

PAPER – 1 : FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, ANNOUNCEMENTS AND NOTIFICATIONS

A. Applicable for November, 2012 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. This is because, off balance sheet exposures of NBFCs have increased with the increased participation, in the designated currency options and futures and interest rate futures, as clients for the purpose of hedging their underlying exposures.

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. Earlier, explanation (2) to para 16 of the aforementioned Regulations, recognized only 6 items as off balance sheet items which had linkages to NBFI activities.

Now, 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.

The amending Notifications DNBS.PD.No.237/ CGM (US) 2011 and DNBS.PD.No. 238/CGM (US) 2011 both dated December 26, 2011 (further amended by DNBS.PD.No.239/ CGM (US) 2011 and DNBS.PD.No. 240/CGM (US) 2011 respectively both dated December 30, 2011) amending the Non- Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) directions, 2007 (herein after referred to as the said Directions) and the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 respectively have been issued for meticulous compliance. As per these notifications, RBI directs that the Directions shall be amended with immediate effect as follows, namely -

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/rediscouted	100
v.	Lease contracts entered into but yet to be executed	100
vi.	Sale and repurchase agreement and asset sales with	100

	recourse, where the credit risk remains with the NBFC.	
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 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 vides its notification number G.S.R 913(E), dated 29th December, 2011, made the following amendment in 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

* 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

differences arising on reporting of long term foreign currency monetary items till 31st March 2020 instead of 31st March 2012.

(Source: www.mca.gov.in)

(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.

(Source: www.mca.gov.in)

(v) Securities and Exchange Board of India (Merchant Bankers) (Second Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/17/26149 dated 16th August, 2011 had made amendment to the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992. These Regulations may be called as the Securities and Exchange Board of India (Merchant Bankers) (Second Amendment) Regulations, 2011. The following amendments have been made in regulation 14, sub-regulation (1) of the SEBI (Merchant Bankers) Regulations, 1992:

- (a) in clause (d), for the full stop, the figure “ ; ” shall be substituted;
- (b) after clause (d), the following new clause shall be inserted, namely:-
 - “(e) Records and documents pertaining to due diligence exercised in pre-issue and post-issue activities of issue management and in case of takeover, buyback and delisting of securities.”

(vi) Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/19/26273 dated 17th August, 2011 had made amendment to the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992. These Regulations may be called as the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2011. The following amendments have been made:

- (i) in regulation 17, in sub-regulation (1), clause (n) shall be substituted with the following, namely:-
 - “(n) Client account opening form in the format as may be specified by the Board.”
- (ii) in regulation 26, existing clause (xii), shall be substituted with the following, namely:-
 - “(xii) Failure to maintain client account opening form.”
- (iii) in Schedule II,
 - (a) under the head “Code of Conduct for Stock Brokers”, clause D shall be omitted.
 - (b) under the head “Code of Conduct for Sub-Brokers”, in clause C, sub-clause (4) shall be omitted.

(vii) Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board vide notification No. LAD-NRO/GN/2011-12/27668 dated 30th August, 2011 had made amendment to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996. These Regulations may be called as the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011. The SEBI (Mutual Funds) (Amendment) Regulations, 2011 can be downloaded from the link http://www.sebi.gov.in/cms/sebi_data/attachdocs/1315305030302.pdf

(viii) 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 be presumed as encouraged to follow by all the entities.

(ix) All Deposit taking NBFCs - CRAR Fifteen percent w.e.f March 31, 2012

In terms of paragraph 16 of Non Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, every deposit taking NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 12% of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items. However, in terms of paragraph 16 of Non Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, dated February 22, 2007, every systemically important non-deposit taking NBFC (NBFC-ND-SI) has to maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15% of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items by March 31, 2011.

RBI vide circular no. RBI/2010-11/408 DNBS.PD/CC.No.211 /03.02.002/2010-11 dated February 17, 2011 has decided to align the minimum capital ratio of all deposit taking as well as systemically important non-deposit taking NBFCs to 15%. Accordingly, all deposit taking NBFCs shall maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off-balance sheet items w.e.f. March 31, 2012.

(x) Amendment to Definition of Infrastructure Loan under Non-Banking Financial (Non-Deposit/Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

The term "Infrastructure Loan" has been defined in Para 2(viii) of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, respectively. It has now been decided to include "Telecom Towers" also as an infrastructure facility for availing credit facility. Thus, amendment of paragraph 2 of the said directions has been made as:

'In sub-clause (e) of clause (viii) in sub-paragraph (1) of the said Directions, the term "Telecom Towers" shall be inserted before the term "network of trunking".'

B. Not applicable for November, 2012 examination

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

The Ministry of Corporate Affairs (MCA) has issued 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 November, 2012 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 November, 2012 examination.

PART – II : QUESTIONS AND ANSWERS**QUESTIONS****Accounting Standards****AS-13**

1. (a) Lal Ltd. had made an investment of ₹ 500 lakhs in the equity shares of Nose Ltd. on 10.01.2012. The realisable value of such investment on 31.03.2012 became ₹ 300 lakhs as Yellow Ltd. lost a case of patent rights. Lal Ltd. follows financial year as accounting year. How will you recognize this reduction in financial statements for the year 2011-12.

AS-2

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

Find out the value of inventory when the selling price is (i) ₹ 175 and (ii) ₹ 225.

AS-6

- (c) In the Trial Balance of M/s. Aditya Ltd. as on 31-3-2012, balance of machinery appears ₹ 5,60,000. The company follows rate of depreciation on machinery @ 10% p.a. on Written Down Value Method. On scrutiny it was found that a machine appearing in the books on 1-4-2011 at ₹ 1,60,000 was disposed of on 30-9-2011 at ₹ 1,35,000 in part exchange of a new machine costing ₹ 1,50,000.

You are required to calculate:

- (i) Total depreciation to be charged in the Profit and Loss Account.
- (ii) Loss on exchange of machine.
- (iii) Book value of machinery in the Balance Sheet as on 31.3.2012.

AS-26

- (d) London International Ltd. is developing a new production process. During the financial year ending 31st March, 2011, the total expenditure incurred was ₹ 50 lakhs. This process met the criteria for recognition as an intangible asset on

1st December, 2010. Expenditure incurred till this date was ₹ 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2012 was ₹ 80 lakhs. As at 31st March, 2012, the recoverable amount of know-how embodied in the process is estimated to be ₹ 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

- (i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2011 and carrying value of intangible as on that date.
- (ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2012.

Ignore depreciation.

AS-19

2. (a) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.
 - (i) State with reason whether the lease constitutes finance lease.
 - (ii) Calculate unearned finance income.

AS-24

- (b) A cosmetic goods producer has changed the product line as follows:

	Day Cream	Night Cream
January 2011 – September, 2011 per month	2,00,000	2,00,000
October 2011 – December 2011 per month	1,00,000	3,00,000
January, 2012 – March, 2012 per month	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plant capacity. The Board of Directors of the Company has passed a resolution in March, 2011 to this effect. The company follows calendar year as its accounting year. Should it be treated as discontinuing operation?

AS-18

- (c) Ganga Ltd. sold goods for ₹ 90 lakhs to Yamuna Ltd. during financial year ended 31-3-2012. The Managing Director of Ganga Ltd. own 100% of Yamuna Ltd. The sales were made to Yamuna Ltd. at normal selling prices followed by Ganga Ltd.

The Chief accountant of Ganga Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

AS-28

- (d) Ego Ltd., purchased a Fixed Asset four years back at a cost of ₹ 100 lakhs and depreciates it on SLM basis at 10% per annum. At the end of this year, it has revalued the asset at ₹ 50 lakhs and has written off the loss on revaluation to the Profit and Loss Account. However, on the date of revaluation, the Market price is ₹ 45 lakhs and the expected disposal costs are ₹ 2 lakhs. What will be the treatment in respect of Impairment Loss on the basis that fair value for revaluation purposes is determined by market value and Value in Use is estimated at ₹ 40 lakhs?

AS-20

3. (a) Shree Co. Ltd. supplied the following information. You are required to compute the basic earning per share:

(Accounting year 1.1.2011 – 31.12.2011)	
Net Profit	: Year 2011 : ₹ 20,00,000
	: Year 2012 : ₹ 30,00,000
No. of shares outstanding prior to Right Issue	: 10,00,000 shares
Right Issue	: One new share for each four outstanding i.e., 2,50,000 shares.
	Right Issue price – ₹ 20
	Last date of exercise rights – 31.3.2012.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.2012	: ₹ 25

AS-25

- (b) Accountants of Neelam Ltd. show a net profit of ₹ 7,20,000 for the third quarter of 2012 after incorporating the following:
- Bad debts of ₹ 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
 - Extra ordinary loss of ₹ 35,000 incurred during the quarter has been fully

recognized in this quarter.

- (iii) Additional depreciation of ₹ 45,000 resulting from the change in the method of charge of depreciation.

Ascertain the correct quarterly income.

AS-22

- (c) Fame Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is ₹ 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.

AS-16

- (d) An amount of ₹ 20,00,000 was incurred for construction of a building and it was ready for occupation on 31.12.2012. The construction expenditure was incurred out of working capital facilities availed from the Bank. Interest payable to it @ 15% p.a. The average working capital loan has never fallen below ₹ 25 lakhs during the construction period.

The details of expenditure incurred are as follows:	(₹)
July 2012	3,00,000
August, 2012	4,50,000
September, 2012	2,00,000
October, 2012	5,00,000
November, 2012	3,00,000
December, 2012	<u>2,50,000</u>
	<u>20,00,000</u>

Calculate the value of the qualifying asset.

AS-11

4. (a) Nitin Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.2012 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.2012 and 31.12.2012 respectively. First instalment was paid on 31.12.2012. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

AS-4 & 5

- (b) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the

company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

AS 29

- (c) Ram Company has at its financial year ended 31st March, 2012 fifteen law suits outstanding none of the which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

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

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

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

AS 12

- (d) A limited company has set up its business in a designated backward area and is entitled to a capital subsidy of 15% under a scheme in force. Accordingly, it received a subsidy of ₹ 30 lakhs on an investment of ₹ 200 lakhs in the unit. The accountant would like to treat it as income and reduce the losses made in the first year of its operations ending with 31st March, 2009. You are asked to advise the accountant, whether his view is in conformity with AS 12.

IFRS

5. Explain the differences between IGAAP, US GAAP and IFRS with regard to
- True & Fair View;
 - Comparative Position;
 - Reporting Elements.

Revised Schedule VI

6. X Ltd is a company engaged in the business of manufacturing white & rose wine. The process of manufacturing white & rose wine takes around 2 years. Due to this reason X Ltd has prepared its financial statements considering its operating cycle as 2 years, and accordingly classified the raw material purchased & held in stock for less than 2 years as current asset. Comment on the accuracy of the decision and the treatment of asset by X Ltd as per revised Schedule VI?

Corporate Financial Reporting

7. On 30th September, 2009 Express Enterprises Ltd. was incorporated with an Authorised Capital of ₹ 50 lakhs. Its first accounts were closed on 31st March, 2010 by which time it had become a listed company with an issued, subscribed and paid up capital of ₹ 40 lakhs in 4,00,000 Equity Shares of ₹ 10 each.

The company started off with two lines of business namely 'Hardware Division' and 'Software Division', with equal asset base with effect from 1st April, 2010. The 'Chemicals Division' was added by the company on 1st April, 2011. The following data is gathered from the books of account of Express Enterprises Ltd.:

Trial Balance as on 31st March, 2012

(₹ in 000's)

	Dr.	Cr.
Hardware Division sales	–	6,000
Cost of Hardware Division sales	2,600	–
Software Division sales	–	8,000
Cost of sales of Software Division	4,300	–
Chemicals Division Sales	–	1,500
Cost of sales of Chemicals Division	900	–
Administration costs	2,000	–
Distribution costs	1,500	–
Dividend-Interim	1,200	–
Fixed Assets at cost	9,000	–
Depreciation on Fixed Assets	–	1,500
Stock on 31st March, 2012	400	–
Trade Debtors	440	–
Cash at Bank	160	–
Trade Creditors	–	500
Equity Share Capital in shares of ₹ 10 each	–	4,000
Retained Profits	–	1,000
	<u>22,500</u>	<u>22,500</u>

Additional Information:

- (a) Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.
- (b) Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.
- (c) Directors have proposed a Final Dividend of ₹ 800 thousands.
- (d) Some of the users of Chemicals Division are unhappy with the product and have lodged claims against the company for damages of ₹ 750 thousands. The claim is hotly contested by the company on legal advice.
- (e) Fixed Assets worth ₹ 3000 thousands were added in the Chemicals Division on 1.4.2011.
- (f) Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.
- (g) Income tax rate may be assumed at 35%.
- (h) During the year Hardware Division has sold to Alpha Ltd. goods having a sales value of ₹ 2500 thousands. Mr. Gamma, the Managing Director of Express Enterprises Ltd. owns 100% of the issued Equity Shares of Alpha Ltd. The sales made to Alpha Ltd. were at normal selling price of Express Enterprises Ltd.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2012 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards.

Corporate Restructuring - Buy back

8. The Balance Sheet of Ajay Ltd. as on 31.3.2012 is given:

(₹ in '000)

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

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

Corporate Restructuring – Absorption

9. The following are the summarized Balance Sheets of Sonu Ltd. and Monu Ltd. for the year ending on 31st March, 2012: (₹ in crores)

	Sonu Ltd.	Monu Ltd.
Equity share capital – in equity shares of ₹ 10 each	50	40
Preference share capital – in 10% preference shares of ₹ 100 each	-	60
Reserves and Surplus	<u>200</u>	<u>150</u>
	250	250
Loans – Secured	<u>100</u>	<u>100</u>
Total funds	<u>350</u>	<u>350</u>
Applied for: Fixed assets at cost less depreciation	150	150
Current assets	<u>200</u>	<u>200</u>
	<u>350</u>	<u>350</u>

The present worth of fixed assets of Sonu Ltd. is ₹ 200 crores and that of Monu Ltd. is ₹ 429 crores. Goodwill of Sonu Ltd. is ₹ 40 crores and of Monu Ltd. is ₹ 75 crores.

Monu Ltd. absorbs Sonu Ltd. by issuing equity shares at par in such a way that intrinsic net worth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

- Show the Balance Sheet after absorption.
- Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings.

Corporate Restructuring – Demerger

10. The summarized Balance Sheet of Ujala Ltd. as at 31st March, 2012 is given below. In it, the respective shares of the company's two divisions namely Big Division and Small Division in the various assets and liabilities have also been shown.

(₹ in crores)

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

Loan funds included, inter alia, Bank Loans of ₹ 15 crores specifically taken for Small Division and Debentures of the paid up value of ₹ 125 crores redeemable at any time between 1st October, 2011 and 30th September, 2012.

On 1st April, 2012 the company sold all of its investments for ₹ 102 crores and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to Big Division.

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

Axe Ltd. recorded in its books the fixed assets at ₹ 218 crores and all other assets and liabilities at the same values at which they appeared in the books of Ujala Ltd.

You are required to:

- (i) Show the journal entries in the books of Ujala Ltd.
- (ii) Prepare Ujala Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Axe Ltd.
- (iii) Calculate the intrinsic value of one share of Ujala Ltd. immediately before the demerger and immediately after the demerger; and
- (iv) Calculate the gain, if any, per share to the shareholders of Ujala Ltd. arising out of the demerger.

Consolidated Financial Statements

11. On 31st March, 2012 the summarized Balance Sheets of Rich Ltd. and its subsidiary Poor Ltd. stood as follows:

Liabilities	Rich Ltd. (₹ in lakhs)	Poor Ltd. (₹ in lakhs)
Share Capital:		
Authorised	<u>15,000</u>	<u>6,000</u>
Issued and Subscribed:		
Equity Shares of ₹ 10 each, fully paid up	12,000	4,800
General Reserve	2,784	1,380
Profit and Loss Account	2,715	1,620
Bills Payable	372	160
Sundry Creditors	1,461	854
Provision for Taxation	855	394
Proposed Dividend	<u>1,200</u>	<u>-</u>
	<u>21,387</u>	<u>9,208</u>
	Rich Ltd.	Poor Ltd.
Assets	(₹ in lakhs)	(₹ in lakhs)
Land and Buildings	2,718	-
Plant and Machinery	4,905	4,900
Furniture and Fittings	1,845	586
Investments in shares in Poor Ltd.	3,000	-
Stock	3,949	1,956
Debtors	2,600	1,363
Cash and Bank Balances	1,490	204

Bills Receivable	360	199
Sundry Advances	<u>520</u>	<u>-</u>
	<u>21,387</u>	<u>9,208</u>

The following information is also provided to you:

- (a) Rich Ltd. purchased 180 lakh shares in Poor Ltd. on 1st April, 2011 when the balances to General Reserve and Profit and Loss Account of Poor Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.
- (b) On 4th July, 2011 Poor Ltd. declared a dividend @ 20% for the year ended 31st March, 2011.
Rich Ltd. credited the dividend received by it to its Profit and Loss Account.
- (c) On 1st January, 2012 Poor Ltd. issued 3 fully paid-up shares for every 5 shares held as bonus shares out of balances to its general reserve as on 31st March, 2011.
- (d) On 31st March, 2012 all the bills payable in Poor Ltd.'s balance sheet were acceptances in favour of Rich Ltd. But on that date, Rich Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its creditors.
- (e) On 31st March, 2012, Poor Ltd.'s stock included goods which it had purchased for ₹ 100 lakh from Rich Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of Rich Ltd. and its subsidiary Poor Ltd. as at 31st March, 2012 bearing in mind the requirements of AS 21.

Financial Instruments

12. On 1 April, 2008 Delta Ltd. issued ₹ 30,00,000, 6 % convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.12 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%. Being compound financial instrument, you are required to separate equity and debt portion as on 01.04.08. The present value of Re. 1 receivable at the end of the end of each year based on discount rates of 6% and 10% can be taken as:

	6%	10%
End of year 1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

Employee Share Based Payments

13. At the beginning of year 1, an enterprise grants 300 options to each of its 1,000 employees. The contractual life (comprising the vesting period and the exercise period) of options granted is 6 years. The other relevant terms of the grant are as below:

Vesting Period 3 years

Exercise Period 3 years

Expected Life 5 years

Exercise Price ₹ 50

Market Price ₹ 50

Expected forfeitures per year 3%

The fair value of options, calculated using an option pricing model, is ₹ 15 per option. Actual forfeitures, during the year 1, are 5 per cent and at the end of year 1, the enterprise still expects that actual forfeitures would average 3 per cent per year over the 3-year vesting period. During the year 2, however, the management decides that the rate of forfeitures is likely to continue to increase, and the expected forfeiture rate for the entire award is changed to 6 per cent per year. It is also assumed that 840 employees have actually completed 3 years vesting period.

200 employees exercise their right to obtain shares vested in them in pursuance of the ESOP at the end of year 5 and 600 employees exercise their right at the end of year 6. Rights of 40 employees expire unexercised at the end of the contractual life of the option, i.e., at the end of year 6. Face value of one share of the enterprise is ₹ 10. Show the necessary journal entries.

Mutual Fund

14. .Luck Mutual Fund is registered with SEBI and having its registered office at Mumbai. The fund is in the process of finalising the annual statement of accounts of one of its open ended mutual fund schemes. From the information furnished below you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31st March, 2012.

	₹ '000
Opening Balance of net assets	12,00,000
Net Income for the year (Audited)	85,000
8,50,200 units issued during 2011-12	96,500
7,52,300 units redeemed during 2011-12	71,320
The par value per unit is ₹ 100	

NBFCs

15. From the following details of a Non-Banking Finance Company, compute the amount of provision against advances:

	₹.in lakhs
Standard assets	8,400
Sub-standard assets	670
Unsecured portions of doubtful debts	50
Loss assets	24

Valuation of Goodwill

16. From the following particulars of two companies, ascertain the value of goodwill. Terms and conditions are as follows:

- Assets are to be revalued.
- Goodwill is to be valued at four years' purchase of average super profits for three years. Such average is to be calculated after adjustment of depreciation at ten per cent on the amount of increase/decrease on revaluation of fixed assets. Income tax is to be ignored.
- Normal profit on capital employed is to be taken at 10 per cent, capital employed being considered on the basis of net revalued amounts of tangible assets.

The summarized Balance Sheets and relevant information are given below:

(Amount in lakhs)

Liabilities	X Ltd.	Y Ltd.	Assets	XLtd.	YLtd.
Equity shares of ₹ 10 each	12.00	14.00	Goodwill	-	1.00
Reserves	2.00	1.00	Net tangible block	16.00	12.00
10 percent debentures	4.00	-	Current assets	6.00	5.00
Trade and expenses creditors	4.00	3.00			
	22.00	18.00		22.00	18.00

	X Ltd.	Y Ltd..
	₹	₹
Revaluation of tangible block	20,00,000	10,00,000
Revaluation of current assets	7,00,000	2,80,000
Average annual profit for three years before charging debenture interest	3,60,000	2,88,000

Valuation of Share

17 The summarized Balance Sheet of Tirupati Limited as on 31.12.2012 is as follows:

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
1,00,000 equity shares of ₹ 10 each fully paid	10	Goodwill	5
1,00,000 equity shares of ₹ 6 each, fully paid up	6	Fixed assets	15
Reserves and Surplus	4	Other tangible assets	5
Liabilities	<u>10</u>	Intangible assets (market value)	3
	<u>30</u>	Miscellaneous expenditure to the extent not written off	<u>2</u>
			<u>30</u>

Fixed assets are worth ₹ 24 lakhs. Other Tangible assets are revalued at ₹ 3 lakhs. The company is expected to settle the disputed bonus claim of ₹1 lakh not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years' purchase of average super-profit for the last 4 year.

After tax, profits and dividend rates were as follows:

Year	PAT	Dividend %
	(₹ in lakhs)	
2009	3.0	11%
2010	3.5	12%
2011	4.0	13%
2012	4.1	14%

Normal expectation in the industry to which the company belongs is 10%.

C holds 20,000 equity shares of ₹10 each fully paid and 10,000 equity shares of ₹6 each, fully paid up. He wants to sell away his holdings.

Determine the break-up value and market value of both kinds of shares.

What should be the fair value of shares, if controlling interest is being sold?

Value Added Statement

18. Following is an extract of Profit & Loss Account of Aman Ltd. for the year ended 31st March, 2012.

Particulars	₹ 000s
Sales (including Excise Duty Recoveries)	1,454
Other Income	<u>26</u>
Total	<u>1,480</u>
Materials	1,060
Excise Duty	124
Salaries, Wages & Employee Benefits	38
Other Expenses	94
Interest & Finance Charges	14
Depreciation	10
Provision for Taxation	62
Preliminary Expenses written off	10
Transfer to Debenture Redemption Reserve	10
Proposed Dividend	10
Transfer to General Reserve	<u>48</u>
Total	<u>1,480</u>

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

Prepare a Value Added Statement for the year ended 31st March, 2012. Also show statement showing application of value added.

Economic Value Added

19. OM Commercial Bank has a criterion that it will give loan to companies that have an economic value added greater than zero for the past three years on average. The bank is considering lending money to a small company that has the economic value characteristics shown below. Does that company meet the bank's criterion for a positive economic value added? The data relating to the company is as follows:
- (i) Average operating income after tax equals ₹ 25,00,000 per year for the last three years.
 - (ii) The average total assets of company over the past three years equals ₹ 75,00,000.

- (iii) The weighted average cost of capital appropriate for the company equals 10% which is applicable to all three years.
- (iv) The company's average current liabilities over the past three year equals ₹ 15,00,000.
- (v) Human Resources Accounting
20. From the following details, compute according to Lev and Schwartz (1971) model, the value of human resources of the employees.

(i)	Annual average earnings of an employee till the retirement age		₹ 30,000
(ii)	Age of retirement		62 years
(iii)	Discount rate		15%
(iv)	No. of employees		50
(v)	Average age		60 years

SUGGESTED ANSWERS/HINTS

Answer

1. (a) Recognition of reduction in value of investment would depend upon the nature of investment and nature of decline as per Accounting Standard 13 "Accounting for Investments". As per provisions of the standard, if the investments were acquired for long term and decline is temporary in nature, reduction in value will not be recognized and investments would be carried at cost. If the decline is of permanent nature, it will be charged to profit and loss account. If the investments are current investments, then the reduction should be recognized and charged to Profit and Loss Account as the current investments are carried at cost or fair value, whichever is less.
- (b) As per para 24 of AS 2 'Valuation of Inventories', materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.
 - (i) Raw material inventory would be valued at net realisable value i.e. ₹75 because the selling price of the finished product is less than ₹ 225 (100+125) per kg.

- (ii) When selling price is ₹ 225 - Raw material inventory would be valued at ₹100 per kg because the selling price of the finished product is not less than ₹ 225.
- (c) (i) Total Depreciation to be charged in the Profit and Loss Account

	₹
Depreciation on old machinery in use [10% of (5,60,000-1,60,000)]	40,000
Add: Depreciation on new machine @ 10% for six months	
$\frac{\text{₹} 1,50,000 \times 10\% \times \frac{6}{12}}{\text{₹}}$	<u>7,500</u>
Total depreciation on machinery in use	47,500
Add: Depreciation on machine disposed of (10% for 6 months)	
$\frac{\text{₹} 1,60,000 \times 10\% \times \frac{6}{12}}{\text{₹}}$	<u>8,000</u>
So, total depreciation to be charged in Profit and Loss A/c	<u>55,500</u>

- (ii) Loss on Exchange of Machine

	₹
Book value of machine as on 1.4.2011	1,60,000
Less: Depreciation for 6 months @ 10%	<u>(8,000)</u>
Written Down Value as on 30.9.2011	1,52,000
Less: Exchange value	<u>(1,35,000)</u>
Loss on exchange of machine	<u>17,000</u>

- (iii) Book Value of Machinery in the Balance Sheet as on 31.03.2012

	₹
Balance as per trial balance	5,60,000
Less: Book value of machine sold	<u>(1,60,000)</u>
	4,00,000
Add: Purchase of new machine	<u>1,50,000</u>
	5,50,000
Less: Depreciation on machinery in use	<u>(47,500)</u>
	<u>5,02,500</u>

(d) As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2011

(1) Carrying value of intangible as on 31.03.2011:

At the end of financial year 31st March 2011, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2010).

(2) Expenditure to be charged to Profit and Loss account:

The ₹ 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2011. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2012

(1) Expenditure to be charged to Profit and Loss account:

	(₹ in lakhs)
Carrying Amount as on 31.03.2011	28
Expenditure during 2011 – 2012	<u>80</u>
Total book cost	108
Recoverable Amount	<u>72</u>
Impairment loss	<u>36</u>

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2012.

(2) Carrying value of intangible as on 31.03.2012:

	(₹ in lakhs)
Total Book Cost	108
Less: Impairment loss	<u>36</u>
Carrying amount as on 31.03.2012	<u>72</u>

2. (a) (i) Present value of residual value = ₹ 40,000 × 0.7513 = ₹ 30,052

Present value of lease payments = ₹ 3,00,000 – ₹ 30,052 = ₹ 2,69,948.

The present value of lease payments being 89.98% $\frac{2,69,948}{3,00,000} \times 100$ of the fair value, i.e. being a substantial portion thereof, the lease constitutes a finance lease.

(ii) Calculation of unearned finance income

	₹
Gross investment in the lease $[(₹ 1,08,552 \times 3) + ₹ 40,000]$	3,65,656
Less: Cost of the equipment	<u>3,00,000</u>
Unearned finance income	<u>65,656</u>

Note: - In the above solution, annual lease payment has been determined on the basis that the present value of lease payments plus residual value is equal to the fair value (cost) of the asset.

- (b) Business enterprises frequently close facilities, abandon products, or even product lines, and reduce the size of their workforce in response to market forces. These kinds of terminations, generally, are not in themselves discontinuing operations unless they satisfy the definition criteria. By gradually reducing the size of operations in the product line of Day Cream, the company has increased its scale of operations in Night Cream. Such a change is a gradual or evolutionary, phasing out of a product line or class of services does not meet definition criteria in paragraph 3(a) of AS 24 – namely, disposing of substantially in its entirety, a component of the enterprise. Hence, changeover is not a discontinuing operation.
- (c) As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Ganga Ltd. and Yamuna Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Ganga Ltd is wrong.

(d) Recognition of Loss on Revaluation:

Particulars	Computation	₹ in lakhs
(1) Original Cost of the Asset	Given	100.00
(2) Accumulated Depreciation for four years	$100 \times 10\% \times 4 \text{ years}$	40.00
(3) Carrying amount before Revaluation	Net Book Value (1)-(2)	60.00
(4) Fair Value = Revalued amount	Given	50.00

$$* \text{ Annual lease payments} = \frac{\text{Rs. } 2,69,948}{2.4868} = \text{Rs. } 1,08,552 \text{ (approx.)}$$

(5) Loss on Revaluation debited to Profit and Loss Account (3) – (4)	10.00	
(6) Carrying amount after revaluation	(3) – (5) [or] Fair Value (Market Value)	50.00

Recognition of Impairment Loss:

	₹ In lakhs
(1) Net Selling Price = Market Value – Disposal Costs = ₹ 45 lakhs – ₹ 2 lakhs	43
(2) Value in use	40
(3) Recoverable Amount = Net Selling Price or Value in Use, whichever is higher	43
(4) Carrying Amount after revaluation	50
(5) Impairment Loss = Carrying amount less Recoverable Amount.	7

3. (a) Computation of Basic Earnings Per Share

(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 2011	Year 2012
	₹	₹
EPS for the year 2011 as originally reported = $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = (₹ 20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 2011 restated for rights issue = [₹ 20,00,000 / (10,00,000 shares × 1.04*)]	1.92 (approx.)	
EPS for the year 2012 including effects of rights issue $\frac{\text{₹ 30,00,000}}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$ $\frac{\text{₹ 30,00,000}}{11,97,500 \text{ shares}}$		2.51 (approx.)

* Refer working note 2.

Working Notes:**1. Computation of theoretical ex-rights fair value per share**

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$= \frac{(\text{₹ } 25 \times 10,00,000 \text{ shares}) + (\text{₹ } 20 \times 2,50,000 \text{ shares})}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}}$$

$$= \frac{\text{₹ } 3,00,00,000}{12,50,000 \text{ shares}} = \text{₹ } 24$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}}$$

$$= \frac{\text{₹ } 25}{\text{₹ } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

- (b) In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of ₹ 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹ 20,000 to the next quarter. Therefore, ₹ 20,000 should be deducted from ₹ 7,20,000. The treatment of extra-ordinary loss of ₹ 35,000/- being recognized in the same quarter is correct.

Recognising additional depreciation of ₹ 45,000 in the same quarter is in tune with AS 25. Hence, no adjustments are required for these two items.

Neelam Ltd should report quarterly income as ₹ 7,00,000 (₹ 7,20,000 – ₹ 20,000).

- (c) In the case of tax free companies, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

Of ₹ 200 lakhs, ₹ 80 lakhs will reverse in the tax holiday period. Therefore, Deferred Tax Liability will be created on ₹ 120 lakhs @ 35% (i.e.) ₹ 42 lakhs.

In the second year, the entire ₹ 400 lakhs will reverse only after the tax holiday period.

Therefore, deferred tax charge in the Profit and Loss Account will be ₹ 400 x 35% = 140 lakhs and deferred tax liability in the Balance Sheet will be (42+140) = ₹ 182 lakhs.

(d)

Month	Expenditure on qualifying asset	Interest	Cumulative expenditure including interest
July 2012	3,00,000		3,00,000
August, 2012	4,50,000	3,750	7,53,750
September, 2012	2,00,000	9,422	9,63,172
October, 2012	5,00,000	12,040	14,75,212
November, 2012	3,00,000	18,440	17,93,652
December, 2012	<u>2,50,000</u>	<u>22,421</u>	20,66,073
Total	<u>20,00,000</u>	<u>66,073</u>	

The value of the qualifying asset is ₹ 20,66,073.

- 4 (a) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{\text{₹ 3,000 lakhs}}{\text{₹ 40}} = 75 \text{ lakhs US Dollars}$$

$$\text{Exchange difference} = 75 \text{ lakhs US Dollars} \times (42.50 - 40.00) = \text{₹ 187.50 lakhs}$$

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 187.50 lakhs should be charged to profit and loss account for the year.

- (b) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be

considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

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

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

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

Expected loss in first ten cases	=	$\text{₹ } 90,000 \times 0.3 + \text{₹ } 1,60,000 \times 0.1$
	=	$\text{₹ } 43,000 \times 10$
	=	$\text{₹ } 4,30,000$
Expected loss in remaining five cases	=	$\text{₹ } 60,000 \times 0.3 + \text{₹ } 95,000 \times 0.2$
	=	$\text{₹ } 37,000 \times 5$
	=	$\text{₹ } 1,85,000$
Total Contingent Liability	=	$\text{₹ } 4,30,000 + \text{₹ } 1,85,000 = \text{₹ } 6,15,000$

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

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

5. (a) **True & Fair View:** Under IFRS and IGAAP framework, there is an assumption that adoption of IFRS /IGAAP leads to a true and fair presentation, there is no such assumption under US GAAP.
- (b) **Comparative Position:** Under IGAAP and IFRS, comparative financial figures are to be provided for one previous years, whereas under USGAAP (SEC requirement for listed companies) comparatives are to be provided for two previous years except for Balance Sheet.
- (c) **Reporting Elements -** IFRS prescribes the minimum structure and content of financial statement including Statement of Changes in equity (in addition to Balance sheet, Income statement, Cash flow statement ,notes comprising significant accounting Policy and other explanatory notes). Under US GAAP in addition to statement of changes in Equity, Statement of Comprehensive Income is required. Both of these statements are not required under IGAAP.
6. As per revised schedule VI, "an operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents".

In the above given case, the process of manufacturing of white and rose wine takes around 2 years, therefore, its realisation into cash and cash equivalents will be done only when it is ready for sale i.e. after two years. Hence, we cannot take operating cycle of this product as 12 months. Therefore, the contention of the company's management is correct that the operating cycle of the product white and rose wine is two years and not 12 months (as presumed in general circumstances).

7. **Express Enterprises Ltd.**

Profit and Loss Account for the year ending 31st March, 2012

	<i>Particulars</i>	<i>Note No.</i>	<i>(₹ '000)</i>
I.	Revenue from operations (6,000 + 8,000 + 1,500)		15,500
II.	Total revenue		15,500
III.	Expenses		
	Cost of Sales		(7,800)
	Distribution costs		(1,500)
	Administration costs		(2,000)
	Total expenses		11,300
IV.	Profit before tax		4,200
V.	Tax Expenses		

	Current tax	1,239		
	Deferred tax	<u>231</u>		1,470
VI.	Profit or Loss for the period			2,730

Express Enterprises Ltd.
Balance Sheet as at 31st March, 2012

Particulars	Note No.	(₹ '000)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	4,000
(b) Reserves and Surplus	2	1,195.55
(2) Current Liabilities		
Trade payables		500
Other current liabilities	3	1,565.45
Short term provisions	4	1,239
Total		8,500
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	5	7,500
(2) Current assets		
(a) Inventories		400
(b) Trade receivables		440
(c) Cash and cash equivalents		160
Total		8,500

Notes to Accounts:

		(₹ '000)	(₹ '000)
1.	Share Capital		
	Authorised Share capital		
	5,00,000 Equity shares of ₹ 10 each		<u>5,000</u>

	Issued and subscribed 4,00,000 shares of ₹ 10 each, fully paid up		<u>4,000</u>
2.	Reserves and surplus		
	Retained profit brought forward (₹ 1,000 – ₹ 210)		790
	Profit after tax of the current year	2,730	
	Amount transferred to General Reserve* (10% of ₹ 2,730)	(273)	
	Amount transferred to CDT** (16.2225% of ₹ 2,000)	(324.45)	
	Dividends (₹ 1,200 + ₹ 800)	<u>(2,000)</u>	
	Profit for the year		<u>132.55</u>
	Total Profit		922.55
	Reserves		<u>273</u>
			<u>1,195.55</u>
3.	Other current liabilities		
	Proposed dividend	800	
	Dividend Distribution Tax	324.45	
	Deferred Tax Liability (₹ 210 + ₹ 231)	<u>441</u>	<u>1,565.45</u>
4.	Short term provisions		
	Provision for tax		<u>1,239</u>
5.	Tangible assets		
	Fixed Assets		
	Gross block	9,000	
	Less: Depreciation	<u>(1,500)</u>	<u>7,500</u>

* As per Companies (Transfer of Profits to Reserves) Rules, the amount to be transferred to the reserves shall not be less than 10% of the current profits since proposed dividend exceeds 20% of the paid up capital.

** The dividend distributed by an Indian Company is exempt from income tax in the hands of shareholders. However, the Indian company is liable to pay Dividend Distribution Tax (DDT) @ 16.2225% (i.e. inclusive of surcharge and education cess on such dividend).

Disclosures

1. Segmental Disclosures (Business Segments)

(₹ in '000)

	Hardware Division	Software Division	Chemical division	Total
Sales	<u>6,000</u>	<u>8,000</u>	<u>1,500</u>	<u>15,500</u>
Cost of Sales	2,600	4,300	900	7,800
Administration Cost (5:3:2)	1,000	600	400	2,000
Distribution Cost (3:1:1)	900	300	300	1,500
Profit/Loss	<u>1,500</u>	<u>2,800</u>	<u>(100)</u>	<u>4,200</u>
	<u>6,000</u>	<u>8,000</u>	<u>1,500</u>	<u>15,500</u>
Original cost of Assets (Equal Capital Base)	3,000	3,000	3,000	9,000
Depreciation @ 10% p.a.				
For the year ended 31.3.2011	300	300	NIL	600
For the year ended 31.3.2012	300	300	300	900

Note: Chemicals division is a reportable segment as per assets criteria.

2. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

	₹ in '000
Opening Timing Difference on 1.4.2011	
WDV of fixed assets as per books	5,400
WDV of fixed assets as per Income Tax Act	<u>4,800</u>
Difference	<u>600</u>
Deferred Tax Liability @ 35% on ₹ 600	210
This has been adjusted against opening balance of retained profits.	
Current year (ended 31st March, 2012)	(₹ in '000)
Depreciation as per books	900
Depreciation as per Income Tax Act (₹ 480 + ₹ 480 + ₹ 600)	<u>1,560</u>
Difference	<u>660</u>
Deferred Tax Liability @ 35% on ₹ 660 (to be carried forward)	231

3. **Contingent Liabilities not provided:** Company is contesting claim for damages for ₹ 7,50,000 and as such the same is not acknowledged as debts.
4. **Related Party Disclosure:** Para 3 of AS 18 lists out related party relationships. It includes individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises, and relatives of any such individual. In the instant case, Mr. Gamma as a managing director controls operating and financial actions of Express Enterprise Ltd. He is also owning 100% share capital of Alpha Ltd. thereby exercising control over it. Hence, Alpha Ltd. is a related party as per para 3 of AS 18.

Disclosure to be made:

Name of the related party	Alpha Ltd.
Nature of relationship	common director
Nature of the transaction	Sale of goods at normal commercial terms
Volume of the transaction	Sales to Alpha Ltd. worth ₹ 2500 thousands

Working Note:

Tax computation

	(₹ in '000)
Profit before tax for the year ended 31.3.2012	4,200
Add: Depreciation provided in the books (₹ 300 + ₹ 300 + ₹ 300)	<u>900</u>
	5,100
Less: Depreciation as per Income Tax Act (₹ 480 + ₹ 480 + ₹ 600)	<u>(1,560)</u>
Taxable Income	<u>3,540</u>
Tax at 35% on ₹ 3,540	<u>1,239</u>

8. **In the books of Ajay Ltd.**

Journal Entries for Buy-back of shares

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

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

9. (a)

Monu Ltd.
Balance Sheet as at 1st April, 2012

Particulars	Note No.	(₹ in crores)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	125
(b) Reserves and Surplus	2	375
(2) Non-Current Liabilities		
Long-term borrowings	3	200
Total		700
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	4	300
(2) Current assets	5	400
Total		700

Notes to Accounts

		(₹ in Crores)	(₹ in Crores)
1.	Share Capital		
	6.5 crores equity shares of ₹ 10 each (of the above shares, 2.5 crores equity shares are allotted as fully paid-up for consideration other than cash)	65	
	60 lakhs 10% Preference shares of ₹ 100 each	<u>60</u>	125
2.	Reserves and surplus		
	As per last Balance Sheet	150	
	Capital Reserve	<u>225</u>	375
3.	Long Term Borrowings		
	Secured Loans:		
	As per last Balance Sheet	100	
	Taken over on absorption of Sonu Ltd.	<u>100</u>	200
4.	Tangible Assets		
	As per last Balance Sheet	150	
	Taken over on absorption of Sonu Ltd.	<u>150</u>	300
5.	Current assets		
	As per last Balance Sheet	200	
	Taken over on absorption of Sonu Ltd.	<u>200</u>	400

(b) Valuation of shares on intrinsic value basis

(i)	Sonu Ltd.	Monu Ltd.
	(₹ in crores)	
Equity share capital	50	40
Reserves and Surplus	<u>200</u>	<u>150</u>
	250	190
Goodwill agreed upon	40	75
Increase in the value of fixed assets (Present worth less book value)	<u>50</u>	<u>279</u>
	<u>340</u>	<u>544</u>

(ii)	Sonu Ltd.	Monu Ltd.
Number of Equity shares	5 crores	4 crores
Intrinsic value per equity share	₹ 68	₹ 136
(iii) Ratio of intrinsic value of shares in the two companies	1 : 2	

Since the shares are to be issued at par, the number of equity shares of ₹ 10 each to be issued to maintain the intrinsic net worth = 5 crores / 2 = 2.5 crores

(iv) Statement to prove the accuracy of workings

		(₹ in crores)	
(1)	Equity share capital (after absorption)		65
	Reserves and Surplus (after absorption)		<u>375</u>
			440
	Add: Unrecorded value of goodwill ₹ (40 + 75)		115
	Add: Unrecorded incremental value of fixed assets ₹ (50+279)		<u>329</u>
			<u>884</u>
(2)	Number of equity shares	6.5 crores	
(3)	Intrinsic value of an equity share (884/6.5)	₹ 136	

Working Note:

Calculation of Capital Reserve on Absorption

	(₹ in crores)
Fixed Assets taken over	150
Net current assets taken over	<u>200</u>
	350
Less: Secured loans taken over	<u>(100)</u>
Net Assets taken over	250
Less: Purchase consideration	<u>(25)</u>
Capital Reserve	<u>225</u>

10. (i) Journal Entries in Ujala Ltd.'s books

(₹ in crores)

	Dr.	Cr.
	Amount	Amount
Bank Account (Current Assets) Dr.	102	
To Investments		97
To Profit and Loss Account (Reserves and Surplus)		5
(Sale of investments at a profit of ₹ 5 crores)		
Debentures (Loan Funds) Dr.	125	
To Bank Account (Current Assets)		125
(Redemption of debentures at par)		
Current Liabilities Dr.	93	
Bank Loan (Loan Funds) Dr.	15	
Provision for Depreciation Dr.	81	
Reserves and Surplus (Loss on Demerger) Dr.	645	
To Fixed Assets		249
To Current Assets		585
(Assets and liabilities pertaining to Small Division taken out of the books on transfer of the division to Axe Ltd.)		

(ii) (a) Ujala Ltd.'s Balance Sheet after demerger

Particulars	Note No.	(₹ in crores)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		345
(b) Reserve and Surplus	1	45
(2) Non-Current Liabilities		
Long-term borrowings	2	277
(3) Current Liabilities		270
Total		937
II. Assets		
(1) Non-current assets		

Fixed assets		
Tangible assets		515
(2) Current assets	3	422
Total		937

Notes to Accounts:

	(₹ in crores)
1. Reserves and Surplus	
Balance as on 31st March, 2012	685
Add: Profit on sale of investments	<u>5</u>
	690
Less: Loss on demerger	<u>(645)</u>
Balance shown in balance sheet after demerger	<u>45</u>
2. Loan Funds	
Balance as on 31st March, 2012	417
Less: Bank Loan transferred to Axe Ltd. 15	
Debentures redeemed <u>125</u>	<u>(140)</u>
Balance shown in balance sheet after demerger	<u>277</u>
3. Current Assets	
Balance as on 31st March, 2012	445
Add: Cash received from sale of investments	<u>102</u>
	547
Less: Cash paid to redeem debentures	<u>(125)</u>
Balance in balance sheet after demerger	<u>422</u>

(b) Initial Balance Sheet of Axe Ltd.

Particulars	Note No.	(₹ in crores)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	690
(b) Reserves and Surplus	2	5
(2) Non-Current Liabilities		
Long-term borrowings	3	15

(3) Current Liabilities		93
	Total	803
II. Assets		
(1) Non-current assets		
Fixed assets		218
(2) Current assets		585
	Total	803

Notes to Accounts:

1. Share Capital

	(₹ in crores)
Authorised capital	
90 crores Equity shares of ₹ 10 each	<u>900</u>
Issued and subscribed capital	
69 crores Equity shares of ₹ 10 each	<u>690</u>
(issued for consideration other than cash)	

2. Reserves and Surplus

	(₹ in crores)
Capital Reserve	
Purchase consideration	690
Less: Assets transferred	710
Loan funds transferred	<u>(15)</u>
Capital reserve	<u>5</u>

3. Long-term borrowing

Loan Funds	15
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(iii) Calculation of intrinsic value of one share of Ujala Ltd.

	₹ in crores
Before demerger	
Fixed Assets	683
Net current assets ₹ (667 + 102 – 125)	<u>644</u>
	1,327

Less: Loan funds ₹ (417 – 125)	<u>(292)</u>
	<u>1,035</u>
Intrinsic Value per share = ₹ $\frac{1,035 \text{ crores}}{34.5 \text{ crores}}$ = ₹ 30 per share	
<i>After demerger</i>	
Fixed Assets	515
Net Current Assets ₹ (175 + 102 – 125)	<u>152</u>
	667
Less: Loan funds	<u>(277)</u>
	<u>390</u>

$$\text{Intrinsic Value of one share} = ₹ \frac{390 \text{ crores}}{34.5 \text{ crores}} = ₹ 11.30 \text{ per share}$$

(iv) Gain per share to Shareholders:

After demerger, for every share in Ujala Ltd. the shareholder holds 2 shares in Axe Ltd.

	₹
Value of one share in Ujala Ltd.	11.30
Value of two shares in Axe Ltd. (₹ 10 × 2)	<u>20.00</u>
	31.30
Less: Value of one share before demerger	<u>(30.00)</u>
Gain per share	<u>1.30</u>

The gain per share amounting ₹ 1.30 is due to appreciation in the value of fixed assets by Axe Ltd.

11. Consolidated Balance Sheet of Rich Ltd.
and its subsidiary Poor Ltd. as on 31st March, 2012

Particulars	Note No.	(₹ in Lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) Minority Interest [W. No. 6]		3,120
(3) Current Liabilities		
(a) Trade payables	3	2,802

(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	6	14,954
(2) Current assets		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Cash and cash equivalents	9	1,694
(d) Short term loans and advances	10	520
Total		27,530

Notes to Accounts

		(₹ in lacs)	(₹ in lacs)
1.	Share Capital		
	Authorised		<u>15,000</u>
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up		12,000
2.	Reserves and surplus		
	Capital Reserve (Note 5)	1,320	
	General Reserve (₹ 2,784 + 108)	2,892	
	Profit and Loss Account:		
	Rich Ltd. ₹ 2,715		
	Less: Dividend wrongly credited ₹ 360		
	Unrealised Profit ₹ <u>20</u> (₹ 380)		
	₹ 2,335		
	Add: Share in Poor Ltd.'s		
	Revenue profits ₹ <u>612</u>	<u>2,947</u>	7,159
3.	Trade payables		
	Bills Payable		
	Rich Ltd. ₹ 372		

	Poor Ltd.	₹ <u>160</u>		
		₹ 532		
	Less: Mutual owing	₹ <u>(45)</u>	487	
	Sundry Creditors			
	Rich Ltd.	1,461		
	Poor Ltd.	<u>854</u>	<u>2,315</u>	2,802
4.	Short term provisions			
	Provision for Taxation			
	Rich Ltd..		855	
	Poor Ltd.		<u>394</u>	1,249
5.	Other current liabilities			
	Proposed Dividend			
	Rich Ltd..			1,200
6.	Tangible assets			
	Land and Buildings			
	Rich Ltd..		2,718	
	Plant and Machinery			
	Rich Ltd..	₹ 4,905		
	Poor Ltd.	₹ <u>4,900</u>	9,805	
	Furniture and Fittings			
	Rich Ltd...	₹ 1,845		
	Poor Ltd.	₹ <u>586</u>	2,431	14,954
7.	Inventories			
	Stock			
	Rich Ltd..		3,949	
	Poor Ltd.		<u>1,956</u>	
			5,905	
	Less: Unrealised profit		<u>(20)</u>	5,885
8.	Trade receivables			
	Debtors			
	Rich Ltd..	₹ 2,600		
	Poor Ltd.	₹ <u>1,363</u>	3,963	

	Bills Receivable			
	Rich Ltd..	₹ 360		
	Poor Ltd.	₹ <u>199</u>		
		₹ 559		
	Less: Mutual Owing	₹ <u>(45)</u>	<u>514</u>	4,477
9.	Cash and cash equivalents			
	Cash and Bank Balances			
	Rich Ltd..		1,490	
	Poor Ltd.		<u>204</u>	1,694
10.	Short term loans and advances			
	Sundry Advances			
	Rich Ltd..			520

Working Notes:

1. Poor Ltd.'s General Reserve Account

	₹ in lakhs		₹ in lakhs
To Bonus to Equity Shareholders	1,800	By Balance b/d	3,000
To Balance c/d	1,380	By Profit and Loss A/c	180
	—	(Balancing figure)	—
	<u>3,180</u>		<u>3,180</u>

2. Poor Ltd.'s Profit and Loss Account

	₹ in lakhs		₹ in lakhs
To General Reserve	180	By Balance b/d	1,200
To Dividend paid		By Net Profit for the	
(20% on ₹3,000 lakhs)	600	year*	1,200
To Balance c/d	<u>1,620</u>	(Balancing figure)	—
	<u>2,400</u>		<u>2,400</u>

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of Rich Ltd. 60%	(720)
(General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	<u> </u>
Share of Minority Shareholders (40%)	<u>480</u>

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 – ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (₹ 1,200 – ₹ 600)	<u>600</u>
	<u>1,800</u>

Rich. Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

	₹ in lakhs
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits	<u>1,080</u>
	3,960
Less: Cost of shares less dividend received (₹ 3,000 – ₹ 360)	<u>(2,640)</u>
Capital reserve	<u>1,320</u>

6. Calculation of Minority Interest

	₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits	480
Share in capital profits	<u>720</u>
	<u>3,120</u>

7. Unrealised profit in respect of stock

$$₹ 100 \text{ lakhs} \times \frac{25}{125} = ₹ 20 \text{ lakhs}$$

12.

Separation of Equity and Debt Portion	₹
Present value of the principal repayable in 4 Years $30,00,000 \times 1.10 \times 0.68$ (10% Discount factor)	22,44,000
Present value of Interest 1,80,000 x 3.17 (4 years cumulative 10% discount factor)	<u>5,70,600</u>
Total liability component (Debt Portion)	<u>28,14,600</u>
Equity Portion (Balance)	1,85,400
Proceeds of the issue	<u>30,00,000</u>

13.

Year 1	Employee compensation expense A/c Dr.	13,69,010	
	To Stock Options Outstanding A/c (Being compensation expense recognised in respect of the ESOP)		13,69,010
Year 2	Employee compensation expense A/c Dr.	11,22,740	
	To Stock Options Outstanding A/c (Being compensation expense recognised in respect of the ESOP)		11,22,740
Year 3	Employee compensation expense A/c Dr.	12,88,250	
	To Stock Options Outstanding A/c (Being compensation expense recognised in respect of ESOP)		12,88,250
Year 5	Bank A/c @ ₹ 50 Dr.	30,00,000	
	Stock Options Outstanding A/c @ ₹ 15 Dr.	9,00,000	
	To Share Capital A/c @ ₹ 10		6,00,000
	To Securities Premium A/c @ ₹ 55		33,00,000
	(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)		
Year 6	Bank A/c @ ₹ 50 Dr.	90,00,000	
	Stock Options Outstanding A/c @ ₹ 15 Dr.	27,00,000	
	To Share Capital A/c @ ₹ 10		18,00,000

	To Securities Premium A/c @ ₹ 55 (Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)		99,00,000
	Stock Options Outstanding A/c Dr. To General Reserve (Being the balance standing to the credit of the Stock Options Outstanding Account, in respect of vested options expired unexercised, transferred to the general reserve)	1,80,000	1,80,000

Working Notes:

1. The enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below:

No. of options expected to vest = $300 \times 1,000 \times 0.97 \times 0.97 \times 0.97 = 2,73,802$ options

Fair value of options expected to vest = $2,73,802 \text{ options} \times ₹ 15 = ₹ 41,07,030$

2. As the enterprise still expects actual forfeitures to average 3 per cent per year over the 3-year vesting period, therefore, it recognizes ₹ 41,07,030/3 towards the employee services.

3. The revised number of options expected to vest

= $2,49,175 (3,00,000 \times .94 \times .94 \times .94)$.

The fair value of revised options expected to vest

= ₹ 37,37,625 ($2,49,175 \times ₹ 15$).

The expense to be recognised during the year is determined as below:

Revised total fair value ₹ 37,37,625

Revised cumulative expense at the end of year 2

= (₹ 37,37,625 $\times 2/3$) ₹ 24,91,750

Less: Expense already recognised in year 1 ₹ 13,69,010

Expense to be recognised in year 2 ₹ 11,22,740

4. The expense to be recognised during the year is determined as below:

No. of options actually vested = $840 \times 300 = 2,52,000$

Fair value of options actually vested ($\text{₹ } 2,52,000 \times \text{₹ } 15$) =	$\text{₹ } 37,80,000$
Expense already recognised	<u>$\text{₹ } 24,91,750$</u>
Expense to be recognised in year 3	<u>$\text{₹ } 12,88,250$</u>

14. Statement showing the Movement of Unit Holders' Funds
for the year ended 31st March, 2012

	(₹'000)
Opening balance of net assets	12,00,000
Add: Par value of units issued ($8,50,200 \times \text{₹ } 100$)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working Note)	<u>15,390</u>
	13,85,410
Less: Par value of units redeemed ($7,52,300 \times \text{₹ } 100$)	<u>75,230</u>
Closing balance of net assets (as on 31 st March, 2012)	<u>13,10,180</u>

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
	₹ 000	₹ 000
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve /Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund (issued & Redeemed)	15,390	

15. Calculation of provision required on advances as on 31st March, 2012:

	Amount ₹ in lakhs	Percentage of provision	Provision ₹ in lakhs
Standard assets	8,400	0.25	21
Sub-standard assets	670	10	67
Unsecured portions of doubtful debts	50	100	50
Loss assets	24	100	<u>24</u>
			<u>162</u>

16. Valuation of Goodwill

	X Ltd.	Y Ltd.
	₹	₹
Average annual profit after charging debenture interest	3,20,000	2,88,000

Less/Add : Depreciation on amount increased/decreased on revaluation	(-)40,000	+20,000
	2,80,000	3,08,000
Less: Normal profit at 10% on capital employed as calculated in working note	1,90,000	98,000
Super Profit	90,000	2,10,000
Goodwill valued at four years' purchase of super profits	3,60,000	8,40,000

Working Note:

Calculation of Capital Employed

	X Ltd..	Y Ltd.
	₹	₹
Tangible fixed assets	20,00,000	10,00,000
Current assets	7,00,000	2,80,000
	27,00,000	12,80,000
Less: Debentures and Creditors	<u>8,00,000</u>	<u>3,00,000</u>
	<u>19,00,000</u>	<u>9,80,000</u>

$$17. (i) \text{ Break up value of ₹1 of share capital} = \frac{\text{₹ 28.98}}{\text{₹ 16.00}} = \text{₹ 1.81}$$

$$\text{Break up value of ₹ 10 paid up share} = \text{₹ 1.81} \times \text{₹ 10} = \text{₹ 18.10}$$

$$\text{Break up value of ₹ 6 paid up share} = \text{₹ 1.81} \times \text{₹ 6} = \text{₹ 10.86}$$

Market value of shares:

$$\text{Average dividend} = \frac{11\% + 12\% + 13\% + 14\%}{4} = 12.5\%$$

$$\text{Market value of ₹ 10 paid up share} = \frac{12.5\%}{10\%} \times 10 = \text{₹ 12.50}$$

$$\text{Market value of ₹ 6 paid up share} = \frac{12.5\%}{10\%} \times 6 = \text{₹ 7.50}$$

- (ii) Break up value of share will remain as before even if the controlling interest is being sold. But the market value of shares will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Average Profit}^*}{\text{Paid up value of shares}} \times 100 = \frac{\text{₹ 3.4 lakhs}}{\text{₹ 16 lakhs}} \times 100 = 21.25\%$$

Market value of shares:

$$\text{For ₹ 10 paid up share} = \frac{21.25\%}{10\%} \times 10 = ₹ 21.25$$

$$\text{For ₹ 6 paid up share} = \frac{21.25\%}{10\%} \times 6 = ₹ 12.75$$

$$\text{Fair value of shares} = \frac{\text{Breakup value} + \text{Market value}}{2}$$

$$\text{Fair value of ₹ 10 paid up share} = \frac{18.10 + 21.25}{2} = ₹ 19.68$$

$$\text{Fair value of ₹ 6 paid up share} = \frac{10.86 + 12.75}{2} = ₹ 11.81$$

* (Transfer to reserves has been ignored)

Working Notes:

(₹ in lakhs)

(a) Calculation of average capital employed

Fixed assets		24.00
Other tangible assets		3.00
Intangible assets		<u>3.00</u>
		30.00
Less: Liabilities	10	
Bonus	<u>1</u>	<u>11.00</u>
		19.00
Less: $\frac{1}{2}$ of profits [$\frac{1}{2}$ (4.1 – Bonus 1.0)]		<u>1.55</u>
Average capital employed		<u>17.45</u>

(b) Calculation of super profit

Average profit = $\frac{1}{4}$ (3 + 3.5 + 4 + 4.1 – Bonus 1.0)	
= $\frac{1}{4} \times 13.6$	3.400
Less: Normal profit = 10 % of ₹17.45 lakh	<u>(1.745)</u>
Super profit	<u>1.655</u>

(c) Calculation of goodwill

3 Years' purchase of average super-profit = 3 × 1.655 = ₹ 4.965 lakhs	
Increase in value of goodwill = $\frac{1}{2}$ (book value + 3 years' super profit)	
= $\frac{1}{2}$ (5 + 4.965)	
= ₹ 4.9825 lakhs	

Net assets as revalued including book value of goodwill	24.00
Add: Increase in goodwill (rounded-off)	<u>4.98</u>
Net assets available for shareholders	<u>28.98</u>

Note: In the above solution, tax effect of disputed bonus and corporate dividend tax has been ignored.

18. Value added Statement of Aman Ltd for the year ended 31st March, 2012

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

19. Computation of Economic Value Added

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

NOPAT = Net Operating Profit after Tax

COCE = Cost of Capital Employed

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

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

Working Notes:

1. Capital Employed

Particulars	₹
Average total assets	75,00,000
Less: Average current liabilities	<u>15,00,000</u>
Total capital employed	<u>60,00,000</u>

2. Cost of capital = Capital employed x Weighted average cost of capital

$$= ₹ 60,00,000 \times 10\% = ₹ 6,00,000$$

20. 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:

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

Where,

V_t = 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

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

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

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

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