can be used to estimate the applicable discount factor to P/E Ratio.

In the given case, market value of the comparable equity is 20% [i.e. {(240 - 200) / 200} × 100] above the net asset value. So, market value of Profit Ltd.'s share should be ₹ 160 + 20% of ₹ 160 i.e. ₹ 192. Given EPS of ₹ 20, the P/E ratio of Profit Ltd. can be derived as ₹ 192/20 = 9.6, which is 2.4 less than the P/E ratio of 12 of the comparable firm.

- (d) Value per equity share of Profit Ltd. = (₹ 192 + ₹ 160) / 2 = ₹ 176

Total Value = 2,00,000 × ₹ 176 = ₹ 3,52,00,000.

(b) Statement showing computation of 'Net Owned Fund'

		₹ in 000
Paid up Equity Capital		100
Free Reserves		<u>500</u>
		600
Less: Deferred expenditure		<u>(200)</u>
	A	<u>400</u>
Investments		
In shares of subsidiaries and group companies		100
In debentures of subsidiaries and group companies		<u>100</u>
	B	<u>200</u>
10% of A		40
Excess of Investment over 10% of A (200-40)	C	160
Net Owned Fund [(A) - (C)] (400-160)		240

17. Valuation of shares of Wifi Ltd.

	₹
Capital employed (net tangible assets) as on 31.3.2012 (W.N.1)	12,07,477
Add: Value of goodwill (W.N.3)	<u>33,870</u>
	12,41,347
Add: Non-Trade investments	1,80,000
Add : Calls in arrear	<u>20,000</u>
	14,41,347
Less : Preference share capital	<u>3,00,000</u>
Equity available for equity shareholders	<u>11,41,347</u>
No. of shares	60,000
Value of a fully paid equity share $\frac{11,41,347}{60,000 \text{ shares}}$	₹19.02
Values of a partly paid equity share (₹19.02- ₹ 2)	₹ 17.02

Workings Notes:

1. Capital employed as on 31.3.2012

	₹	₹
Machinery		3,00,000
Freehold properties		4,50,000
Vehicles		1,00,000
Furniture (W.N.4)		<u>64,580</u>
		9,14,580
Add: 15%		<u>1,37,187</u>
		10,51,767
Trade investment		18,000
Inventories		2,00,000
Trade Receivables		3,60,000
Cash at bank		60,000
Tax recoverable (W.N.5)		<u>17,710</u>
		17,07,477
Less : Outside liabilities:		
Trade Payables	3,00,000	
Bank loan	<u>2,00,000</u>	<u>(5,00,000)</u>
		<u>12,07,477</u>

2. Average profits for last three years

	2009-10	2010-11	2011-12
	₹	₹	₹
Reported profits	2,50,000	2,80,000	3,30,000
Add: Furniture purchased wrongly charged to revenue (net of tax)	<u>10,000</u>	<u>-</u>	<u>-</u>
	2,60,000	2,80,000	3,30,000
Less: Depreciation on furniture purchased (net of tax)	<u>(1,000)</u>	<u>(900)</u>	<u>(810)</u>
	2,59,000	2,79,100	3,29,190
Less: Dividend on non trading investments (net of tax)	<u>(9,000)</u>	<u>(9,000)</u>	<u>(9,000)</u>
		2,70,100	3,20,190

	2,50,000		
Less: Adjustment for stock overvaluation (net of tax)			(25,000)
Less: Provision for doubtful debts (not tax deductible)			<u>(40,000)</u>
	<u>2,50,000</u>	<u>2,70,100</u>	<u>2,55,190</u>

Average profit $7,75,290/3 = 2,58,430$

3. Computation of goodwill

	₹
Capital employed	<u>12,07,477</u>
Average Profit (W.N.2)	2,58,430
Normal profit @ 20% on capital employed	<u>2,41,495</u>
Super profit	<u>16,935</u>
Goodwill at 2 years' purchase	33,870

4. Value of furniture as on 31.3.2012

	₹	₹
Furniture (Given in balance sheet) as on 31.3.2012		50,000
Add: Purchased on 1.4.2009	20,000	
Less: Depreciation @10% on WDV	<u>(2,000)</u>	
WDV as on 31.3.2010	18,000	
Less: Depreciation @10% on WDV	<u>(1,800)</u>	
WDV as on 31.3.2011	16,200	
Less: Depreciation @10% on WDV	<u>(1,620)</u>	
WDV as on 31.3.2012	<u>14,580</u>	<u>14,580</u>
Total		<u>64,580</u>

5. Tax recoverable

		₹
Tax recoverable:		
Due to additional depreciation on furniture [(2,000 + 1,800 + 1,620) x 50%]	2,710	
Due to overvaluation of stock (50,000 x 50%)	<u>25,000</u>	27,710

Less: Tax liability of furniture wrongly charged to profit and loss account (20,000 x 50%)		<u>(10,000)</u>
		<u>17,710</u>

Assumptions:

1. Profit given in the question is assumed as post tax profit.
2. Terminal capital employed has been considered for valuation of goodwill and shares. It is also possible to adjust half of the profits earned in 2011-12 for calculation of average capital employed.
3. Dividend from non-trade investment is assumed to be subject to tax.
4. Provision for doubtful debts is not allowed in the Income Tax Act. Hence, it is not tax deductible.

18. Market Share of Rough-use Ltd.

- (a) Last year's market share = 100% – Fake Brands 10% - Chinese Imports 40% - Other Domestic Brands (large players) 34% = 16%
- (b) Increase or decrease in market share: Chinese Imports 0.25% + Local Brands 0.5% - Other Domestic Brands (large players) 0.5% = 0.25% i.e. increase in others' market share. Hence, market share of Rough-use Ltd. is expected to fall by 0.25% every year over the decade, from the current level of 16%. Therefore, this year it will be 15.75%, next year 15.50%, the year after 15.25% etc.

Brand Valuation under Market Approach

Year	Market Size (₹ in Crores)	Market Share of Rough-use Ltd.	Market Share (₹ in Crores)	Expected Profit (₹ in Crores)	Discount Factor @ 10%	Discounted Cash Flow (₹ in Crores)
1	8,000.00 + 5% = 8,400.00	15.75%	1,323.00	@ 8% = 105.84	0.909	96.22
2	8,400.00 + 5% = 8,820.00	15.50%	1,367.10	@ 8% = 109.37	0.826	90.34
3	8,820.00 + 5% = 9,261.00	15.25%	1,412.30	@ 11% = 155.32	0.751	116.65
4	9,261.00 + 7% = 9,909.27	15.00%	1,486.39	@ 11% = 163.50	0.683	111.67
5	9,909.27 + 7% = 10,602.92	14.75%	1,563.93	@ 11% = 172.03	0.621	106.83
6	10,602.92 + 7% = 11,345.12	14.50%	1,645.04	@ 11% = 180.95	0.564	102.06
7	11,345.12 + 7% = 12,139.28	14.25%	1,729.85	@ 11% = 190.28	0.513	97.62

8	12,139.28 + 7% = 12,989.03	14.00%	1,818.46	@11% = 200.03	0.467	93.41
9	12,989.03 + 7% = 13,898.26	13.75%	1,911.01	@11% = 210.21	0.424	89.13
10	13,898.26 + 7% = 14,871.14	13.50%	2,007.60	@11% = 220.84	0.386	85.24
	Brand Value					<u>989.17</u>

Brand Value of Rough-use Ltd. under Market Oriented Approach is ₹ 989.17 crores.

19. (a)

Smart Ltd.

Balance Sheet (Extract)

(Section relating to intangible asset)

as on 31st March 2012

	Note No.	₹
Assets		
(1) Non- current asset		
Intangible assets	1	6,79,200

(b)

Statement of Profit and Loss (Extract)

for the year ended 31st March 2012

	Note No.	₹
Revenue from Operations		<u>40,000</u>
Total Revenue		<u>?</u>
Expenses:		
Amortization	2	88,800
Other expenses	3	<u>400</u>
Total Expenses		<u>?</u>

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	3,38,400	
	Franchise (Refer to Note 2)	96,000	
	Patents	<u>2,44,800</u>	6,79,200
2.	Amortization expenses		
	Goodwill	37,600	

	Franchise	24,000	
	Legal Cost	<u>27,200</u>	88,800
3.	Other expenses		
	Franchise for 1% of 40,000		400

Working Notes:

		₹
(1)	Cash Paid	7,20,000
	Less: Fair value of net assets	<u>(3,44,000)</u>
	Goodwill	3,76,000
	Less: Amortisation (over 10 years as per SLM)	<u>(37,600)</u>
	Balance to be shown in the balance sheet	<u>3,38,400</u>
(2)	Franchise	1,20,000
	Less: Amortisation (over five years)	<u>(24,000)</u>
	Balance to be shown in the balance sheet	<u>96,000</u>
(3)	Legal Costs (₹ 1,02,000 + ₹ 1,70,000)	2,72,000
	Less: Amortisation (over ten years as per SLM)	<u>(27,200)</u>
	Balance to be shown in the balance sheet	<u>2,44,800</u>

- (4) As per para 63 of AS 26, 'Intangible Assets', there is a rebuttable presumption that useful life of an intangible asset will not exceed ten years. If life is taken for more than 10 years, then company will have to disclose the significant reasons for the assumption. Here, Smart Ltd. has simply stated that life is unlimited by saying that Ok Ltd.'s products are popular. However, this cannot be constituted as significant reason. Therefore, this assumption has not been taken into consideration.

20. (a) Value Added Statement of Merit Ltd. For the year ended 31.03.2012

Particulars		₹
Sales/Turnover		40,57,000
Less: Bought in Materials		
Decrease in Stock	24,000	
Purchases	20,20,000	
Manufacturing and other expenses	<u>2,30,000</u>	<u>(22,74,000)</u>
Value Added by Trading Activities		17,83,000

Add: Other Income		<u>55,000</u>
Gross Value Added		<u>18,38,000</u>

Applied as follows:

₹		
1. To Pay Employees		
- Salaries, Wages, etc		10,00,000
2. To Pay Government as		
- Taxes, Duties etc (40,000+3,000)		43,000
3. To Pay Providers of capital		
- Interest on borrowings	4,69,000	
- Dividends	<u>35,000</u>	5,04,000
4. To Pay for Maintenance and Expenses of the Company		
- Depreciation	2,44,000	
- Debenture Redemption Reserve	10,000	
- General Reserve	10,000	
- Retained Earnings	<u>27,000</u>	<u>2,91,000</u>
Total Application of Value Added		<u>18,38,000</u>

(b) Computation of Economic Value Added

Particulars	₹ in lakhs
Profit before Interest and Taxes (from W.N.1)	578.33
Less: Interest (50 + 45)	<u>(95.00)</u>
	483.33
Less: Taxes	<u>(193.33)</u>
	290
Add: Interest (net of tax) [95 x (1 - 0.40)]	<u>57</u>
Net Operating Profit After Taxes	347
Less: Cost of Capital (WACC x Capital Employed)	(2,000 x 12.95%)
	<u>(259.00)</u>
Economic Value Added	<u>88.00</u>

Working Notes:**1. Calculation of Profit Before Tax**

<i>Particulars</i>	<i>Computation</i>	<i>₹ in lakhs</i>
Profit before Interest and Taxes	Balancing figure	578.33
Less: Interest on Debentures	10% x ₹ 500 lakhs	(50.00)
Interest on Bank Term Loan	10% x ₹ 450 lakhs	<u>(45.00)</u>
Profit Before Tax	(₹ 290.00 ÷ 60%)	483.33
Less: Tax @ 40%	(₹ 290.00 ÷ 60%) x 40%	<u>(193.33)</u>
Profit after Tax		290.00
Less: Preference Dividend	12% x ₹ 250 lakhs	<u>(30.00)</u>
Residual earnings for equity shareholders		260.00
Less: Equity Dividend	20% x ₹ 800 lakhs	<u>(160.00)</u>
Net balance in Profit and Loss Account	Given	<u>100.00</u>

2. Computation of Cost of Equity :

$$= \text{Risk Free Rate} + \text{Beta} \times (\text{Market Rate} - \text{Risk Free Rate})$$

$$= 6.5\% + 1.5 (16.5\% - 6.5\%) = 21.5\%$$

3. Cost of Debt

Interest ₹ 45 lakhs

Less: Tax (40%) (₹ 18 lakhs)

Interest after Tax ₹ 27 lakhs

$$\text{Cost of Debt} = \frac{27}{450} \times 100 = 6\%$$

4. Computation of Weighted Average Cost of Capital

<i>Component</i>	<i>Amount</i>	<i>Ratio</i>	<i>Individual Cost</i>	<i>WACC</i>
Equity	₹ 800 lakhs	800 ÷ 2000 = 0.40	$K_e = 21.5$	8.6
Preference	₹ 250 lakhs	250 ÷ 2000 = 0.125	$K_e = 12$	1.5
Debt (500+ 450)	₹ 950 lakhs	950 ÷ 2000 = 0.475	$K_e = 6$	2.85
Total	₹ 2,000 lakhs		K_e	12.95%