

PAPER – 1: FINANCIAL REPORTING
QUESTIONS

Consolidated Financial Statements of Group Companies

1. Tarun Ltd. had acquired 25% of the equity share capital of Varun Ltd. at Rs. 2,40,000 by 1-7-2009. It had received Rs. 8,000 as dividend for the year 2008-09. Equity share capital of Varun Ltd. is Rs. 5,00,000. Varun Ltd. had not provided for the dividend when the accounts for the year 2008-09 were prepared. Find out goodwill/capital reserve against investment in Varun Ltd. as well as the value at which investment shall be reported in consolidated financial statements to be prepared by Tarun Ltd. as on 31-3-2010, if the balances in profit and loss account were Rs. 84,000 and Rs. 1,92,000 respectively at the end of 2008-09 and 2009-10.
2. The summarized Balance Sheets of Amber Ltd. and Om Ltd. as at 31st March, 2010 are as follows:

(Rs. in lakhs)

<i>Liabilities</i>	<i>Amber Ltd.</i>	<i>Om Ltd.</i>	<i>Assets</i>	<i>Amber Ltd.</i>	<i>Om Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>
Share capital:			Plant at cost less		
Equity shares of			depreciation	86.4	72.9
Rs. 10 each	216.0	108.0	Furniture, Fixtures & Fittings	23.4	7.2
Securities premium	32.4	-	Stock at cost	18.0	13.5
Capital reserve on 1.04.09	-	7.2	Sundry debtors	73.8	47.6
			Trade investment	-	2.7
General reserve on 1.04.09	13.5	9.0	Goodwill at cost	45.0	13.6
Profit & Loss A/c	70.2	21.6	Investment:		
Sundry creditors	29.7	19.7	8.64 lakhs shares of Om Ltd. at cost	97.2	-
	_____	_____	Balance at bank	<u>18.0</u>	<u>8.0</u>
	<u>361.8</u>	<u>165.5</u>		<u>361.8</u>	<u>165.5</u>

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Additional information:

- (1) On 1st April, 2009 Amber Ltd. acquired from the shareholders of Om Ltd. 8.64 lakhs shares of Rs. 10 each in Om Ltd. and allotted in consideration thereof 6.48 lakhs of its own shares of Rs. 10 each at a premium of Rs. 5 per share.
- (2) The consideration for the shares of Om Ltd. was arrived at inter-alia by valuing certain assets of Om Ltd. on 1st April, 2009 as under:
 - (i) Plant at Rs. 90 lakhs
 - (ii) Furniture, Fixtures & Fittings at Rs. 8 lakhs
 - (iii) No value on Trade Investment and Goodwill.

No adjustments were made in the books of accounts of Om Ltd. in respect of the above valuation.

During 2009-10 there was no purchase or sale of these assets. It is desired that such adjustments should however be made in the consolidated accounts.

- (3) The figures for Plant and Furniture, Fixtures and Fittings at 31.3.2010 shown in the Balance Sheet are after providing depreciation for 2009-10 at the rates of 10 per cent per annum and 20 per cent per annum respectively, on the book values as at 1.04.09.
- (4) The Profit and Loss Account of Om Ltd. showed a credit balance of Rs. 27 lakhs on 1.04.09. A dividend of 10% was paid in January, 2010 for the year 2008-09. This dividend was credited to Profit and Loss A/c of Amber Ltd.

You are required to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Amber Ltd. and its subsidiary as at 31st March, 2010.

Corporate Restructuring

3. Roshni and Jyoti have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called Ujala Ltd.

Following is the Balance Sheet of Roshni and Jyoti as at 31.3.2010:

Liabilities	Roshni	Jyoti	Assets	Roshni	Jyoti
	Rs.	Rs.		Rs.	Rs.
Capital	7,75,000	8,55,000	Plant & machinery	4,85,000	6,14,000
Current liabilities	6,23,500	5,57,600	Building	7,50,000	6,40,000
	<u> </u>	<u> </u>	Current assets	<u>1,63,500</u>	<u>1,58,600</u>
	<u>13,98,500</u>	<u>14,12,600</u>		<u>13,98,500</u>	<u>14,12,600</u>

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Following are the additional information:

- (i) The authorised capital of the new company will be Rs.25,00,000 divided into 1,00,000 equity shares of Rs.25 each.
- (ii) Liabilities of Roshni includes Rs.50,000 due to Jyoti for the purchases made. Jyoti made a profit of 20% on sale to Roshni.
- (iii) Roshni has goods purchased from Jyoti, cost to him Rs.10,000. This is included in the Current asset of Roshni as at 31st March, 2010.
- (iv) The assets of Roshni and Jyoti are to be revalued as under:

	Roshni	Jyoti
	Rs.	Rs.
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

- (v) The purchase consideration is to be discharged as under:
 - (a) Issue 24,000 equity shares of Rs. 25 each fully paid up in the proportion of their profitability in the preceding 2 years.
 - (b) Profits for the preceding 2 years are given below:

	Roshni	Jyoti
	Rs.	Rs.
1 st year	2,62,800	2,75,125
II nd year	<u>2,12,200</u>	<u>2,49,875</u>
Total	<u>4,75,000</u>	<u>5,25,000</u>

- (c) Issue 12% preference shares of Rs.10 each fully paid up at par to provide income equivalent to 8% return on capital employed in the business as on 31.3.2010 after revaluation of assets of Roshni and Jyoti respectively.

You are required to:

- (i) Compute the amount of equity and preference shares issued to Roshni and Jyoti.
 - (ii) Prepare the Balance Sheet of Ujala Ltd. immediately after amalgamation.
4. Somya Ltd. has the following Capital Structure as on 31.03.2010:

Particulars	(Rs. in crores)
Equity Share Capital (Shares of Rs. 10 each fully paid)	- 330

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Reserves and Surplus:		
General Reserve	240	-
Securities Premium Account	90	-
Profit & Loss Account	90	-
Infrastructure Development Reserve	<u>180</u>	600
Loan Funds		1,200

The shareholders of Somya Ltd., on the recommendation of their Board of Directors, have approved on 12.09.2010 a proposal to buy back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs. 25 per share and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information.

Show the accounting entries in the company's books assuming that the entire buy back is completed by 09.12.2010. Narrations should form part of your answer.

Valuation

5. The summarized Balance Sheet of 'Shubhashish' Private Ltd. as on 31.03.2010 is as under:

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>		<i>Amount</i>
	<i>Rs.</i>			<i>Rs.</i>
Share Capital:		Fixed Assets:		
Equity Shares of Rs.10		Goodwill		1,75,000
each	5,00,000	Leasehold Property	1,60,000	
8% Preference Shares		(-) Depreciation	<u>70,000</u>	90,000
of Rs. 10 each fully paid	2,00,000	Plant & Machinery	2,50,000	
Reserves & Surplus:		(-) Depreciation	<u>25,000</u>	2,25,000
General Reserve	1,00,000	Investment at cost		4,00,000

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Profit & Loss A/c	2,20,250	Current Assets:		
Current Liabilities:		Stock at cost		82,500
Bank Loan	1,00,000	Sundry Debtors		40,500
Sundry Creditors	<u>49,750</u>	Balance at Bank		<u>1,57,000</u>
	<u>11,70,000</u>			<u>11,70,000</u>

A holder of 10,000 Equity Shares in the company has agreed to sell these shares at a value based on the above Balance Sheet, but subject to adjustment of the valuation of the following:

- (1) The leasehold property was acquired on 1.4.2000 and at the Balance Sheet date the lease has a further six years to run. The cost should be written off over the term of the lease by equal annual charges. Till date, Rs. 7,000 per annum had been written off.
- (2) In 2007-08, goods costing Rs. 6,000 were purchased and have been included since that date at cost in the Stock lists. The goods were valueless on the Balance Sheet date.
- (3) An expense Creditor Rs. 3,750 of the current year has been omitted from being recorded in the books.
- (4) A General Reserve of 10 per cent on total Debtors, after specific provision for Doubtful Debts, has been made for the first time in the current year accounts.
- (5) Goodwill is to be valued at two years' purchase of the average Profits, after the above adjustments, of three years 2007-08; 2008-09; and 2009-10, such profits being those available for dividend for Equity shareholders.
- (6) The profits of the company as shown by the accounts before appropriations and before providing for preference dividends were as follows:

Year	Rs.
2007-08	80,400
2008-09	92,900
2009-10	89,650

You are required to compute the total consideration due to the Vending Shareholder.

6. (a) "Intangibles are not easily measurable and it poses severe challenges in valuation of brands." Elucidate some of the difficulties faced by accountants in brand valuation.
- (b) Explain the purpose of valuation of liabilities in financial accounting.

Value Added

7. (a) Discuss the relevance of value added statements in corporate financial reporting.

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- (b) From the following Profit and Loss Account of Jindals Limited, prepare Gross Value Added Statement:

Profit and Loss Account for the year ended 31st March, 2010

	(Rs. in lakhs)	(Rs. in lakhs)
<i>Income</i>		
Sales		400
Other Income		<u>25</u>
		425
<i>Expenditure</i>		
Production and Operational Expenses	300	
Administrative Expenses	15	
Interest and Other Charges	15	
Depreciation	<u>10</u>	<u>340</u>
Profit before taxes		85
Provision for taxes		<u>15</u>
		70
Balance as per last Balance Sheet		<u>5</u>
		<u>75</u>
Transferred to:		
General Reserve		40
Proposed Dividend		10
Surplus carried to Balance Sheet		<u>25</u>
		<u>75</u>
Break-up of some of the expenditures is as follows:		
Production and Operational Expenses:		
Consumption of Raw Materials and Stores		160
Salaries, Wages and Bonus		30
Cess and Local Taxes		10
Other Manufacturing Expenses		<u>100</u>
		<u>300</u>
Administrative Expenses:		
Audit Fee		3

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Salaries and Commission to Directors		4
Other Expenses		<u>8</u>
		<u>15</u>
Interest and other Charges:		
On Working Capital Loans from Bank		5
On Fixed Loans from ICICI		7.5
On Debentures		<u>2.5</u>
		<u>15</u>

Market Value Added, Shareholders' Value Added and Economic Value Added

8. (a) Write short notes on:
- Market Value Added,
 - Shareholders' Value Added.
- (b) From the following data compute the Economic Value Added:

Share Capital	Rs.	1,600 crores
Long-term Debt	Rs.	320 crores
Interest	Rs.	32 crores
Reserves and Surplus	Rs.	3,200 crores
Profit before Interest and Tax	Rs.	1,432 crores
Tax Rate		30%
Cost of equity		14.2%

Inflation Accounting

9. What are the limitations of historical accounting in a period of inflation? Explain in brief.

Human Resource Reporting

10. (a) Write short note on human resource accounting.
- (b) From the following details, compute according to Lev and Schwartz (1971) model, the value of human resources of the employees.
- Annual average earnings of an employee till the retirement age Rs.30,000
 - Age of retirement 62 years
 - Discount rate 15%
 - No. of employees 50
 - Average age 60 years

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Financial Reporting for Financial Institutions

11. Write short notes on:
- (a) Minimum components of annual report of a mutual fund.
 - (b) Capital adequacy requirements of merchant bankers
 - (c) Books of accounts maintained by Stock Brokers.
12. (a) From the following details of a Non-Banking Finance Company, compute the amount of provision against advances as per Non Banking Financial (Deposit, Accepting or Holding), Companies Prudential Norms (Reserve Bank) Directions, 2007:

	<i>Rs.in lakhs</i>
Standard assets	8,400
Sub-standard assets	670
Secured portions of doubtful debts (more than three years)	220
Unsecured portions of doubtful debts	50
Loss assets	24

- (b) ABC Mutual Funds have introduced a scheme 'Prima Fund'. Its major details are:
- Scheme size Rs. 100 crores
- Face value Rs. 20
- Investments in quoted shares having market value Rs. 200 crores.
- Compute the NAV per unit of the fund. Is there any appreciation in units of fund?

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

13. (a) Write short note on "convergence of Accounting Standards in line with IFRS"?
- (b) Explain the treatment of "Definition of subsidiary" with reference to Indian AS and IAS/IFRS.

Financial Instruments

14. (a) Can an equity instrument, such as a preference share, with fixed or determinable payments be classified within loans and receivables by the holder?
- (b) Does AS 30 permit the recognition of an impairment loss through the establishment of an allowance for future losses when a loan is given?

Share Based Payments

15. Beta Ltd. grants 1,000 employees stock options on 1.4.2007 at Rs.80, when the market price is Rs.320. The vesting period is 2½ years and the maximum exercise period is one

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year. 300 unvested options lapse on 1.5.2009. 600 options are exercised on 30.6.2010. 100 vested options lapse at the end of the exercise period.

Pass Journal Entries giving suitable narrations.

Accounting Standards and Guidance Notes

16. (a) While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010, a debtor for Rs. 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010.
- (b) On 1st April, 2009, Amazing Construction Ltd. obtained a loan of Rs. 32 crores to be utilized as under:
- (i) Construction of sealink across two cities:
(work was held up totally for a month during the year : Rs. 25 crores
due to high water levels)
 - (ii) Purchase of equipments and machineries : Rs. 3 crores
 - (iii) Working capital : Rs. 2 crores
 - (iv) Purchase of vehicles : Rs. 50,00,000
 - (v) Advance for tools/cranes etc. : Rs. 50,00,000
 - (vi) Purchase of technical know-how : Rs. 1 crores
 - (vii) Total interest charged by the bank for the year ending : Rs. 80,00,000
31st March, 2010
- Show the treatment of interest by Amazing Construction Ltd.
- (c) M Ltd. launched a project for producing product A in Nov. 2008. The company incurred Rs. 30 lakhs towards research and development expenses up to 31st March, 2010. Due to unfavourable market conditions the management feels that it is not possible to manufacture and sell the product in the market for next so many years. The management hence wants to defer the expenditure write off to future years. Advise the company as per the applicable Accounting Standard.
17. (a) Can Gamma Ltd. a wire netting company, while valuing its finished stock at the year end include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses?
- (b) A company installed a plant at a cost of Rs. 20 lacs with estimated useful life of 10 years and decided to depreciate on 10% p.a. under straight line method. In the fifth year, company decided to switch over from straight line method to written down

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value method. The rate of depreciation will not change. Compute the resultant surplus/deficiency if any, and state how will you treat the same in the accounts.

- (c) An amount of Rs. 9,90,000 was incurred on a contract work upto 31-03-2010. Certificates have been received to date to the value of Rs.12,00,000 against which Rs.10,80,000 has been received in cash. The cost of work done but not certified amounted to Rs. 22,500. It is estimated that by spending an additional amount of Rs. 60,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of work is Rs.12,50,000. Compute an estimate of the profit to be taken to the Profit and Loss Account as per AS 7.
18. (a) On 25th January, 2010, Planet Advertising Limited obtained advertisement rights for World Cup Hockey Tournament to be held in March/April, 2010 for Rs. 520 lakhs. They furnish the following information:
- (1) The company obtained the advertisements for 70% of available time for Rs. 700 lakhs by 31st January, 2010.
 - (2) For the balance time they got bookings in February, 2010 for Rs. 240 lakhs.
 - (3) All the advertisers paid the full amount at the time of booking the advertisements.
 - (4) 40% of the advertisements appeared before the public in March, 2010 and balance 60% appeared in the month of April, 2010.

You are required to calculate the amount of profit/loss to be recognized in the financial year 2009-10 as per AS 9.

- (b) Calculate the diluted earnings per share from the following information:
- | | |
|--|---------------|
| Net profit for the current year (after tax) | Rs. 85,50,000 |
| Number of equity shares outstanding | 20,00,000 |
| Number of 8% convertible debentures of Rs. 100 each
(Each debenture is convertible into 10 equity shares) | 1,00,000 |
| Interest expenses for the current year | Rs. 8,00,000 |
| Tax relating to interest expenses | 30% |
- (c) X Ltd. sold goods to its associate Company for the 1st quarter ending 30.6.2010. After that, the related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year has to be disclosed as related party transaction.
- (d) Ergo Industries Ltd. gives the following estimates of cash flows relating to fixed asset on 31-12-2010. The discount rate is 15%.

Year	Cash Flow (Rs. in lakhs)
2011	4,000
2012	6,000

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2013	6,000
2014	8,000
2015	4,000
Residual value at the end of 2015	= Rs. 1,000 lakhs
Fixed Asset purchased on 1-1-2008	= Rs. 40,000 lakhs
Useful life	= 8 years
Net selling price on 31-12-2010	= Rs. 20,000 lakhs

Calculate on 31-12-2010:

- (i) Value in use on 31-12-2010;
 - (ii) Carrying amount at the end of 2010;
 - (iii) Recoverable amount on 31-12-2010;
 - (iv) Impairment loss to be recognized for the year ended 31-12-2010.
19. (a) Garden Ltd. acquired fixed assets viz. plant and machinery for Rs.20 lakhs. During the same year it sold its furniture and fixtures for Rs.5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS-3?
- (b) As on 1st April, 2009 the fair value of plan assets was Rs.1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2009 the plan paid out benefits of Rs.20,000 and received inward contributions of Rs.40,000. On 31st March, 2010 the fair value of plan assets was Rs.1,50,000 and present value of the defined benefit obligation was Rs.1,45,000. Actuarial losses on the obligations for the year 2009-10 were Rs.1,000. You are required to find the actual returns on plan assets.
- (c) AS Ltd. leased a machine to SB Ltd. on the following terms:

	(Rs. in lakhs)
Fair value of the machine	4.00
Lease term	5 years
Lease Rental Per annum	1.00
Guaranteed Residual value	0.20
Expected Residual value	0.40
Internal Rate of Return	15%
Depreciation is provided on straight line method at 10 per cent per annum. Ascertain Unearned Financial Income.	

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- (d) Meghna Ltd. took a factory premises on lease on 1.4.07 for Rs.2,00,000 per month. The lease is operating lease. During March, 2008, Meghna Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Meghna Ltd. seeks your advice.
20. (a) The Chief Accountant of ANZ Ltd., gives the following data regarding its six segments:

							(Rs. in lakhs)
Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

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

- (b) "MAT credit is a deferred tax asset." Explain.
- (c) Explain the recommendations of Guidance Note on applicability of AS 25 to Interim Financial Statements.
- (d) "Remuneration paid to key management personnel is not considered as a related party transaction, requiring disclosure under AS 18". Comment on the validity of the statement.

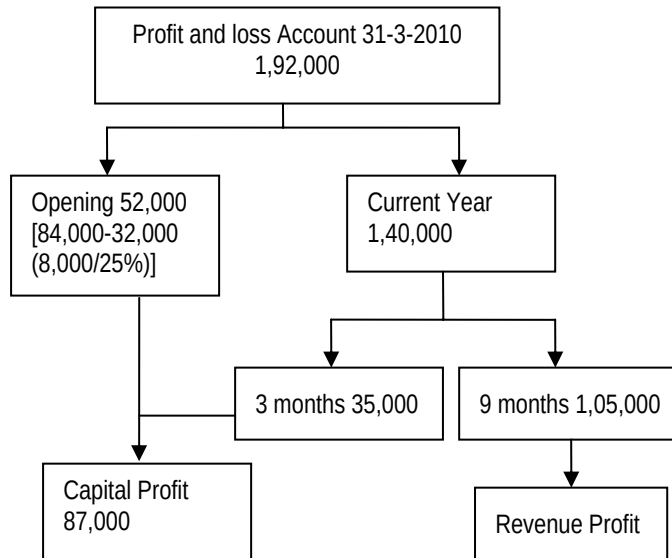
SUGGESTED ANSWERS / HINTS

1.

Date of Acquisition	1-7-2009
Date of consolidation	31-3-2010
Pre-acquisition period	3 months
Post-acquisition period	9 months
% of Holding	25%

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Analysis of Capital and Revenue profits



	Total	Tarun Ltd.
	100%	25%
(i) Capital Profit	87,000	21,750
(ii) Revenue Profit	1,05,000	26,250
(iii) Equity Share Capital	5,00,000	1,25,000

Computation of Goodwill/Capital Reserve

		Rs.
Investments		2,40,000
Less: Pre-Acquisition dividend	8,000	
Nominal Value of shares	1,25,000	
Share in Capital Profits	<u>21,750</u>	1,54,750
Goodwill		<u>85,250</u>

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Investment in associate under equity method

Nominal Value of Investment	1,46,750
Goodwill	85,250
	<u>2,32,000</u>
Add: Share of Revenue Profit	26,250
	<u>2,58,250</u>

2. Consolidated Balance Sheet of Amber Ltd & its subsidiary Om Ltd.

As on 31st March, 2010

<i>(Rs.in lakhs)</i>			
Liabilities		Assets	
<i>Share Capital</i>		<i>Fixed Assets</i>	
Equity shares of Rs. 10 each	216.00	Goodwill (W.N.2)	27.88
Minority Interest (W.N.3)	27.36	Plant (W.N.7)	167.40
<i>Reserve & Surplus</i>		Furniture, fixtures & fittings (W.N.8)	29.80
Securities premium	32.40	<i>Current Assets</i>	
General reserve	13.50	Stock (18+13.5)	31.50
Profit and loss account (W.N.4)	65.32	Sundry Debtors (73.8 + 47.6)	121.40
<i>Current Liabilities</i>		Balance at bank (18 + 8)	26.00
Sundry Creditors (29.7+19.7)	<u>49.40</u>		
	<u>403.98</u>		<u>403.98</u>

Working Notes:

1. Analysis of Accumulated Profits & Reserves of Om Ltd.

<i>(Rs. in lakhs)</i>				
		<i>Pre-Acquisition</i>		<i>Post Acquisition</i>
P&L account bal. as on 31.3.2010 Rs.21.60 lakhs				
P&L account bal. on 1.4.09	27.00			
Less: Dividend for 2008-09	<u>10.80</u>	16.20	(21.60 –16.20)	5.40

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Capital reserve		7.20		
General reserve		9.00		
Upward revaluation of plant (W.N.5)		9.00		
Downward revaluation of furniture, fixtures and fittings (W.N.6)		(1.00)		
Trade Investment written off		(2.70)		
Goodwill written off		(13.60)		
Additional depreciation on plant				(0.90)
Overcharged depreciation on furniture, fixtures and fittings				<u>0.20</u>
		<u>24.10</u>		<u>4.70</u>
Share of Amber Ltd. (80%)		19.28		3.76
Minority interest (20%)		4.82		0.94

2. Goodwill

		(Rs. in lakhs)
Amount paid for investment in Om Ltd.		97.20
Less: Dividend for the year 2008-09		<u>8.64</u>
		88.56
Less: Nominal value of shares acquired	86.40	
Share in pre-acquisition profit (80%)	<u>19.28</u>	<u>105.68</u>
Capital reserve		<u>17.12</u>
Goodwill to be shown in the consolidated balance sheet = Rs. 45.00 lakhs – Rs. 17.12 lakhs = Rs. 27.88 lakhs		

3. Minority Interest (Rs. in lakhs)

Share Capital (20%)	21.60
Share in pre-acquisition profit (20%)	4.82
Share in post-acquisition profit (20%)	<u>0.94</u>
	<u>27.36</u>

4. Consolidated Profit and Loss Account of Amber Ltd.

	(Rs. in lakhs)
Profit and Loss A/c of Amber Ltd.	70.20
Less: Dividend for the year 2008-09	<u>(8.64)</u>

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	61.56
Add: Share in post acquisition profit of Om Ltd.	<u>3.76</u>
	<u>65.32</u>

5. Upward revaluation of Plant of Om Ltd.

$$\left[\text{Rs. 90 lakhs} - \left(\text{Rs. 72.9 lakhs} \times \frac{100}{90} \right) \right] = \text{Rs. 9 lakhs}$$

6. Downward revaluation of Furniture, Fixtures & Fittings of Om Ltd.

$$\left[\text{Rs. 8 lakhs} - \left(\text{Rs. 7.2 lakhs} \times \frac{100}{80} \right) \right] = \text{Rs. 1 lakh}$$

7. Value of Plant in the consolidated balance sheet *Rs. in lakhs*

	Om Ltd.	Amber Ltd.	Total
Balance as on 31.3.2010	72.9	86.4	
Add: Upward revaluation	<u>9.0</u>		
	81.9		
Less: Additional depreciation to be charged	<u>(0.9)</u>		
	<u>81.0</u>	<u>86.4</u>	<u>167.4</u>

8. Value of Furniture, Fixtures & Fittings in the consolidated balance sheet

Rs. in lakhs

	Om Ltd.	Amber Ltd.	Total
	7.2	23.4	
Less: Downward revaluation	<u>(1.0)</u>		
	6.2		
Add: Overcharged depreciation	<u>0.2</u>	—	
	<u>6.4</u>	<u>23.4</u>	<u>29.8</u>

3. (i) Calculation of amount of equity shares issued to Roshni and Jyoti

Profits of	Roshni	Jyoti
	Rs.	Rs.
I year	2,62,800	2,75,125
II year	<u>2,12,200</u>	<u>2,49,875</u>
Total	<u>4,75,000</u>	<u>5,25,000</u>

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No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability

	Roshni	Jyoti
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of amount of 12% Preference shares issued to Roshni and Jyoti

	Roshni	Jyoti
	Rs.	Rs.
Capital employed (Refer working note 1)	8,40,000	9,24,000
8% return on capital employed	67,200	73,920
12% Preference shares to be issued		
$\left[67,200 \times \frac{100}{12} \right]$	Rs. 5,60,000	
$\left[73,920 \times \frac{100}{12} \right]$		Rs. 6,16,000

Total Purchase Consideration

	Roshni	Jyoti
	Rs.	Rs.
Equity shares	2,85,000	3,15,000
12% Preference shares	<u>5,60,000</u>	<u>6,16,000</u>
Total	<u>8,45,000</u>	<u>9,31,000</u>

(ii) Balance Sheet of Ujala Ltd. (after amalgamation)

Liabilities	Rs.	Assets	Rs.
Authorised share capital:		Fixed assets:	
1,00,000 Equity Shares of Rs.25 each	<u>25,00,000</u>	Goodwill (W.N.1)	14,000
Issued and subscribed share capital:		Plant and Machinery	12,00,000
24,000 Equity Shares of Rs.25 each	6,00,000	Building	14,23,000
1,17,600 12% Preference shares of	11,76,000	Current Assets (W.N.2)	2,70,100

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Rs.10 each (All of the equity and preference shares have been issued for consideration other than cash)		
Current Liabilities (W.N. 3)	<u>11,31,100</u>	
	<u>29,07,100</u>	<u>29,07,100</u>

Working Notes:

1. Goodwill

	Roshni Rs.	Jyoti Rs.
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	<u>1,63,500</u>	<u>1,58,600</u>
	14,63,500	14,81,600
Less: Current liabilities	<u>6,23,500</u>	<u>5,57,600</u>
Net assets (capital employed)	8,40,000	9,24,000
Less: Purchase consideration	<u>8,45,000</u>	<u>9,31,000</u>
Goodwill	<u>5,000</u>	<u>7,000</u>
Total purchased goodwill		12,000
Add: Unrealised profit of Rs.10,000 @ 20% = Rs.2,000 is adjusted from current assets and from goodwill (since P & L A/c is not given)		<u>2,000</u>
Total Goodwill		<u>14,000</u>

2. Current Assets

	Roshni Rs.	Jyoti Rs.
Balances before amalgamation	1,63,500	1,58,600
Less: Liabilities of Roshni due to Jyoti	-	50,000
Less: Unrealised Profit on stock i.e. Rs.10,000 x 20%	<u>2,000</u>	
Total	<u>1,61,500</u>	<u>1,08,600</u>
Grand Total		<u>2,70,100</u>

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3. Current Liabilities

	Roshni Rs.	Jyoti Rs.
Balances before amalgamation	6,23,500	5,57,600
Less: Liabilities of Roshni due to Jyoti	<u>50,000</u>	<u>-</u>
Total	<u>5,73,500</u>	<u>5,57,600</u>
Grand Total		<u>11,31,100</u>

4. Statement determining the maximum number of shares to be bought back

(Shares in crores)

	Particulars	
(a)	Shares Outstanding Test (W.N.1)	8.25
(b)	Resources Test (W.N.2)	6.25
(c)	Debt Equity Ratio Test (W.N.3)	5.00
(d)	Maximum number of shares that can be bought back [least of the above]	5.00

Journal Entries for the Buy Back

Rs. in crores

		Debit	Credit
Equity share buy back account	Dr.	150	
To Bank account			150
(Being buy back of five crores equity shares of Rs. 10 each @ Rs. 30 per share)			
Equity share capital account	Dr.	50	
Securities premium account	Dr.	90	
General reserve account (Bal. Fig.)	Dr.	10	
To Equity share buy back account			150
(Being cancellation of shares bought back)			
General reserve account	Dr.	50	
To Capital redemption reserve account			50
(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital redeemed through free reserves)			

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Working Notes:

1. Shares Outstanding Test

<i>Particulars</i>	(Shares in crores)
Number of Shares Outstanding	33
25% of the Shares Outstanding	8.25

2. Resources Test

<i>Particulars</i>	
Paid up Capital (Rs. in crores)	330
Free Reserves (Rs. in crores)	<u>420</u>
Shareholders Funds (Rs. in crores)	<u>750</u>
25% of Shareholders Fund (Rs. in crores)	187.5
Buy back price per share	Rs.30
Number of Shares that can be bought back (Shares in crores)	6.25

3. Debt Equity Ratio Test

	Particulars	
(a)	Loan Funds (Rs. in crores)	1,200
(b)	Minimum Equity to be maintained after buy back in the ratio of 2:1 (Rs. in crores)	600
(c)	Present Equity Shareholders Fund (Rs. in crores)	750
(d)	Maximum Permitted Dilution of Equity (Rs. in crores) [(b)-(c)]	150
(e)	Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores)	5

5. Calculation of Adjusted Profits of Shubhashish Ltd.

Year		2007-08		2008-09		2009-10
		<i>Rs.</i>		<i>Rs.</i>		<i>Rs.</i>
Profit before appropriation and preference dividend		80,400		92,900		89,650
Less: Under provision for writing off of lease	3,000		3,000		3,000	
Stock written off	-		-		6,000	
Expenses omitted	-		-		3,750	
Dividend on preference shares	<u>16,000</u>	<u>(19,000)</u>	<u>16,000</u>	<u>(19,000)</u>	<u>16,000</u>	<u>(28,750)</u>

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		61,400		73,900		60,900
Add: General reserve created on 31.3.10 on debtors in excess of specific provisions		—		—		<u>4,500</u>
Adjusted profits		<u>61,400</u>		<u>73,900</u>		<u>65,400</u>

$$\text{Adjusted Average Profits} = \frac{\text{Rs.61,400} + \text{Rs.73,900} + \text{Rs.65,400}}{3} = \text{Rs. 66,900}$$

$$\text{Goodwill} = \text{Rs. 66,900} \times 2 = \text{Rs. 1,33,800}$$

Net Assets owned by Equity Shareholders

	Rs.
Goodwill	1,33,800
Leasehold property $\left(\frac{\text{Rs.1,60,000}}{16} \times 6 \right)$	60,000
Plant & machinery	2,25,000
Investments	4,00,000
Stock (Rs. 82,500 – Rs. 6,000)	76,500
Sundry debtors (Rs. 40,500 + Rs. 4,500)	45,000
Bank balance	<u>1,57,000</u>
	10,97,300
Less: Current liabilities:	
Bank loan	1,00,000
Sundry creditors (Rs. 49,750 + Rs. 3750)	<u>53,500</u>
	9,43,800
Less: Preference share capital	<u>2,00,000</u>
Net assets owned by equity shareholders	<u>7,43,800</u>

$$\text{Value per equity share} = \frac{\text{Rs.7,43,800}}{50,000}$$

$$= \text{Rs. 14.876}$$

$$\text{Total consideration due to vending shareholder} = 10,000 \text{ Equity shares @ Rs. 14.876}$$

$$= \text{Rs. 1,48,760}$$

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6. (a) Intangibles are not easily measurable and it poses severe challenges in valuation of brands also. Some of the difficulties faced by the accountants in brand valuation are as follows:
1. **Distinctiveness:** Brands need to be valued distinctively as different from other intangibles such as Goodwill etc. For instance, any attempt to commonly treat brand as a part of Goodwill as is done at present may create serious distortions in accounting position. Besides, this would create handicaps in brand accounting. This is because, a brand cannot be treated like any other item such as patents and copyrights. In fact, a brand needs to be separately disclosed in the Balance sheet, because of its significant contribution to corporate image and identity.
 2. **Disclosure:** There is always a problem of making disclosure of brand values in financial statements. This is because, there is no standard accounting practice requiring statement and disclosure of brand values in a particular way.
 3. **Uncertainty:** The problem that is associated with the brand, as an item of intangibles, is that its possible returns are uncertain, immeasurable and non-current in nature.
 4. **No Market:** The prevailing practice is that the intangibles are not required to be revalued according to some accounting standards on account of the non-existence of an active secondary market for them. In fact, the need for brand accounting arises mainly on account of conditions warranted by acquisition and merger.
 5. **New Brands:** A related problem, in accounting for such intangibles as brands is that it is often difficult to determine whether a new one is being gradually substituted for an existing brand. This raises the issue as to how to account for it in subsequent years. In such case, the relevant question is: Should the original cost of brand be written-down as it erodes? It may be difficult to determine whether a brand remains the same asset overtime as it is subtly reshaped to meet new market opportunities.
 6. **Joint Costs:** The contribution to the value of a brand is made not simply by investing a desirable product with a customer seductive name, but by building market share by the skilful exploitation of the product in a whole host of ways of general efficiency with which a business is conducted by expending money on a joint cost basis. It is very difficult to segregate and account for joint costs that are incurred and the cost of brand developed as a result of general operations of the business.
- (b) Proper valuation of liabilities is required to ensure true and fair financial position of the business entity. In other words, all matters which affect the financial position of the business have to be disclosed. Under or over valuation of liabilities may not only affect the operating results and financial position of the current period but will also affect the operating results and financial position for the next accounting periods.

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

(b)

Jindals Limited

Gross Value Added Statement for the year ended 31st March, 2010

	<i>Rs. in lakhs</i>	<i>Rs. in lakhs</i>
Sales		
Less: Cost of bought in material or services:		400
Production and Operational Expenses (160 + 100)	260	
Administrative Expenses (3 + 8)	11	
Interest on working capital loans	<u>5</u>	<u>276</u>
Value added by manufacturing and trading activities		124
Add: Other Income		<u>25</u>
Total Value Added		<u>149</u>

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Application of Value Added:

To	Pay Employees:			%
	Salaries, Wages and Bonus	30		20.14
To	Pay Directors:			
	Salaries and Commission	4		2.68
To	Pay Government:			
	Cess and Local taxes	10		
	Income Tax	<u>15</u>	25	16.78
To	Pay Providers of Capital:			
	Interest on Debentures	2.5		
	Interest on Fixed Loans	7.5		
	Dividend	<u>10</u>	20	13.42
To	Provide for Maintenance and Expansion of the Company:			
	Depreciation	10		
	General Reserve	40		
	Retained Profit (25 – 5)	<u>20</u>	<u>70</u>	<u>46.98</u>
			<u>149</u>	<u>100.00</u>

8. (a) (i) Market Value Added is the market value of capital employed in the firm less the book value of capital employed. Market value added is calculated by summing up the paid up value of equity and preference share capital, Retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt. Market value added measures cumulatively the performance of corporate entity. A High market value added means that the company has created substantial wealth for shareholders. On the other hand negative MVA means that the value of management's actions and investments are less than the value of the capital contributed to the company by the capital market or that the wealth and value has been destroyed.
- (ii) **Shareholders' Value Added** is a value-based performance measure of a company's worth to shareholders. The basic calculation is net operating profit after tax (NOPAT) minus the cost of capital from the issuance of debt and equity, based on the company's weighted average cost of capital (WACC).

(b) Computation of Economic Value Added

	<i>Rs. in crores</i>
Net operating profit after tax (W.N.4)	980.0
Add: Interest on long term fund (W.N.1)	<u>22.4</u>
	1002.4
Less: Cost of capital (13.75% of Rs. 5,120 crores)	<u>704.0</u>
Economic Value Added	<u>298.4</u>

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Working Notes:

- Interest on long term fund (after tax) and Cost of Debt

	<i>Rs. in crores</i>
Interest	32.0
Less: Tax @ 30%	<u>9.6</u>
	<u>22.4</u>
Cost of Debt = $\frac{22.4}{320} \times 100 = 7\%$	

- Calculation of Weighted Average Cost of Capital (WACC)

	<i>Rs. in crores</i>
Cost of Equity (14.20% of Rs. 4,800 crores)	681.6
Cost of Debt (7% of Rs. 320 crores)	<u>22.4</u>
	<u>704.0</u>
WACC = $\frac{704}{5,120} \times 100 = 13.75\%$	

- Capital Employed

	<i>Rs. in crores</i>
Share capital	1,600
Reserve and surplus	3,200
Long term debt	<u>320</u>
	<u>5,120</u>

- Calculation of Net Operating Profit after Tax

	<i>Rs. in crores</i>
Profit before interest and tax	1,432
Less: Interest on long term debt	<u>(32)</u>
	1,400
Less: Tax (30% of Rs. 1,400)	<u>420</u>
	<u>980</u>

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

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revenues expressed at current prices. Again, historical cost based accounting reflects assets at their historical cost instead of current cost. It results in understatement of the net worth of an enterprise. Historical cost based accounting thus fails to serve the primary purpose of the financial statements. It presents a distorted view of the profitability by overstating it and of intrinsic worth by understating it.

10. (a) Human Resource Accounting (HRA) is an attempt to identify, quantify and report investments made in human resources of an organization. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information. Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resource. Human resources are not thus recognized as 'assets' in the Balance Sheet. While investments in human resources are not considered as assets and not amortised over the economic service life, the result is that the income and expenditure statement comprising current revenue and expenditure gives a distorted picture of the real affairs of the organization. Human resource accounting provides scope for planning and decision making in relation to proper manpower planning. Also, such accounting can bring out the effect of various new rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes and laws.
- (b) According to Lev and Schwartz, the value of human capital embodied in a person of age t is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following formula:

$$V = \sum_{t=\tau}^t \frac{I(t)}{(1+r)^{t-\tau}}$$

Where,

V = the human capital value of a person t years old.

$I(t)$ = the person's annual earnings up to retirement.

r = a discount rate specific to the person.

t = retirement age.

Value of employees

$$= \frac{30,000}{(1+0.15)^{(62-60)}} + \frac{30,000}{(1+0.15)^{(62-61)}}$$

$$= \frac{30,000}{(1+0.15)^2} + \frac{30,000}{(1+0.15)}$$

$$= 22,684.31 + 26,086.96 = 48,771.27$$

$$\text{Value of the employees} = \text{Rs. } 48,771.27 \times 50 = \text{Rs. } 24,38,564$$

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- 11. (a)** Every mutual fund or the asset management company is required to prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule.

According to Eleventh Schedule, the annual report shall contain –

- (i) Report of the board of Trustees on the operations of the various schemes of the fund and the fund as a whole during the year and the future outlook of the fund;
- (ii) Balance Sheet and Revenue Account in accordance with paras 2, 3 and 4, respectively of this Schedule;
- (iii) Auditor's Report in accordance with paragraph 5 of this Schedule;
- (iv) Brief statement of the Board of Trustees on the following aspects, namely:-
 - (a) Liabilities and responsibilities of the Trustees and the Settlor;
 - (b) Investment objective of each scheme;
 - (c) Basis and policy of investment underlying the scheme;
 - (d) If the scheme permits investment partly or wholly in shares, bonds, debentures and other Scrips or securities whose value can fluctuate, a statement on the following lines :

“The price and redemption value of the units, and income from them, can go up as well as down with the fluctuations in the market value of its underlying investments;”
 - (e) Comments of the Trustees on the performance of the scheme, with full justification.
- (v) Statement giving relevant perspective historical 'per unit' statistics in accordance with paragraph 6 of this Schedule;
- (vi) Statement on the following lines :

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

- (b)** Capital adequacy requirements of merchant bankers have been specified by SEBI under the SEBI (Merchant Bankers) Regulations, 1992. Regulation 7 specifies that the requirement of capital adequacy shall be a net worth of not less than five crore rupees [amended by SEBI (Merchant Banker) (Third Amendment) Regulations, 2006]. For the purpose of this regulation, 'Net worth' means the sum of paid-up capital and free reserves of the applicant at the time of making application under sub-regulation (1) of regulation 3.

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- (c) Every stock broker is required to maintain the following books of account, records and documents as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:
- (a) Register of transactions (Sauda book);
 - (b) Clients ledger;
 - (c) General ledger;
 - (d) Journals;
 - (e) Cash book;
 - (f) Bank Pass Book;
 - (g) Documents register, containing, inter alia, particulars of securities received and delivered in physical form and the statement of account and other records relating to receipt and delivery of securities provided by the depository participants in respect of dematerialized securities;
 - (h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
 - (i) Counterfoils or duplicates of contract notes issued to clients;
 - (j) Written consent of clients in respect of contracts entered into as principals;
 - (k) Margin deposit book;
 - (l) Register of accounts of sub-brokers;
 - (m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.
 - (n) An agreement with the sub-broker and with the client of sub-broker to establish privities of the contract between the stock broker and the client of the stock broker. [Inserted by SEBI (Stock Brokers and Sub-Brokers) (Amendment) Regulations, 2003].

12. (a) Calculation of provision required on advances as on 31st March, 2010:

	<i>Amount Rs. in lakhs</i>	<i>Percentage of provision</i>	<i>Provision Rs. in lakhs</i>
Standard assets	8,400	NIL	NIL
Sub-standard assets	670	10	67
Secured portions of doubtful debts			
(More than three years)	220	50	110
Unsecured portions of doubtful debts	50	100	50
Loss assets	24	100	<u>24</u>
			<u>251</u>

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(b) Scheme size	Rs. 100 crores
Face value	Rs. 20 per unit
Number of units (Rs. 100 crores / Rs. 20)	5 crore units
Market value of investments	Rs. 200 crores
NAV per unit (Rs. 200 crores / 5 crore)	Rs. 40
Appreciation in investment (Rs. 40 – Rs. 20)	Rs. 20 per unit

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

(b) Definition of subsidiary

Indian AS	IAS/IFRS
Definition of subsidiary is based on voting control or control over the composition of the board of directors. The existence of currently exercisable potential voting rights is not taken into consideration.	Control is presumed to exist when parent owns, directly or indirectly through subsidiaries, more than one half of an entity's voting power. The existence of currently exercisable potential voting rights is also taken into consideration.

14. (a) Yes. If a non-derivative equity instrument, such as a preference share, is required to be recorded as a liability by the issuer as per the relevant Accounting Standard, and it has fixed or determinable payments and is not quoted in an active market, it can be classified within loans and receivables by the holder, provided the definition is otherwise met. Paragraphs 31-46 of AS 31 “Financial Instruments : Presentation” provide guidance about the classification of a financial instrument as a liability or as equity from the perspective of the issuer of a financial instrument. If an instrument meets the definition of an equity instrument under AS 31, it cannot be classified within loans and receivables by the holder.
- (b) No. Paragraph 47 of AS 30 “ Financial Instruments : Recognition and Measurement” requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or

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privileges). In addition, paragraph 64 of AS 30 requires that an impairment loss is recognised only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with paragraphs 47 and 64 of AS 30 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

15. Journal Entries in the Books of Beta Ltd.

<i>Date</i>	<i>Particulars</i>	<i>Dr. (Rs.)</i>	<i>Cr. (Rs.)</i>
31.3.2008	Employees compensation expenses account	Dr. 96,000	
	To Employees stock option outstanding account		96,000
	(Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of Rs. 240 each, amortised on straight line basis over $2\frac{1}{2}$ years)		
	Profit and loss account	Dr. 96,000	
	To Employees compensation expenses account		96,000
	(Being expenses transferred to profit and loss account at the end of the year)		
31.3.2009	Employees compensation expenses account	Dr. 96,000	
	To Employees stock option outstanding account		96,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of Rs. 240 each, amortised on straight line basis over $2\frac{1}{2}$ years)		
	Profit and loss account	Dr. 96,000	
	To Employees compensation expenses account		96,000
	(Being expenses transferred to profit and loss account at the end of the year)		

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31.3.2010	Employees stock option outstanding account (W.N.)	Dr.	24,000	
	To General Reserve account (W.N.)			24,000
	(Being excess of employees compensation expenses transferred to general reserve account)			
30.6.2010	Bank A/c (600 x Rs.80)	Dr.	48,000	
	Employee stock option outstanding account (600 x Rs.240)	Dr.	1,44,000	
	To Equity share capital account (600 x Rs. 10)			6,000
	To Securities premium account (600 x Rs. 310)			1,86,000
	(Being 600 employees stock option exercised at an exercise price of Rs. 80 each)			
01.10.2010	Employee stock option outstanding account	Dr.	24,000	
	To General reserve account			24,000
	(Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)			

Working Note:

On 31.3.2010, Beta Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

	Rs.
No. of options actually vested (700 x Rs.240)	1,68,000
Less: Expenses recognized Rs.(96,000 + 96,000)	<u>1,92,000</u>
Excess expenses transferred to general reserve	<u>24,000</u>

16. (a) As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

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A debtor for Rs. 3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting Rs. 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.

- (b) According to para 3 of AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

As per para 6 of AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized	Interest to be charged to Profit & Loss A/c
Construction of sea-link	Yes	62,50,000	(80,00,000*(25/32)
Purchase of equipments and machineries	No		7,50,000 (80,00,000*(3/32)
Working capital	No		5,00,000 (80,00,000*(2/32)
Purchase of vehicles	No		1,25,000 (80,00,000*(.5/32)
Advance for tools, cranes etc.	No		1,25,000 (80,00,000*(.5/32)
Purchase of technical know-how	No		2,50,000 (80,00,000*(1/32)
Total		<u>62,50,000</u>	<u>17,50,000</u>

- (c) As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS 26. Therefore, the management cannot defer the expenditure write off to future years and the company is required to expense the entire amount of Rs. 30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

17. (a) As per para 6 of AS 2 "Valuation of Inventories", cost of inventories comprise of all costs of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Interest and other borrowing

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costs are usually considered as overheads that don't contribute to bringing the inventories to their present location and condition. Therefore, the proposal of Gamma Ltd., to include interest on bank over draft as an element of cost is not acceptable. Interest on bank overdraft will not form part of cost of production.

- (b) Table showing depreciation under Straight Line Method (SLM) and depreciation under Written Down Value Method (WDV)

<i>Rs. in lacs</i>		
Depreciation		
Year	SLM	WDV
I	2.00	2.00
II	2.00	1.80
III	2.00	1.62
IV	<u>2.00</u>	<u>1.46*</u>
Total	<u>8.00</u>	<u>6.88</u>

*Rounded off

As per para 21 of AS 6 'Depreciation Accounting', when a change in the method of depreciation is made, depreciation should be re-calculated in accordance with the new method from the date of the asset put to use. The deficiency or surplus arising from retrospective re-computation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, surplus amounting Rs.1.12 lakhs (8.00 – 6.88) should be credited to profit and loss statement in the fifth year. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

- (c) **Computation of estimate of profit as per AS 7**

	<i>Rs.</i>
Expenditure incurred upto 31.3.2010	9,90,000
Estimated additional expenses (including provision for contingency)	<u>60,000</u>
Estimated cost (A)	<u>10,50,000</u>
Contract price (B)	<u>12,50,000</u>
Total estimated profit [(B-A)]	<u>2,00,000</u>
Percentage of completion (9,90,000 / 10,50,000) x 100	94.29%

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Computation of estimate of the profit to be taken to Profit and Loss Account:

$$\text{Total estimated profit} \times \frac{\text{Expenses incurred till 31.3.2010}}{\text{Total estimated cost}}$$

$$2,00,000 \times \frac{9,90,000}{10,50,000} = \text{Rs. } 1,88,571 \text{ (approx)}$$

According to para 21 of AS 7 'Construction Contracts', when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date. Thus, estimated profit amounting Rs.1,88,571 should be recognised as revenue in the statement of profit and loss.

18. (a) As per para 12 of AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Further, appendix B to AS 9 states that revenue from advertising should be recognized when the service is completed. The service as regards advertisement is deemed to be completed when the related advertisement appears before the public.

In the given problem, 40% of the advertisement appeared before the public in March, 2010 and balance 60% in April, 2010.

Total profit will be computed as follows:

	Rs. in lakhs
Advertisement for 70% of available time obtained by 31 st January, 2010	700
Advertisement for 30% of available time obtained by February, 2010	<u>240</u>
Total	940
Less: Cost of advertisement rights	<u>(520)</u>
Profit	<u>420</u>

The profit amounting Rs. 420 lakhs should be apportioned in the ratio of 40:60 for the months of March and April, 2010. Thus, the company should recognise Rs.168 lakhs (i.e. Rs. 420 lakhs × 40%) in March, 2010 i.e. the financial year 2009-10 and rest Rs. 252 lakhs (i.e. Rs. 420 lakhs × 60%) in April, 2010 i.e. the financial year 2010-11.

- (b) "In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per para 26 of AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity

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shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Computation of diluted earnings per share

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

	Rs.
Net profit for the current year	85,50,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of Rs. 8,00,000)	<u>2,40,000</u>
Adjusted net profit for the current year	<u>91,10,000</u>

Number of equity shares resulting from conversion of debentures

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

$$\text{Diluted earnings per share} = \frac{91,10,000}{30,00,000 \text{ shares}} = \text{Rs. 3.037 per share approx.}$$

- (c) As per para 23 of AS 18, transactions of X Ltd. with its associate company for the first quarter ending 30.06.2010 only are required to be disclosed as related party transactions. The transactions for the period in which related party relationship did not exist need not be reported.
- (d) Calculation of value in use

Year	Cash Flow	Discount as per 15%	Discounted cash flow
2011	4,000	0.870	3,480
2012	6,000	0.756	4,536
2013	6,000	0.658	3,948
2014	8,000	0.572	4,576
2015	4,000	0.497	<u>1,988</u>
			<u>18,528</u>

Value in use = Rs. 18,528 lakhs

Calculation of carrying amount:

Original cost = Rs. 20,000 lakhs

Depreciation for 3 years = $[(40,000 - 1000) \times 3/8] = \text{Rs. 14,625}$

Carrying amount on 31-12-2010 = $[40,000 - 14,625] = \text{Rs. 25,375}$

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Recoverable amount = Rs. 20,000 lakhs (higher of value in use and net selling price)

Impairment Loss = Rs. (25,375-20,000) = Rs. 5,375 lakhs

19. (a) According to Para 21 of AS 3 (Revised) 'Cash Flow Statements', an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and disposal of fixed assets is not prescribed in para 22 and 24 of the standard. Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furniture and fixtures.

(b) **Computation of Actual Returns on Plan Assets**

Fair value of plan assets as on 31 March, 2010		1,50,000
Less: Fair value of plan assets as on 1 April, 2009	1,00,000	
Contributions received	<u>40,000</u>	<u>1,40,000</u>
		10,000
Add: Benefits paid		<u>20,000</u>
Actual return on plan assets		<u>30,000</u>

- (c) As per AS 19 on Leases, **unearned finance income** is the difference between (a) the **gross investment** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where :

Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(Rs. 1,00,000 × 5 years) + Rs. 20,000] + Rs. 20,000

= Rs. 5,40,000 (a)

Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	M.L.P. inclusive of URV Rs.	Internal rate of return (Discount factor @ 15%)	Present Value Rs.
1	1,00,000	0.8696	86,960
2	1,00,000	0.7561	75,610

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3	1,00,000	0.6575	65,750
4	1,00,000	0.5718	57,180
5	1,00,000	0.4972	49,720
	<u>20,000</u> (GRV)	0.4972	<u>9,944</u>
	5,20,000		3,45,164 (i)
	<u>20,000</u> (URV)	0.4972	<u>9,944</u> (ii)
	<u>5,40,000</u>	(i) + (ii)	<u>3,55,108</u> (b)

Unearned Finance Income = (a) – (b)
 = Rs. 5,40,000 – Rs. 3,55,108
 = Rs. 1,84,892

(d) In accordance with the provisions of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous* as the economic benefit of lease contract for next 33 months up to 31.12.2010 will be nil. However, the lessee, Meghna Ltd., has to pay lease rent of Rs. 66,00,000 (i.e. 2,00,000 p.m. for next 33 months). Therefore, provision on account of Rs.66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right.

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

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

Further, if the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified

* For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

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as reportable segments, even if they do not meet the 10% threshold, until at least 75% of total enterprise revenue is included in reportable segments.

- (a) On the basis of 'Revenue' criteria, segments M and N are reportable segments.
- (b) On the basis of 'Result' criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of Rs. 200 lakhs)
- (c) On the basis of 'Asset' criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence the opinion of chief accountant that segments 'M' and 'N' alone should be reported is wrong.

- (b) Payment of MAT, does not by itself, result in any timing difference since it does not give rise to any difference between the accounting income and the taxable income which are arrived at before adjusting the tax expense, namely, MAT. In other words, under AS 22, deferred tax asset and deferred tax liability arise on account of differences in the items of income and expenses credited or charged in the profit and loss account as compared to the items of income that are taxed or items of expense that are allowed as deduction, for the purposes of the Act. Thus, deferred tax assets and deferred tax liabilities do not arise on account of the amount of the tax expense itself. In view of this, it is not appropriate to consider MAT credit as a deferred tax asset for the purposes of AS 22.
- (c) The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise. For example, quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchanges and the listed enterprises do not meet the definition of 'interim financial report' as per AS 25. However, the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.
- (d) As per the Guidance Note on 'Remuneration paid to key management personnel – whether a related party transaction', the transaction should be between related parties to qualify as a related party transaction. Since key management personnel are related parties under AS 18, remuneration paid to key management personnel is a related party transaction requiring disclosures under AS 18. Further, in case non-executive directors on the Board of Directors are not related parties, remuneration paid to them is not considered a related party transaction. According to the recommendation given in the Guidance Note, remuneration paid to key management personnel should be considered as a related party transaction requiring disclosures under AS 18. In case non-executive directors on the Board of Directors are not related parties, remuneration paid to them should not be considered a related party transaction.

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ANNEXURE

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR MAY, 2011 EXAMINATION

The following List of Institute's Publications is relevant for the forthcoming examination i.e. May, 2011. Students may kindly take it into consideration while preparing for the examination.

Final Examination

Paper 1: Financial Reporting

I. Statements and Standards

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

II. Guidance Notes on Accounting Aspects

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

***Note**

1. The Core Group was constituted by the Ministry of Corporate Affairs for convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS). This Core Group decided that there will be two separate sets of Accounting Standards viz.

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(i) Indian Accounting Standards converged with the IFRS (Ind AS)

These are the standards which are being converged by eliminating the differences of the Indian Accounting Standards vis-à-vis IFRS. These standards shall be applied for all companies falling under Phase I to Phase III as prescribed under the roadmap issued by the core group. At present, these Ind ASs are in the form of Exposure Drafts and not yet finalized and therefore, not applicable for the students appearing in May, 2011 Examination.

(ii) Accounting Standards

The companies not falling within the threshold limits prescribed for IFRS compliance in the respective phases shall continue to apply these standards in the preparation and presentation of financial statements.

2. Students are expected to have thorough knowledge of the Accounting Standards (AS 1 to AS 29) and Guidance Notes on various aspects issued by ICAI. As far as AS 30, 31 and 32 are concerned, in view of the complexities involved, the questions involving conceptual issues (not involving application issues) may be asked. Since a separate topic of 'Financial Instruments' is included in the curriculum, simple practical problems based on AS 30, 31 and 32 may be asked.
3. The Accounting Standard Interpretations (ASI) have been issued from time to time by the Council of the ICAI. These interpretations address questions that arise in course of application of a particular Accounting Standard. ASI 2 and ASI 11 have been withdrawn. ASI 12, 23, 27 and 29 have been withdrawn and issued as Guidance Notes. The remaining interpretations have been merged as explanations to the relevant paragraphs of the related Accounting Standards.

Text of all applicable Accounting Standards and Guidance Notes are available in the Appendices of Volume II of Financial Reporting Study Material. These can be accessed at http://www.icaai.org/post.html?post_id=5936

Note : Notifications (in relation to syllabus) issued till 31st October, 2010 will be applicable for May, 2011 Examination.