As 30 31 32

1.X Ltd. has entered into a contract by which it has the option to sell its identified Property, Plant and Equipment (PPE) to Y Ltd. for ` 100 million after 3 years whereas its current market price is ` 180 million. Is the put option of X Ltd. a financial instrument? Explain.

Answer

It is necessary to evaluate the past practice of X Ltd. If X Ltd. has the past practice of settling net, then it becomes a financial instrument. If X Ltd. Intends to sell the identified PPE and settle by delivery and there is no past practice of settling net, then the contract should not be accounted for as derivative under AS 30 and AS 31.

A **financial instrument** is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A **financial asset** is any asset that is:
(a) cash;
(b) an equity instrument of another entity;
(c) a contractual right:
(i) to receive cash or another financial asset from another entity; or
(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:
(i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

A **financial liability** is any liability that is:
(a) a contractual obligation:
(i) to deliver cash or another financial asset to another entity; or
(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
(b) a contract that will or may be settled in the entity's own equity instruments and is
(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity 's own equity instruments.

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

2.As 30

Example: Omega Ltd. has entered into hedging relationship. At the year end the entity assesses the fair value of the hedged item and hedging instrument and the gains and losses

arise as follows:
Hedged Item – gain of ` 1,000
Hedged instrument – loss of ` 1,200
The effectiveness of the hedge has been calculated as:
` 1,200/1,000 = 120%. The hedge is assessed as highly effective as it is between 80 to 125%.

3.On February 1, 2011 Omega Ltd enters in to a contract with Beta Ltd. to receive the fair value of 1000
Omega's own equity shares outstanding as of 31.1.2012 in exchange for payment of
` 1,04,000 in cash i.e., ` 104 per share on 31.1.2012. The contract will be settled in net cash-
(i) fair value of forward on 1.2.2011 - Nil
(ii) fair value of forward 31.12.2011 ` 6,300
(iii) fair value of forward 31.1.2012 ` 2,000.

Give journal entries on the basis that the net amount is settled in cash. Omega Ltd closes its books on
31st December.

Solution

(a) 1.2.2011
No entry is required because the fair value of derivatives is zero and no cash is paid or received
(b) 31.12.2011
Forward Asset Dr. 6,300
To Gain 6,300
(c) 31.1.2012
Loss Dr. 4,300
To Forward Asset 4,300
(d) Cash Dr. 2,000
To Forward asset 2,000

4.Example: A lease contract contains a provision that rentals increase each year by 10%. Is there an embedded derivative in this contract?
Answer: No. There is no embedded derivative since lease rental does not depend on any underling basis.

5.Example: X Co. entered with Y Co. to sell coal over a period of two year. The coal price will be determined as per the increase in electricity prices. Is there an embedded derivative?
Answer: Yes, there is embedded derivative because cash flow of the contract or settlement price is dependent on underlying electricity price.

AS 29

At the end of the financial year ending on 31st December, 2011, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (₹)
In respect of five cases (Win)	100%	–
Next ten cases (Win)	60%	–
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	–
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

\

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should
be disclosed in the financial statements if following conditions are satisfied:
(i) There is a present obligation arising out of past events but not recognized as provision.
(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
(iii) The possibility of an outflow of resources embodying economic benefits is also remote.
(iv) 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 five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per 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 next ten cases = 30% of ` 1,20,000 + 10% of ` 2,00,000
= ` 36,000 + ` 20,000
= ` 56,000
Expected loss in remaining five cases = 30% of ` 1,00,000 + 20% of ` 2,10,000
= ` 30,000 + ` 42,000
= ` 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ` 9,20,000
(` 56,000 × 10 + ` 72,000 × 5) as contingent liability.

AS 28

Illustration 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to fixed asset on 31-12-2010. The discount is 15%.
Year Cash Flow (` In lakhs)
2011 4000
2012 6000
2013 6000
2014 8000
2015 4000
Residual value at the end of 2015 = ` 1000 lakhs
Fixed Asset purchased on 1-1-2008 = ` 40,000 lakhs
Useful life = 8 years
Net selling price on 31-12-2015 = ` 20,000 lakhs
Calculate on 31-12-2010:
(a) Carrying amount at the end of 2010
(b) Value in use on 31-12-2010
(c) Recoverable amount on 31-12-2010
(d) Impairment loss to be recognized for the year ended 31-12-2010
(e) Revised carrying amount
(f) Depreciation charge for 2011

Solution

Calculation of value in use

Year	*Cash Flow*	*Discount as per 15%*	*Discounted cash flow*
2011	4,000	0.870	3,480
2012	6,000	0.756	4,536
2013	6,000	0.658	3,948
2014	8,000	0.572	4,576
2015	4,000	0.497	1,988
2015	(residual) 1,000	0.497	497
			19,025

Value in use = ₹ 19,025 lakhs

Net Selling Price = ₹ 20,000 lakhs

Recoverable amount = higher of value in use and net selling price i.e. ₹ 20,000 lakhs.

Calculation of carrying amount:

Original cost = ₹ 40,000 lakhs

Depreciation for 3 years = [(40,000-1000)×3/8] = ₹ 14,625

Carrying amount on 31-12-2010 = [40,000-14,625] = ₹ 25,375

Recoverable amount = ₹ 20,000 lakhs

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

Revised carrying amount = ₹ (25,375-5,375) = ₹ 20,000 lakhs

Depreciation Charge for 2011 = (20,000-1000)/5 = ₹ 3,800

Illustration 2

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.2004. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:-

For the year ended on	*Estimated cash flow (₹ in lakhs)*
31.3.2011	50
31.3.2012	30
31.3.2013	30
31.3.2014	20
31.3.2015	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.2010 is ₹ 60 lakhs.

Solution

Present value of future cash flow

Year ended	*Future Cash Flow*	*Discount @ 10% Rate*	*Discounted cash flow*
31.3.2011	50	0.909	45.45
31.3.2012	30	0.826	24.78
31.3.2013	30	0.751	22.53
31.3.2014	20	0.683	13.66
31.3.2015	20	0.620	12.40
			118.82
Present value of residual price on 31.3.2015 = 5 × 0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.2010 is ₹ 60 lakhs, the recoverable amount will be higher of ₹ 121.92 lakhs (value in use) and ₹ 60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs

AS 26

Dell International Ltd. is developing a new production process. During the financial year 31st March, 2012, the total expenditure incurred on this process was ` 40 lakhs. The production process met the criteria for recognition as an intangible asset on 1st December, 2011. Expenditure incurred till this date was ` 16 lakhs. Further expenditure incurred on the process for the financial year ending 31st March 2013, was ` 70 lakhs. As at 31-3-2013, the recoverable amount of know-how embodied in the process is estimated to be ` 62 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to work out:

(a) What is the expenditure to be charged to the profit and loss account for the financial year ended

31st March 2012? (Ignore depreciation for this purpose)

(b) What is the carrying amount of the intangible asset as at 31st March 2012?

(c) What is the expenditure to be charged to the profit and loss account for the financial year ended

31st March 2013? (Ignore depreciation for this purpose)

(d) What is the carrying amount of the intangible asset as at 31st March 2013?

Solution

(a) ` 22 lakhs

(b) Carrying amount as on 31-3-2012 will be expenditure incurred after 1-12-2011

= ` 24 lakhs

(c) Book cost of intangible asset as on 31-3-2013 is as follows

Total Book cost = ` (70 + 24) lakhs = ` 94 lakhs

Recoverable amount as estimated = ` 62 lakhs

Difference to be charged to Profit and Loss account = ` 32 lakhs

(d) ` 62 lakhs

2) A Pharma Company spent ` 33 lakhs during the accounting year ended 31st March, 2012 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure. Comment.

Solution

As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of ` 33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2012.

3)Swift Ltd. acquired a patent at a cost of ` 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ` 10,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ` 36,00,000, `46,00,000, ` 44,00,000, ` 40,00,000 and 34,00,000. Find out the amortization cost of the patent for each of the years.

Swift Limited amortised ₹ 10,00,000 per annum for the first two years i.e. ₹ 20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	*Net cash flows* ₹	*Amortization Ratio*	*Amortization Amount* ₹
I	-	0.125	10,00,000[1]
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

4.During 2011, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

Completion of detailed programme and design	*25,000*
Coding and Testing	*20,000*
Other coding costs	*42,000*
Testing costs	*12,000*
Product masters for training materials	*13,000*
Duplication of computer software and training materials, from product masters (2,000 units)	*40,000*
Packing the product (1,000 units)	*11,000*

What amount should be capitalized as software costs in the books of the company, on Balance Sheet date?

Solution

As per para 44 of AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed programme design or working model. In this case, ₹ 45,000 would be recorded as an expense (₹ 25,000 for completion of detailed program design and ₹ 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (₹ 42,000 + ₹ 12,000 + ₹ 13,000) ₹ 67,000.

AS 25

Illustration 1

Sincere Corporation is dealing in seasonal product sales pattern of the product, quarter wise is as follows:

1st quarter 30th June	***10%***
2nd quarter 30th September	***10%***
3rd quarter 31st December	***60%***
4th quarter 31st March	***20%***

Information regarding the 1st quarter ending on 30th June, 2012 is as follows:

Sales	***80 crores***
Salary and other expenses	***60 crores***
Advertisement expenses (routine)	***4 crores***
Administrative and selling expenses	***8 crores***

While preparing interim financial report for first quarter Sincere Corporation wants to defer ` 10 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per AS 25. Also give a comment on the company's view.

Solution

Particulars	(₹ In crores)	
Result of first quarter ending 30th June, 2012		
Turnover	80	
Other Income	Nil	
Total (a)		80
Less: Changes in inventories	Nil	
Salaries and other cost		60
Administrative and selling Expenses (4+8)		12
Total (b)		72
Profit (a)-(b)		8

According to AS 25 the Income and Expense should be recognized when they are earned and incurred respectively. Therefore seasonal incomes will be recognized when they occur. Thus the company's view is not as per AS 25.

Illustration 2

The accounting year of X Ltd. ends on 30th September, 2012 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1-10-2011 and ends on 30-9-2012, the quarterly income is as under:-

1st quarter ending on 31-12-2011	*₹ 200 crores*
2nd quarter ending on 31-3-2012	*₹ 200 crores*
3rd quarter ending on 30-6-2012	*₹ 200 crores*
4th quarter ending on 30-9-2012	*₹ 200 crores*
Total	*₹ 800 crores*

Average actual tax rate for the financial year ending on 31-3-2012 is 20% and for financial year ending 31-3-2013 is 30%. Calculate tax expense for each quarter.

Solution

Calculation of tax expense

1st quarter ending on 31-12-2011	200×20%	₹ 40 lakhs
2nd quarter ending on 31-3-2012	200×20%	₹ 40 lakhs
3rd quarter ending on 30-6-2012	200×30%	₹ 60 lakhs
4th quarter ending on 30-9-2012	200×30%	₹ 60 lakhs

ILLUSTRATION 3

Accountants of Poornima Ltd. show a net profit of ` 7,20,000 for the third quarter of 2011 after incorporating the following:

(I)Bad debts of ` 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter

(ii) 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 assuming that ` 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

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.

Poornima Ltd should report quarterly income as ` 7,00,000 (` 7,20,000– ` 20,000

Illustration 4

Intelligent Corporation (I–Corp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	II	III	IV
Ending 31st March	30th June	30th September	31st December
15%-	15%-	50%-	-25%

For the First quarter ending 31st March, 2011, I–Corp. gives you the following information:

	₹ crores
Sales	50
Salary and other expenses	30
Advertisement expenses (routine)	02
Administrative and selling expenses	08

While preparing interim financial report for the first quarter 'I–Corp.' wants to defer ₹ 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the company's view.

Solution

Result of the first quarter ended 31st March, 2011

			(₹ in crores)
Turnover			50
Add: Other Income			Nil
Total			50
Less: Change in inventories	Nil		
Salaries and other cost		30	
Administrative and selling expenses (8 + 2)	10		40
Profit			10

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per para 38 of AS 25, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of ₹ 21 crores is not tenable as expenditures are uniform through out all quarters.

AS22

Illustration 1

From the following details of A Ltd. for the year ended 31-03-2012, calculate the deferred tax asset/ liability as per AS 22

Particulars	*₹*
Accounting Profit	*6,00,000*
Book Profit as per MAT	*3,50,000*
Profit as per Income Tax Act	*60,000*
Tax rate	*20%*
MAT rate	*7.50%*

Solution

Tax as per accounting profit 6,00,000×20%= ₹ 1,20,000

Tax as per Income-tax Profit 60,000×20% =₹ 12,000

Tax as per MAT 3,50,000×7.50%= ₹ 26,250

Tax expense= Current Tax +Deferred Tax

₹ 1,50,000 = ₹ 15,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2012

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2012

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250

= ₹ 1,34,250

Illustration 2

Ultra Ltd. has provided the following information.

Depreciation as per accounting records =₹ 2,00,000

Depreciation as per tax records =₹ 5,00,000

Unamotised preliminary expenses as per tax record = ₹ 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment. Tax rate 50%.

Solution

Calculation of difference between taxable income and accounting income

Particulars	*Amount (₹)*
Excess depreciation as per tax ₹ (5,00,000 – 2,00,000)	3,00,000
Less: Expenses provided in taxable income	(30,000)
Timing difference	2,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50%*2,70,000 = ₹ 1,35,000

Illustration 3

XYZ is an export oriented unit and was enjoying tax holiday upto 31.3.2011. No provision for deferred tax liability was made in accounts for the year ended 31.3.2011. While finalising the accounts for the year ended 31.3.2012, the Accountant says that the entire deferred tax liability upto 31.3.2011 and current year deferred tax liability should be routed through Profit and Loss Account as the relevant Accounting Standard has already become mandatory from 1.4.2001. Do you agree?

Solution

Paragraph 33 of AS 22 on "Accounting For Taxes on Income" relates to the transitional provisions. It

says, "On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets.

Further Paragraph 34 lays down, "For the purpose of determining accumulated deferred tax in the period in which this statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences."

Therefore, in the case of XYZ, even though AS 22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves.

Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

Illustration 4

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20108. For the years ending 31.3.2011 and 31.3.2012, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2010, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 2011 and 2012 for tax purposes. Prepare a statement of Profit and Loss for the years ending 2010, 2011 and 2012.

Solution

Statement of Profit and Loss

	31.3.2010 ₹	*31.3.2011* ₹	*31.3.2012* ₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/adjusted during the year		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Illustration 5

The following particulars are stated in the Balance Sheet of M/s Exe Ltd. as on 31.03.2011:

	(₹ in Lakhs)
Deferred Tax Liability (Cr.)	*20.00*
Deferred Tax Assets (Dr.)	*10.00*

The following transactions were reported during the year 2011-12:

(i)	*Tax Rate*	*50%*
(ii)	*Depreciation – As per Books*	*50.00*
	Depreciation – for Tax purposes	*30.00*
	There were no addition to Fixed Assets during the year.	
(iii)	*Items disallowed in 2010-11 and allowed for Tax purposes in 2011-12*	*10.00*
(iv)	*Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2012*	*20.00*
(v)	*Donations to Private Trusts made in 2011-12*	*10.00*
(vi)	*Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2011-12 (1/10th of ₹ 50.00 lakhs incurred in 2010-2011)*	*5.00*
(vii)	*Repairs to Plant and Machinery ₹ 100.00 lakhs was spread over the period 2011-12 and 2012-13 equally in the books. However, the entire expenditure was allowed for Income-tax purposes.*	

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets and the balances of Deferred Tax Liability/Deferred Tax Asset as on 31.03.2012.

Solution

Impact of various items in terms of deferred tax liability/deferred tax asset

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	₹ 20 lakhs × 50% = ₹ 10 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakhs × 50% = ₹ 5 lakhs
Interest to financial institutions	It is allowed as deduction under section 43B of the IT Act, if the payment is made before the due date of filing the return of income (i.e. 31st October, 2012).	No timing difference	Not applicable	Not applicable

Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	₹ 5 lakhs × 50% = ₹ 2.5 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	₹ 50 lakhs × 50% = ₹ 25 lakhs

Deferred Tax Liability Account

			₹ in lakhs				₹ in lakhs
31.3.2012	To	Profit and Loss account (Depreciation)	10.00	1.4.2011	By	Balance b/d	20.00
					By	Profit and Loss Account (Repairs to plant)	25.00
	To	Balance c/d	35.00				
			45.00				45.00
				1.4.2012	By	Balance b/d	35.00

Deferred Tax Asset Account

			₹ in lakhs				₹ in lakhs
1.4.2011	To	Balance b/d	10.00	31.3.2012	By	Profit and Loss Account: Items disallowed in 2010-11 and allowed as per I.T. Act in 2011-12	5.00
						Share issue expenses	2.50
					By	Balance c/d	2.50
			10.00				10.00
1.4.2012	To	Balance b/d	2.50				

Note: An Exposure Draft of the limited revisions to Accounting Standard (AS) 22, "Accounting for Taxes on Income" has been issued to synchronise the presentation requirements of AS 22, with the presentation requirements prescribed under revised Schedule VI notified under the Companies Act, 1956 (Now Schedule III of the Companies Act, 2013). It is pertinent to note that this Limited Revision is still in the form of exposure draft and will come into effect as and when it will be notified by the Government.

As 21

A Ltd. acquired 60% shares of B Ltd. @ ` 20 per share. Following are the extract of Balance Sheet of BLtd.:

10% Debentures	*10,00,000*
Trade payables	*5,00,000*
Fixed Assets	*70,00,000*
Investments	*45,00,000*
Current Assets	*68,00,000*
Loans & Advances	*22,00,000*

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies fixed assets were to be depreciated @ 10% and investment to be taken at market value of ₹ 60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial ` *Statement.*

Solution

Calculation of Goodwill/Capital Reserve

Particulars	₹	₹
Fixed Assets	70,00,000	
Less: Value written off (70,00,000 x 10%)	(7,00,000)	63,00,000
Investments at Market value		60,00,000
Current Assets		68,00,000
Loans & Advances		22,00,000
Total Assets		2,13,00,000
Less: Total Liabilities: Trade payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Equity		1,48,00,000
Majority Share in Equity (1,48,00,000 x 60%)		88,80,000
Less: Cost of Investment (10,00,000 x 60%) x 20	1,20,00,000	
Less: Dividend Received (6,00,000 x 2)	(12,00,000)	(1,08,00,000)
Goodwill		19,20,000

- Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered for the purpose of above computations.
- Goodwill and capital reserve of different subsidiaries can be adjusted to a net figure by the parent in consolidated financial statement.
- Goodwill of consolidated financial statement need not be written off to consolidated profit and loss account but test of impairment (Refer to AS 28) is made each time a consolidated financial statement is prepared.
- When share application money and allotment money is paid separately on different dates, then as per AS 21, date on which investment led to acquisition to control of subsidiary should be taken as date of investment, i.e., date of allotment.

Illustration 2

A Ltd. purchased 40% stake of B Ltd. for ₹ 12 per share. After two years A Ltd. decided to purchase another 40% share in B Ltd. B Ltd. has 1,00,00,000 equity shares of ₹ 10 each as fully paid up shares. The purchase deal was finalised on the following terms:

- *Purchase price per share to be calculated on the basis of average profit of last three years capitalised at 7.5%. Profits for last three years are ₹ 35 lacs, ₹ 65 lacs and ₹ 89 lacs.*
- *Total assets of B Ltd. of ₹ 11,50,00,000. Assets to be appreciated by ₹ 40,00,000.*
- *Of the External Trade payables for ₹ 2,50,00,000 one trade payable to whom ₹ 10,00,000 was due has expired and nothing is to be paid to settle this liability.*
- *B Ltd. will declare dividend @ 15%.*

Calculate the Goodwill or Capital Reserve for A Ltd. in Consolidated Financial Statement.

Solution

Calculation of Purchase Consideration

Particulars	₹
Profits for Last 3 years: First	89,00,000
Second	65,00,000
Third	35,00,000
Total profits for last 3 years	1,89,00,000
Average Profits (1,89,00,000/3)	63,00,000
Total value of B Ltd. (63,00,000/7.5%)	8,40,00,000
Number of Shares in B Ltd.	1,00,00,000
Value per Share	8.40
Purchase Consideration (1,00,00,000 x 40%) x 8.4	3,36,00,000

Calculation of Goodwill/Capital Reserve

Particulars	₹	₹
Fixed Assets	11,50,00,000	
Add: Appreciation in value of the asset	4,0,00,000	11,90,00,000
Less: Trade payables	2,50,00,000	
Less: Amount to be written off	(10,00,000)	(2,40,00,000)
Net Asset		9,50,00,000
Share in Net Asset (9,50,00,000 x 80%)		7,60,00,000

Less: Cost of Investment: Purchase Consideration	3,36,00,000	
Less: Dividend Received (10,00,00,000 x 40% x 15%)	(60,00,000)	
	2,76,00,000	
Add: Investment (1,00,00,000 x 40% x 12)	4,80,00,000	(7,56,00,000)
Capital Reserve		4,00,000

Illustration 3

Following are the Balance Sheet of A Ltd. and B Ltd.

	₹ '000			₹ '000	
Liabilities	*A Ltd.*	*B Ltd.*	*Assets*	*A Ltd.*	*B Ltd.*
Equity Shares	*6,000*	*5,000*	*Goodwill*	*100*	*20*
6% Preference shares	*-*	*1,000*	*Fixed Assets*	*3,850*	*2,750*
General Reserve	*1,200*	*800*	*Investment*	*1,620*	*1,100*
Profit & Loss Account	*1,020*	*1,790*	*Inventory*	*1,900*	*4,150*
Trade payables	*3,850*	*3,410*	*Trade receivables*	*4,600*	*4,080*
Proposed Dividend	*600*	*500*	*Cash & Bank*	*600*	*400*
	12,670	*12,500*		*12,670*	*12,500*

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following are the other information available:

a. *Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.*

b. *The directors of both the companies have proposed a dividend of 10% on equity share capital for the previous and current year.*

From the above information calculate Pre and Post Acquisition Profits, Minority Interest and Cost of Control.

Solution

Calculation of Pre and Post Acquisition Profits

Particulars	*Pre Acquisition Profits*	(₹) *Post Acquisition Profits*
Profit & Loss Account	10,00,000	7,90,000
General Reserve	800,000	-
	18,00,000	7,90,000
Less: Minority Interest (1800/4)	(4,50,000)	
(790/4)		(1,97,500)
Consolidated Balance Sheet	13,50,000	5,92,500

Calculation of Minority Interest

Particulars	₹
Paid up Equity Share Capital (50,00,000/4)	12,50,000
Paid up Preference Share Capital	10,00,000
Pre Acquisition Profits	4,50,000
Post Acquisition Profits	1,97,500
Minority Interest	28,97,500

Calculation of Goodwill/Capital Reserve

Particulars	₹	₹
Cost of Investment in Subsidiary (50,00,000 x 75% x 125%)	46,87,500	
Less: Dividend Received (50,00,000 x 75% x 10%)	(3,75,000)	43,12,500
Less: Paid up Capital	37,50,000	
Pre Acquisition Profits	13,50,000	(51,00,000)
Capital Reserve		7,87,500

- The losses applicable to the minority are deducted from the minority interest unless minority interest is nil. Any further loss is adjusted with the consolidated group interest except to the extent that the minority has a binding obligation to, and is able to, make the losses good. Subsequently, when the particular subsidiary makes profits, minority share in profits is added to majority share to the extent minority interest losses were absorbed by majority share.

  For example, 25% minority interest has the share in net equity ₹ 40 lacs and company made cumulative losses since the date of investment ₹ 200 lacs. 25% of ₹ 200 lacs, ₹ 50 lacs are minority share in losses. Losses upto ₹ 40 lacs will be adjusted with the minority

interest and further loss of ₹ 10 lacs will be adjusted with the majority interest. Hence in the Consolidated Balance Sheet for the relevant year, minority interest on the liabilities side will be NIL.

In the next year, if subsidiary company makes a profit say, ₹ 60 lacs. Minority interest comes to ₹ 15 lacs, out of these 15 lacs, first ₹ 10 lacs will be added to majority interest as recovery of losses absorbed in past and balance ₹ 5 lacs will appear in Consolidated Balance Sheet as part of the Minority Interest.

Illustration 4

A Ltd. had acquired 80% share in the B Ltd. for ₹ 25 lacs. The net assets of B Ltd. on the day are ₹ 22 lacs. During the year A Ltd. sold the investment for ₹ 30 lacs and net assets of B Ltd. on the date of disposal was ₹ 35 lacs. Calculate the profit or loss on disposal of this investment to be recognised in consolidated financial statement.

Solution

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹	₹
Net Assets of B Ltd. on the date of disposal		35,00,000
Less: Minority Interest (35 lacs x 20%)		(7,00,000)
A Ltd.'s Share in Net Assets		28,00,000
Proceeds from the sale of Investment		30,00,000
Less: A Ltd.'s share in net assets		(28,00,000)
		2,00,000
Less: Goodwill in the Consolidated Financial Statement		
Cost of investment	25,00,000	
Less: A Ltd.'s Share in net asset on the date (22 lacs x 80%)	(17,60,000)	(7,40,000)
Loss on sale of investment		5,40,000

Illustration 5

A Ltd. had acquired 80% share in the B Ltd. for ₹ 15 lacs. The net assets of B Ltd. on the day are ₹ 22 lacs. During the year A Ltd. sold the investment for ₹ 30 lacs and net assets of B Ltd. on the date of disposal was ₹ 35 lacs. Calculate the profit or loss on disposal of this investment to be recognised in consolidated financial statement.

Solution

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹	₹
Net Assets of B Ltd. on the date of disposal		35,00,000
Less: Minority Interest (35 lacs x 20%)		(7,00,000)
A Ltd.'s Share in Net Assets		28,00,000
Proceeds from the sale of Investment		30,00,000
Less: A Ltd.'s share in net assets		28,00,000
		2,00,000
Less: Capital Reserve in the Consolidated Financial Statement		
A Ltd.'s Share in net asset on the date (22 lacs x 80%)	17,60,000	
Less: Cost of investment	15,00,000	2,60,000
Profit on sale of investment		4,60,000