functions, described the manner in which basic functions were implemented. Secondary functions could be modified or eliminated to reduce product cost. The term value has four different meanings:cost value – use value – esteem value and exchange value. The first step in the value analysis process is to define the problem and its scope. Once this is done, the functions of the product and its items are derived. These functions are 'basic' and 'secondary' functions. A cost function matrix or value analysis matrix is prepared. Improvement opportunities are then brainstormed, analyzed and selected.

(B) **SUPPLY CHAIN MANAGEMENT:**

Supply Chain Management encompasses the planning and management of all activities involved in sourcing, procurement, conversion and logistics management activities. Supply chain management integrates supply and demand management within and across companies.

Five basic components of supply chain management are

(a) Plan – develop a strategy for managing all resources that go towards meeting customer demand

(b) Source – choose the supplier

(c) Make – schedule activities for production

(d) Deliver – co-ordinate receipt of order to delivery

(e) Return – receive defectives and excess

(C) **ENTERPRISE RISK MANAGEMENT**

Enterprise risk Management seeks to implement risk awareness and prevention programs throughout the company, thus creating a corporate culture able to handle the risks associated with a rapidly changing business environment. Enterprise Risk Management deals with risks and opportunities affecting value creation and preservation. Enterprise risk management encompasses :-

(i) aligning risk appetite and strategy

(ii) enhancing risk response decisions

(iii) reducing operational surprises and losses

(iv) identifying and managing multiple and cross enterprise risk

(v) seizing opportunities

(vi) improvement in deployment of capital

(D) **DECISION TREE**

Decision tree is a tool which helps to choose between several courses of action. It provides a highly effective structure within which options can be laid out and the possible outcomes of choosing those options can be investigated. It also helps to form a balanced picture of the risks and rewards associated with each possible course of action.

FINAL EXAMINATION - GROUP IV

(SYLLABUS- 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2009

PAPER – P-16 : ADVANCED FINANCIAL ACCOUNTING & REPORTING

Time allowed: 3 Hours **Full Marks 100**

Part A ***questions are compulsory. Attempt all of them.***
Part B ***has seven questions. Attempt any five of them.***

Question 1.

(a) In each of the cases given below one out of the four answers is correct. Indicate the correct answer (= 1 mark)and give your working /reasons briefly (= 1 mark).

(i) PIONEER LTD , acquired 3200 Equity Shares of ARYAN LTD. on March 31,2008. The Share Capital of ARYAN LTD. Consists of 4000 Equity shares of Rs. 100 each . The cost of investment is Rs. 6,80,000. ARYAN LTD. made a bonus issue on march 31,2008 of one Equity share for every four shares held by its shareholders . If the share in the capital profit in ARYAN LTD. is Rs. 2,65,600 (after adjustment of bonus), the amount of goodwill /Capital Reserve shown in the Consolidated Balance sheet on March 31, 2006 is

A. Rs. 4,14,000 (Goodwill);

B. Rs. 2, 80,000(Capital Reserve) ;

C. Rs. 14,400 (Goodwill);

D. Data insufficient.

(ii) MR. BIKIRAM purchased 1000 shares in Rajasthan Laboratories at Rs. 300 per share in 2005. There was Rights issue in 2008 at one share for every two held at a price of Rs.100 per share. If Mr. Bikram subscribed to the rights, what would be carrying cost of 1500 shares

A. Rs 2,50,000;

B. Rs 3,50,000;

C. Rs 3,00,000;

D. Insufficient information.

(iii) ANKITA LTD. has a Plant (Asset) which is carried in the Balance Sheet on 31.03.2009 at Rs.500 lakh. As at that date the value in use is Rs.400 lakh. What would be the impairment loss of the plant, if the net selling price as on 31.03 2009 is Rs. 300 lakh?

A. Rs 100 lakh;

B. Rs 125 lakh;

C. Rs 150 lakh;

D. Incomplete information.

(iv) ASHREEN LTD. started business on 1.04.2008. For the year ended 31st March, 2009, it has earned accounting income of Rs. 20 lakh. However its taxable income was Rs. 15 lakh only due to timing difference. If the tax rate applicable to the company is 40% what would be Deferred Tax Asset?

A. Rs. 2.00 lakh;

B. Rs 2.50 lakh;

C. Rs 6.00 lakh;

D. None of (A), (B), (C).

(v) GAINT LTD. acquired 80% shares of ZOOM LTD. on January 1, 2009. Trade creditors of ZOOM LTD. include Rs. 45,000 for goods supplied by GAINT LTD., on which the latter made a profit of Rs. 9,000. One-fifth of the goods are still in the stock on March 31, 2009. The value of stock to be considered for the purpose of consolidation is

A. Rs 7,200;

B. Rs 4,500;

C. Rs. 1,800;

D. None of (A), (B), (C).

(vi) The share capital of Sanjana Ltd. is Rs. 10,00,000 consisting of fully paid shares of 10,000: 15% preference shares of Rs. 100 each and 9,000 equity shares of Rs. 100 each. The after –tax profit of the company for the year 2008-09 is Rs. 1,23,000. The normal rate of return is 8%. The value of equity share of the company is

A. Rs 171;

B. Rs 125;

C. Rs 154;

D. Rs 150.

(vii) Accounts receivable as at 31.03.2009 is Rs. 5,00,000. Provision for discount on accounts receivable as at 1.04.2008 is Rs16,000 and provision for doubtful debts as on that date stands at Rs. 25,000. Discount allowed during 2008-2009 is Rs. 1,000 and the company maintains 5% provision for bad debts and 3% provision for discounts on debtors. What is the amount to be transferred to profit and loss account as excess provision by way of adjustment on 31.03.2009?

A. Rs. 25,000;

B. Rs 14,250;

C. Rs 750;

D. Rs 10,750.

(viii) An external user of financial statement of a company is

A. Director ;

B. Partner;

C. Supplier;

D. Officer;

each of whom has some relationship with the company. 2×8= 16

(b) Choose the most appropriate one from the stated options and write it down (only indicate by A, B, C or D as you think correct).

(i) Contingent Assets as per AS-29 are

A. Recognized in Balance Sheet if happening is almost certain;

B. Not Recognized in Balance Sheet;

C. Disclosed in Notes to Accounts;

D. None of (A), (B), (C).

(ii) Under the "Pooling of interest method" the difference between the purchase consideration and Share Capital of the transferee Company should be to (as per AS-14)

A. Goodwill or Capital Reserve ;

B. General Reserve ;

C. Amalgamation Adjustment Account;

D. Either (A) or (C).

(iii) RAINBOW LTD has different distinguishable segments. One of them is engaged in providing an individual product and it is subject to risk and returns. Such segment is known as

A. Business Segment;

B. Geographical Segment;

C. Reportable Segment;

D. Primary Segment.

(iv) As per AS-11 exchange difference arising on repayment of fixed asset-linked liabilities should be adjusted to

A. Profit & Loss Account ;

B. Fixed Asset Account;

C. Revaluation Reserve;

D. None of the above.

(v) Under AS-26 the normal period of amortization for the an intangible asset other than goodwill is

A. the best estimate of its useful life;

B. a period of 10 years;

C. useful life or 10 years whichever is shorter;

D. useful life or 10 years whichever is longer. 1 × 5 = 5

(c) State which of the following statements is T (=true) or F (=false):

(i) Actual bad debts turning out to be more or less than provision is an example of a change in Accounting Estimate.

(ii) An employee was terminated from service on 1.1.2008 and was re-instated in service by the Court on 31.05.2009 with all back money which was paid on 1.6.2009. The arrear salary so paid is to be debited to Prior Period Expense (salary).

(iii) Treating operation lease as finance lease is an example of prior period item.

(iv) Government grant receivable as compensation for expenses or losses incurred in previous accounting period is an Extraordinary item to be disclosed separately in Profit & Loss Account of the Company. 1 × 4 = 4

Answer to Question 1(a):

(i) 'C': Rs.14,400 (Goodwill)

Cost of Investment: (3200 + 800) Shares Rs.6,80,000

Less: Face Value of 4000 shares @ Rs.100/-

	Rs.4,00,000	
Less: Share in Capital Profit	2,65,600	6,65,600
Goodwill		Rs.14,400

(ii) 'B': Rs.3,50,000

Cost of Purchase	1000×300	= 3,00,000
Cost of subscribing to Rights	500×100	= 50,000
Total Carrying Cost of 1500 shares		Rs.3,50,000

(iii) 'A': Rs.100 lakh

Impairment Loss = Carrying amount of Plant – Recoverable amount

Recoverable amount is higher of value in use = (Rs.400 lakh) and net selling price (Rs.350 lakh)

∴ Recoverable amount is Rs.400 lakh.

Hence Impairment Loss = (500 – 400) = Rs.100 lakh

(iv) None of (A) (B) & (C)

Tax on Accounting Income @ 40% of 20 lakh = Rs.8.00 lakh

Tax on Taxable Income 40% of 15 lakh = Rs.6.00 lakh

Deferred Tax Liability (8 – 6) = Rs.2.00 lakh

(v) 'A': Rs.7200

Sale value of goods = Rs.45,000

$$\text{Profit Margin} = \frac{\text{Profit}}{\text{Sales}} = \frac{\text{Rs.9000}}{\text{Rs.45000}}\ 20\%$$

$$\text{Unsold Stock (goods)} = 45000 \times \frac{1}{5} = \text{Rs.9,000}$$

Value of stock for consolidation purpose:

(Unsold Stock – Unrealized profit) = Rs.9000 – (9000 × 0.20) = 9000

(vi) D: Rs.150

9,000 Equity Capital	Rs.9,00,000
1,000 Preference Share Capital	Rs.1,00,000
After-tax profit	Rs.1,23,000
(Less) Preference dividend	15,000

Return on Equity Rs.1,08,000 ∴ Value of equity = Rs.1,08,000

∴ Value of one equity share = Rs.13,50,000/9,000 = Rs.150

(vii) 'C': Rs.750

As at 31.3.09. Provision required for discounts = 3% of Rs.5L = Rs.

& Provision required for B/D Debts = 5% of Rs.5L – Rs.

Hence, adjustment required for B/D Debts is Rs.25,000 – Rs.24,250

to b

(viii) C: Suppliers.

Directors, Partners of the company and its officers are not "external" Act provides that Directors and Partners (as shareholders) shall be p Company's Financial Statements. These persons as well as office much economic interest in the well being of the company for which t financial statements.

Suppliers are external persons and their sake in the company is not

Answer to Question 1(b):

(i) – B

(ii) – B

(iii) – A

(iv) – A

(v) – C

Answer to Question 1(c):

(i) – T

(ii) – F

(iii) – T

(iv) – T

PART B

Question 2.

The summarized Balance Sheets of Sun Ltd. and Moon Ltd. for the year ending on 31.03.2009 are as follows :

Liabilities	Sun Ltd. Rs.	Moon Ltd. Rs.	Assets	Sun Ltd. Rs.	Moon Ltd.Rs.
Equity share capital (in shares of Rs.10each)	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
8% Preference share capital, (in share of Rs.10each)	8,00,000	—	Current Assets	25,00,000	23,00,000
10%Preference share capital (in share of Rs.10 each)	—	4,00,000	—	—	—
Reserves	30,00,000	24,00,000	—	—	—
Current Liabilities	18,00,000	10,00,000	—	—	—
	80,00,000	50,00,000	—	80,00,000	50,00,000

The following additional information is provided:

	Sun Ltd.Rs.	Moon Ltd.Rs.
Profit before tax	10,64,000	4,80,000
Taxation	4,00,000	2,00,000
Preference dividend	64,000	40,000
Equity dividend	2,88,000	1,92,000

(i) The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operation.

(ii) Sun Ltd. proposes to absorb Moon ltd. as on 31.03 .2009. The terms of absorption are as under:

(a) Preference shareholders of Moon Ltd. will receive 8% preference shares of Sun Ltd. sufficient to increase the income of preference shareholders of Moon LTD. by 10%.

(b) The equity shareholders ofMoon Ltd. will receive equity shares of Sun Ltd. on the following basis:

(1) The equity shares of Moon Ltd. will be valued by applying to the earnings per share of Moon Ltd .75% of price earnings ratio of sun Ltd. based on the results of 2008- 2009 of both companies

(2) The market price of equity shares of sun Ltd. is Rs. 40 per share.

(3) The number of shares to be issued to the equity shareholders of Moon Ltd. will be based on the above market value.

(4) In addition to equity shares, 8% preference shares of sun Ltd. will be issued to the equity shareholders of Moon Ltd .to marke up for the loss in income arising from the above exchange of shares based on the dividends for the year 2008-2009.

(iii) The assets and liabilities of Moon Ltd. as on 31.03.2009 are revalued by professional valuer as under:

	Increased by Rs.	Decreased by Rs.
Fixed Assets	1,00,000	–
Current Assets	–	2,00,000
Current Liabilities	–	40,000

(iv) For the next two years no increase in the rate of equity dividend is expected.

You are required to set out in detail the purchase consideration including computation of EPS.15

Answer to Question 2:

A.Preference Shareholders

8% preference shares of Sun Ltd. sufficient to increase income by 10%

Particulars	Rs.
Current income from preference shares of Moon Ltd.	40,000
Add: 10% increase	4,000
Income from preference shares of Sun Ltd.	44,000
Value of 8% preference shares of Sun Ltd. to be issued	550,000
(44000×100/8	

B. Equity Shareholders

(i) Consideration by way of equity shares

Valuation of shares of Moon Ltd – (120,000 shares × Rs.24 {WN3}) = Rs.28,80,000

a) Share capital – (72,000 shares* × Rs.10) = Rs. 7,20,000

b) Share premium – (72,000 shares* × Rs.30) = Rs.21,60,000

(ii) Consideration by way of preference shares

Particulars	Rs.
Current equity dividend from Sun Ltd.	1,92,000
Expected equity dividend from Moon Ltd. (12%* for 72,000 shares)	86,400
Loss in income	1,05,600
Number of 8% preference shares to be issued (105,600/8%)	13,20,000

Rate of dividend of Sun Ltd. = 288000 / 2400000 = 12%

C. Total purchase consideration

(5,50,000 + 28,80,000 + 13,20,000) Rs.47,50,000

Working notes:-

(1) Computation of EPS

Particulars	Sun Ltd.Rs.	Moon Ltd.Rs.
Profit before tax	1,064,000	480,000
Less: Tax (given)	(400,000)	(200,000)
Profit after tax	664,000	280,000
Less: Preference dividend	(64,000)	(40,000)
Profit available to equity shareholders	600,000	240,000
Earning per share	2.50	2

(2) P/E ratio Sun Ltd.

P/E ratio = Market Price / EPS = 40/2.5 = 16 times

75% of P/E ratio = 16 × 0.75 = 12 times

(3) Value per share of Moon Ltd.

= EPS * P/E ratio

= Rs 2 * 12 times

= Rs 24

Question 3.

Given below are the Balance Sheets of A Ltd., B Ltd. and C Ltd. as on 31st March , 2008 . You are required to prepare the Consolidated Balance Sheet of the holding company and its subsidiaries as on 31st March , 2008, bearing in mind that the acquisition of shares by the companies was made on the same date.

	A Ltd. Rs.	B Ltd. Rs.	C Ltd. Rs.
Share Capital :			
7,00,000 shares of Re.1 each	7,00,000		
50,000 shares of Rs. 10 each		5,00,000	
1,00,000 shares of Re.1 each			1,00,000
Profit &Loss Account	1,80,000	50,000*	75,000*
Loan from B	1,00,000	–	–
Current Liabilities	5,00,000	1,50,000	1,75,000
	14,80,000	7,00,000	3,50,000

Note : * Inclusive of Pre- acquisition period results as under :

B Ltd – Profits Rs.10,000

C Ltd. – Losses Rs. 15,000

	A Ltd. Rs.	B Ltd. Rs.	C Ltd. Rs.
Represented by –			
Fixed Assets	5,00,000	3,00,000	1,50,000
Investments			
40,000 shares in B at cost	5,00,000		
1,00,000 shares in C at cost	80,000		
5,000 shares in B at cost			60,000
Current Assets	4,00,000	4,00,000	1,40,000
	14,80,000	7,00,000	3,50,000

15

Answer to Question 3.

Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd. as at 31st March, 2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			**Goodwill:**		
7,00,000 shares of Re. 1		7,00,000	B Ltd.	92,000	
Profit & Loss A/c:			B Ltd. via C Ltd.	9,000	
A Ltd.	1,80,000			1,01,000	
A Ltd.'s share in B Ltd. (4/5)	32,000		Less: Capital Reserve		
A Ltd.'s share in C Ltd. (100%)	90,000		C Ltd.	5,000	96,000
A Ltd.'s share in B Ltd.			**Fixed Assets:**		
via C Ltd. (100% of 1/10)	4,000	3,06,000	A Ltd.	5,00,000	
Minority Interest		55,000	B Ltd.	3,00,000	
Current Liabilities:			C Ltd.	1,50,000	9,50,000
A Ltd.	5,00,000		**Current Assets,**		
B Ltd.	1,50,000		**Loans and Advances**		
C Ltd.	1,75,000	8,25,000	A Ltd.	4,00,000	
			B Ltd. *	3,00,000	
			C Ltd.	1,40,000	8,40,000
		18,86,000			18,86,000

* After adjusting loan from B Ltd.

Working Notes: Goodwill:

B Ltd.: Net assets as on the date of acquisition

	Rs.
Share Capital	5,00,000
Pre-acquisition profits	10,000
	5,10,000

A Ltd's Share (40000/50000)510000	4,08,000
Compare: Cost of investment by A Ltd.	5,00,000
Goodwill	92,000
C Ltd's Share (5000/50000) 510000	51,000
Compare Cost of investment by C Ltd.	60,000
Goodwill	9,000

Minority Interest:

Minority Interest in B Ltd = 1 – [(40,000 + 5,000)/50,000] = 1 – 9/10 = 1/10

So, 1/10 of Equity Share Capital	Rs. 50,000
1/10 of P & L A/c of B Ltd. as on the date of Balance Sheet	5,000
	55,000

Note: There is no Minority Interest in C Ltd. as it is a 100% subsidiary.

Capital Reserve of C Ltd:

	Rs.
Net assets as on the date of acquisition share capital	1,00,000
Less: Loss on acquisition	15,000
	85,000
Less: Cost of investment by A Ltd.	80,000
Capital Reserve	5,000

Question 4.

(a) What are the general principles of Government Accounting? 8

(b) State the basic structure in the form of Government accounts. 7

Answer to Question 4(a).

General Principles of Government Accounting

The general principles of Government Accounting are as follows:

1. The Government Expenditure are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account; the accounting is more elaborate than that followed in commercial accounts. The method of budgeting and accounting under the service heads is not designed to bring out the relation in which Government stands to its material assets in use, or its liabilities due to be discharged at more or less distant dates.
2. In its Budget for a year, Government is interested to forecast with the greatest possible accuracy what is expected to be received or paid during the year, and whether the former together with the balance of the past year is sufficient to cover the later. Similarly, in the compiled accounts for that year, it is concerned to see to what extent the forecast has been justified by the facts, and whether it has a surplus or deficit balance as a result of the year's transactions. On the basis of the budget and the accounts, Government determines (a) whether it will be justified in curtailing or expanding its activities should increase or decrease taxation accordingly.
3. In the field of Government accounting, the end products are the mo annual accounts. The monthly accounts serve the needs of the day while the annual accounts present a fair and correct view of the finar Government during the year.

Answer to Question 4(b).

Basic Structure of the form of the accounts

1. Period of Accounts: The annual accounts of the central, state and uni shall record transactions, which take place during financial year runi March.
2. Cash basis Accounts: With the exception of such book adjustmen by these rules on the advice of the Comptroller and Auditor Gene transaction in government accounts shall represent the actual cash re during a financial year.

Form of Accounts: There are mainly three parts i.e., consolidated fund public account.

In consolidated fund there are two divisions i.e., revenue consisting heads and expenditure heads [Revenue Accounts] capital, public d section of receipts heads [capital accounts] whereas contingency f recorded for the transactions connected with the government set up constitution and in Public account transactions relating to the de remittances and suspense shall be recorded.

Question 5.

(a) State the scope of disclosure of Accounting policies as per Accountin

(b) What is the material effect of changes in Accounting Policies?

Answer to Question 5(a).

The following is the scope and explanation to the Indian Accounting S

AS-1 DISCLOSURE OF ACCOUNTING POLICIES

This standard deals with disclosure of significant accounting policies fol and presentation of the financial statements and is mandatory in natu

The accounting policies refer to the specific accounting principles adc

The state of affairs (Balance Sheet) and of the Profit or Loss (P/L A/c) ar affected by the accounting policies followed.

Proper disclosure would ensure meaningful comparison both inter/in enable the users to properly appreciate the financial statements.

Financial statements are intended to present a fair reflection of the fin performance and cash flows of an enterprise. The appropriate applicati policies with additional disclosure would ensure a fair presentation There remains no scope for covering inappropriate accounting trea accounting policies and/or by explanatory notes.

Areas involving different accounting policies by different enterprises are –

- Methods of depreciation, depletion and amortization
- Treatment of expenditure during construction
- Treatment of foreign currency conservation/translation
- Valuation of inventories
- Treatment of intangible assets
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long term contracts
- Treatment of contingent liabilities.

The basic and fundamental consideration in the selection of accounting policy by an enterprise is to ensure true and fair state of affairs as at the Balance Sheet date and of the Profit/Loss for the period ending on that date.

Answer to Question 5(b).

<u>Changes in Accounting Policies</u>

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have material effect in the later period should be disclosed. In the case of a change in accounting policies, having material effect in the current period, the amount by which any item in the financial statements, is affected by such change should also be disclosed to the extent as ascertainable, otherwise the fact that the effect is not (wholly or partially) ascertainable, should be disclosed.

The following are not considered as changes in accounting policies:

Accounting policies adopted for events or transactions that differ in substance at present (eg., introducing Group Gratuity Scheme for employees in place of adhoc ex-gratia payment earlier followed).

Accounting policies pertains to events or transaction which did not occur previously or that were immaterial.

Question 6.

The Board of Directors of Venus Pens Ltd. has decided (on 11.11.2009) to discontinue a portion of PENS division, which presently manufactures two different models – Fancy and Popular by March , 2009. The company will however, continue its Popular pens model. During the financial year ended on March, 2009 the relevant financial information of Pens division is as follows.

	Total	Popular Pens
Fixed Assent	1,700	600
Current Assets	600	200
Current Liabilities	300	150
Loans	1,100	250
Segmental revenue	2,000	600
Segmental expenses	1,400	200
Net operating cash flow	600	700
Investment cash flow	-	(100)
Financing cash flow	300	300

The Board of Directors has approved the plan on 11.11.2008 and an[illegible] 12.12.2008. In this case initial disclosure even has occurred before the e[illegible] financial reporting date and so initial disclosure shall be made in the fina[illegible] the period ended in March, 2009. Effective tax rate is 30%. Advise on di[illegible]

Answer to Question 6.

The following disclosure is suggested

Notes on Accounts (March, 2009)

Note No.____: "On 11th November, 2008, the B.O.D approved of a forma[illegible] Fancy Pens" division, which is one of the distinguishable components of [illegible] is but a part of the Pens Business Segment. The plan was announced on [illegible] This disposal is consistent with the Company's long-term strategy to focu[illegible] Popular Pens division. The company is actively seeking a buyer, and it is [illegible] the year ending March, 2010 the discontinuance of operations will be eff[illegible]

The carrying amounts, as of the balance sheet date, of the total assets to be disposed off, and liabilities to be settle in respect of Fancy Pens are as follows	
Fixed Assets	
Current Assets	
Current Liabilities	

The amount of revenue, expenses and cash flows in respect of the ordinary to the discontinuing operation during the current year are as follows:

Year ended 31st March

	Discontinuing Operation	Continuin[illegible] Operatio[illegible]
Revenue	1,400	600
- Expenses	1,200	200
Net operating income	200	400
Loss on sale of investments	-	(100)
Profit before tax	200	300
Tax expense	(60)	(90)
Net operating flows	140	210
Financing cash flows	-	300

Question 7.

(a) Gold Ltd .(the Transferor company) & silver Ltd. (the Transferor company [illegible] exchange of stock to form GS Ltd . The Pre-amalgamation balance shee[illegible] companies are as follows:

	Gold Ltd. (Rs. In lakh)	Silver Ltd (Rs. in lakh)
Fixed Assets	110	60
Current Assets	80	40
Total Assets	190	100
Share Capital	80	40
(Rs. 10 face value		
Reserve and Surplus	50	40
Debt	60	20
	190	100

For each share held in Silver Ltd., 2 shares of Gold Ltd., were given in exchange (Face Value : Rs.10., share premium Rs. 25) as the market price of Gold Ltd. is Rs.35. The fair market values of the fixed assets and current assets of Silver Ltd. were assessed at Rs.70 lakh and Rs. 45 lakh respectively. Prepare the post–amalgamation balance sheet of GS Ltd., under the 'Pooling' and the 'Purchase' methods. 8

(b) Financial statements are based on historical costs. Evidently inflation or deflation distorts the quality of the financial information furnished in them for the benefit of various users .Discuss the impact of inflation on financial statements and how inflation accounting and management help in improving the quality of these statements. 7

Answer to Question 7(a).

Balance Sheet of GS Ltd., after amalgamation

(Rs. in Lakh)

	Pooling Method	Purchase Method
Fixed Assets	170	180
Current Assets	120	125
Goodwill	–	185
Total Assets	290	490
Share Capital	120	160
Reverse and Surplus	90	50
Share Premium	–	200
Debt	80	80
	290	490

Working Notes:

1. Purchase consideration

No. of shares issued = 8,00,000

Share Capital = 80,00,000

Share Premium = 2,00,00,000

= Rs. 2.80 Crores

2. Net assets acquired = Rs.115 lakh – Rs.20 lakh

= Rs.95 lakh

Goodwill asset acquired = Purchase consideration – Net assets acqu

= 280 – 95 = Rs.185 lakh.

Answer to Question 7(b).

- Financial statements have traditionally been prepared on the basis regarding cost of acquisition of assets. This assumes stability of pri However, in situations of steadily rising or falling prices historical provide a true picture of the financial position of a business firm an usually impacts the quality of the financial statements in following w
- The prices of assets stated in balance sheets are much lower than t costs. As a result business firms remain undervalued and become takeover bids, which may not be in overall interest of shareholders.
- As the prices of fixed assets are undervalued, the amount of deprec statement will also be correspondingly lower. This will present manufacturing costs and may lead to making inappropriate decision buying products.
- If goods and raw materials are purchased for resale, inflation will inf the purchase price charged to income statement will be based on h be lower than the current prices prevailing. These overstated enhancements of expectations for dividends by shareholders.
- Inflation tends to erode the purchasing power of items of current as cash. So also the real values of fixed liabilities do not get reflected
- Inflation also leads to profit being overstated as all expenses are cha at historical costs while income from sales are charged at current p
- Inflation also tends to overstate the growth rates in values of sales i additions. These rates have to be adjusted for inflation to get a rea
- Thus it can be seen that inflation tends to mislead both the inter financial information furnished by companies.

The objectives of inflation accounting and management are multifold a

- To improve the quality of information furnished in financial stateme
- To give effect to the changes in purchasing power caused by in income and expenses during an accounting period, and
- To provide a better basis for inter period comparison of financial st

Question 8.

From the following information of Alfa Ltd. calculate earning per sl with AS-20:

	Year to 31.03.2009 (Rs.)	Year to 31.03.2008 (Rs.)
1. Net profit before tax	3,00,000	1,00,000
2. Current tax	40,000	30,000
Tax relating to earlier years	24,000	(13,000)
Deferred tax	30,000	10,000
3. Profit after tax	2,06,000	73,000

4. Other information :

(i) Profit includes compensation from Central Government towards loss on account of earthquake in 2006(non-taxable) 1,00,000 Nil

(ii) Outstanding convertible 6% Preference share, 1000 issued and paid on 30.09.2007. Face valueRs.100, Conversion ratio 15 equity share for every preference share.

(iii) 15% convertible debentures of Rs. 1,000 each, total face value Rs. 1,00,000, to be converted into 10 Equity shares per debenture issued and paid on 30.06.2007.

(iv) Total no .of Equity shares outstanding as on 31.03.2009,20000 including 10000 bonus shares issued on 01.01.2009, face value Rs.100.

Answer to question 8. 15

Calculation of Earning Per Share (EPS) of Alfa Ltd.

			Rs. Year ended 31.3.09	Rs. Year ended 31.3.08
1.	A	Earning after extraordinary items (2,06,000 – 6,000)(73,000 – 3,000)	2,00,000	70,000
	B	No. of Equity Shares	20,000	20,000
	C	Basic Earnings Per Share [A/B]	10.00	3.50
	A	Earning before extraordinary items	1,00,000	70,000
	B	No. of Equity Shares	20,000	20,000
	C	Basic Earnings Per Share [A/B]	5.00	3.50
2.	Tax Rate applicable	40,000 + 30,000/2,00,000	35%	
		30,000 + 10,000/1,00,000		40%
3.	A	Dividend on Weighted Average Preference Shares	6,000	3,000
	B	Incremental shares	15,000	7,500
	C	EPS on Incremental Shares [A/B]	0.40 (dilutive)	0.40 (dilutive)

4.	A	Convertible Debentures Increase in earnings $(1,00,000 \times \frac{15}{100} \times .65)$	9,750	
* Since the bonus issue is without consideration, the issue is treated, as if, it had occurred prior to the beginning of the year 2007.				
		$(1,00,000 \times \frac{15}{100} \times .60 \times \frac{9}{12})$		6,750
	B	Increase in shares	1,000	750
	C	Increase in EPS [A/B]	9.75 (Antidilutive)	9.00 (Antidilutive)

It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

	Calculation of Diluted EPS	Year ended 31.3.09 Rs.	Year ended 31.3.08 Rs.
A	Profit from continuing ordinary activities before Preference Dividend	1,06,000	73,000
	No. of ordinary equity shares	20,000	20,000
	Adjustment for dilutive potential of 6% convertible pref. shares	15,000	7,500
B	Total no. of shares	35,000	27,500
C	Diluted EPS from continuing ordinary operations [A/B]	3.02	2.65
D	Profit including extraordinary items	2,06,000	73,000
E	Adjusted No. of shares	35,000	27,500
F	Diluted EPS including extraordinary items [D/E]	5.88	2.65

Disclosure of EPS in accordance with AS 20 in the Profit and Loss Account

Earning per share (Face value Rs,100)	31.3.09 (Rs.)	31.3.08 (Rs.)
Basic EPS from continuing ordinary operations	5.00	3.50
Diluted EPS from continuing ordinary operations	3.02	2.65