

PAPER – 1 : ADVANCED ACCOUNTING

Answer **all** questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidate.

Question 1

The following are the summarised Balance Sheets of PD Co. Ltd. and SD Co. Ltd. as on 31.3.2004.

Liabilities	PD Co. Ltd. Rs.	SD Co. Ltd. Rs.
Share Capital:		
Authorised	<u>70,00,000</u>	<u>30,00,000</u>
Issued and Subscribed Capital		
Equity shares of Rs. 10 each fully paid	50,00,000	20,00,000
Capital Reserve	5,00,000	3,10,000
Revenue Reserve	8,50,000	75,000
Profit and Loss Account	4,00,000	2,80,000
Sundry Creditors	2,50,000	2,25,000
Bills Payable	<u>1,00,000</u>	<u>10,000</u>
	<u>71,00,000</u>	<u>29,00,000</u>
Assets	PD Co. Ltd. Rs.	SD Co. Ltd. Rs.
Land and Buildings	20,00,000	15,20,000
Plant and Machinery	20,00,000	8,00,000
Furniture	5,00,000	1,60,000
Investments	16,10,000	—
Stock	3,40,000	1,00,000
Sundry Debtors	3,60,000	2,00,000
Bills Receivable	50,000	40,000
Bank	<u>2,40,000</u>	<u>80,000</u>
	<u>71,00,000</u>	<u>29,00,000</u>

PD Ltd. acquired 80% shares of SD Ltd. on 30.09.2003 at a cost of Rs. 18,10,000. On 1.10.2003 SD Ltd. declared and paid dividend on Equity Shares. PD Ltd. appropriately adjusted its share of dividend in Investment Account.

On 1.4.2003, the Capital Reserve and Profit and Loss Account stood in the books of SD Ltd. at Rs. 50,000 and Rs. 2,75,000 respectively.

Land and Buildings standing in the books of SD Ltd. at Rs. 16,00,000 on 1.4.2003, revalued at Rs.20,00,000 on 1.10.1993. Furniture, which stood in the books at Rs. 2,00,000 on 1.4.2003 revalued at Rs.1,50,000 on 1.10.2003. In both the cases the effects have not yet been given in the books.

SD Ltd. bought an item of machinery from PD Ltd. on hire-purchase basis. The following are the balances in respect of this machinery in the books on 31.03.2004:

	Rs.
Instalment due	20,000
Instalment not due	8,000
Hire-purchase stock reserve	1,600

The above items stood included under appropriate heads in Balance Sheet.

Prepare a Consolidated Balance Sheet of PD Ltd. and its subsidiary SD Ltd. as at 31.03.2004, complying with the requirements of AS-21. (16 marks)

Answer

Consolidated Balance Sheet of PD Co. Ltd. with its subsidiary SD Co. Ltd. as on 31st March, 2004

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
<i>Share Capital:</i>			<i>Fixed Assets:</i>		
Authorised	<u>70,00,000</u>		Land and buildings		
Issued and subscribed			PD Ltd.	20,00,000	
Equity shares of Rs. 10			SD Ltd. (W.N. 2)	<u>19,50,000</u>	39,50,000
each, fully paid up	50,00,000		Plant and machinery		
Minority interest (W.N. 5)	6,14,000		PD Ltd.	20,00,000	
<i>Reserves and surplus:</i>			SD Ltd.	<u>8,00,000</u>	
Capital reserve (W.N. 8)	12,18,000			28,00,000	
Revenue reserve (W.N. 9)	8,80,000		Less: Unrealised profit		
Profit and loss account	4,92,400		on hire purchase		
(W.N. 10)			transaction	<u>5,600</u>	27,94,400
<i>Current liabilities and</i>			Furniture		
<i>provisions:</i>			PD Ltd.	5,00,000	
<i>Current liabilities</i>			SD Ltd. (W.N. 2)	<u>1,35,000</u>	6,35,000

Less: balance as on 1.4.2003	<u>—</u>			
Created during the year	<u>75,000</u>	37,500		37,500
Profit and loss account as on 31.3.2004	2,80,000			
Add: Dividend paid on 1.10.2003 (out of pre-acquisition profits)	<u>2,50,000</u>			
	5,30,000			
Less: balance as on 1.4.2003	<u>2,75,000</u>			
Earned during the year	<u>2,55,000</u>	1,27,500		1,27,500
Profit as on 1.4.2003	2,75,000			
Less: Dividend paid [(Rs.18,10,000 – Rs.16,10,000) × 5/4]	2,50,000			
Balance of pre-acquisition profit as on 31.3.2004	<u>25,000</u>	25,000		
Revaluation reserves as on 1.10.2003:				
Profit on land and buildings (W.N. 2)		4,40,000		
Loss on furniture (W.N. 2)		(30,000)		
Difference in depreciation (for 6 months) due to revaluation:				
Short depreciation on land and building (W.N. 3)				(10,000)
Excess depreciation on furniture (W.N. 3)				<u>5,000</u>
Total		<u>7,80,000</u>	<u>1,30,000</u>	<u>37,500</u> <u>1,22,500</u>
Minority Interest (20%)		1,56,000	26,000	7,500 24,500
Share of PD Co. Ltd. (80%)		<u>6,24,000</u>	<u>1,04,000</u>	<u>30,000</u> <u>98,000</u>

2. Profit or loss on revaluation of assets in the books of SD Ltd. and their book values as on 31.3.2004

Rs.

Land and buildings

Book value as on 1.4.2003	16,00,000
Depreciation at 5% p.a. $[(80,000 \times 100)/16,00,000]$ for 6 months	<u>40,000</u>
	15,60,000

Revalued on 1.10.2003	<u>20,00,000</u>
Profit on revaluation	<u>4,40,000</u>
Value as per balance sheet on 31.3.2004	15,20,000
Add: Profit on revaluation	<u>4,40,000</u>
	19,60,000
Less: Short Depreciation (W.N. 3)	<u>10,000</u>
Value as on 31.3.2004	<u>19,50,000</u>
Furniture:	
Book value as on 1.4.2003	2,00,000
Less: Depreciation @ 20% p.a. $[(40,000 \times 100)/2,00,000]$ for 6 months	<u>20,000</u>
	1,80,000
Revalued on 1.10.2003	<u>1,50,000</u>
Loss on revaluation	<u>30,000</u>
Value as per balance sheet on 31.3.2004	1,60,000
Less: Loss on revaluation	<u>30,000</u>
	1,30,000
Add: Excess depreciation written back (W.N. 3)	<u>5,000</u>
Value as on 31.3.2004	<u>1,35,000</u>

3. Calculation of short/excess depreciation

	<i>Building</i>	<i>Furniture</i>
Revalued figure as on 1.10.2003	20,00,000	1,50,000
Rate of depreciation	5% p.a.	20% p.a.
Depreciation for 6 months on revalued figure (1.10.2003 to 31.3.2004)	50,000	15,000
Depreciation already provided	<u>40,000</u>	<u>20,000</u>
Difference [(short)/excess]	<u>(10,000)</u>	<u>5,000</u>

4. Calculation of cost of control

	Rs.
Share capital in SD Ltd.	16,00,000
Add: Capital profit	<u>6,24,000</u>
	22,24,000
Less: Cost of Investments	<u>16,10,000</u>
Capital Reserve	<u>6,14,000</u>

5. Calculation of minority interest

	<i>Rs.</i>	<i>Rs.</i>
Share capital		4,00,000
Capital (pre-acquisition) profits		1,56,000
Revenue (post-acquisition) profits:		
Capital Reserve	26,000	
Revenue reserve	7,500	
Profit and loss	<u>24,500</u>	<u>58,000</u>
		<u>6,14,000</u>

6. Stock reserve (plant and machinery)

Percentage of profit on hire purchase transaction

$$\frac{1,600 \times 100}{8,000} = 20\%$$

20% on Rs. 20,000 = Rs. 4,000

Total unrealised profit = Rs. 4,000 + Rs. 1,600 = Rs. 5,600

7. Elimination of mutual indebtedness

Elimination of mutual indebtedness in respect of sale of machinery on hire purchase basis will be made as under in the Consolidated Balance Sheet.

	<i>Creditors</i>	<i>Debtors</i>	<i>Stock</i>	<i>Plant and machinery</i>
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
Total (PD Ltd. and SD Ltd.)	4,75,000	5,60,000	4,40,000	28,00,000
Less: Instalment due	20,000	20,000	—	—
Less: Instalment not due	8,000	—	8,000	—
Less: Profit on plant purchased by SD Ltd. from PD Ltd. on hire purchase	—	—	—	5,600
	<u>4, 47,000</u>	<u>5,40,000</u>	<u>4,32,000</u>	<u>27,94,400</u>

For consolidated balance sheet purpose, the unrealised profits will be eliminated by deducting Rs. 5,600 from Plant & Machinery and from profit and loss account.

8. Consolidated capital reserve as on 31.3.2004

	<i>Rs.</i>
Capital reserve of PD Ltd. as on 31.3.2004	5,00,000
Add: Share in post acquisition capital reserve of SD Ltd. (W.N. 1)	1,04,000
Add: Cost of control (W.N. 4)	<u>6,14,000</u>
	<u>12,18,000</u>

9. Consolidated revenue reserve as on 31.3.2004

	<i>Rs.</i>
Revenue reserve of PD Ltd. as on 31.3.2004	8,50,000
Add: Share in post acquisition revenue reserve of SD Ltd. (W.N. 1)	<u>30,000</u>
	<u>8,80,000</u>

10. Consolidated profit and loss account as on 31.3.2004

	<i>Rs.</i>
Profit and loss account balance of PD Ltd. as on 31.3.2004	4,00,000
Add: Share in post acquisition profit and loss account of SD Ltd. (W.N. 1)	98,000
Less: Unrealised profit on hire purchase	<u>(5,600)</u>
	<u>4,92,400</u>

Note: In the question, the balance of capital reserve and profit and loss account of SD Ltd., as on 1.4.2003 only has been given and not of revenue reserve. Hence, it has been assumed in the above solution that the revenue reserve is created during the year from current year's profits.

Question 2

The following is the Profit and Loss Account of Galaxy Ltd. for the year ended 31.03.2004. Prepare a Gross Value Added Statement of Galaxy Ltd. and show also the reconciliation between Gross Value Added and Profit before taxation.

Profit and Loss Account for the year ended 31.03.2004

	<i>Notes</i>	<i>Amount</i>
		<i>(Rs. in lakhs)</i>
<i>Income:</i>		
<i>Sales</i>	—	890
<i>Other Income</i>	—	<u>55</u>
		945
<i>Expenditure:</i>		
<i>Production and operational expenses</i>	(a)	641
		—

Administration expenses (Factory)	(b)	33	—
Interest	(c)	29	—
Depreciation		<u>17</u>	<u>720</u>
Profit before taxes		—	225
Provision for taxes	(d)	—	<u>30</u>
Profit after tax		—	195
Balance as per last Balance Sheet		—	<u>10</u>
			<u>205</u>
Transferred to General Reserve		45	—
Dividend paid		<u>95</u>	—
		140	—
Surplus carried to Balance Sheet		<u>65</u>	—
		<u>205</u>	—

Notes:

- (a) Production and Operational expenses Rs. in lakhs
- | | |
|--|------------|
| Consumption of raw materials | 293 |
| Consumption of stores | 59 |
| Salaries, Wages, Gratuities etc. (Admn.) | 82 |
| Cess and Local taxes | 98 |
| Other manufacturing expenses | <u>109</u> |
| | <u>641</u> |
- (b) Administration expenses include salaries, commission to Directors Rs.9.00 lakhs
Provision for doubtful debts Rs. 6.30 lakhs.
- Rs. in lakhs
- (c) Interest on loan from ICICI Bank for working capital 9
- Interest on loan from ICICI Bank for fixed loan 10
- Interest on loan from IFCI for fixed loan 8
- Interest on Debentures 2
- 29
- (d) The charges for taxation include a transfer of Rs. 3.00 lakhs to the credit of Deferred Tax Account.
- (e) Cess and Local taxes include Excise Duty, which is equal to 10% of cost of bought-in material. (16 marks)

Answer**Galaxy Ltd.****Gross Value Added Statement for the year ended 31st March, 2004**

	<i>Rs. in lakhs</i>	<i>Rs. in lakhs</i>
Sales		890
Less: Cost of bought in materials and services:		
Production and operational expenses (293 + 59 + 109)	461	
Administration expenses (33 – 9)	24	
Interest on working capital loan	9	
Excise duty (Refer working note)	<u>55</u>	<u>549</u>
Value added by manufacturing and trading activities		341
Add: Other income		<u>55</u>
Total value added		<u>396</u>

Application of Value Added

			<i>%</i>
To Employees			
Salaries, wages, gratuities etc.		82	20.71%
To Directors			
Salaries and commission		9	2.27%
To Government			
Cess and local taxes (98 – 55)	43		
Income tax	<u>27</u>	70	17.68%
To Providers of capital			
Interest on debentures	2		
Interest on fixed loan	18		
Dividends	<u>95</u>	115	29.04%
To Provide for maintenance and expansion of the company			
Depreciation	17		
General reserve	45		
Deferred tax	3		
Retained profits (65 – 10)	<u>55</u>	<u>120</u>	<u>30.30%</u>
		<u>396</u>	<u>100%</u>

Statement showing reconciliation of Gross Value Added with Profits before taxation

		<i>Rs. in lakhs</i>
Profits before taxes		225
<i>Add:</i>		
Depreciation	17	
Directors' remuneration	9	
Salaries, wages & gratuities etc.	82	
Cess and local taxes	43	
Interest on debentures	2	
Interest on fixed loan	<u>18</u>	<u>171</u>
Total value added		<u>396</u>

Working Note:**Calculation of Excise Duty**

Say cost of bought in materials and services is 'x'

Excise Duty is 10% of x = x/10

$$x = 461 + 24 + 9 + x/10$$

$$x = 494 + x/10 = 549 \text{ (approx.)}^*$$

$$\text{Excise Duty} = 549 - 494 = \text{Rs. } 55$$

* The above calculated excise duty is not exactly 10% of cost of bought in material amounting Rs. 549. The difference is due to approximation.

Question 3

The Capital Structure of M/s XYZ Ltd., on 31st March, 2003 was as follows:

		<i>Rs.</i>
<i>Equity Capital</i>	<i>18,000 Shares of Rs. 100 each</i>	<i>18,00,000</i>
<i>12% Preference Capital</i>	<i>5,000 Shares of Rs. 100 each</i>	<i>5,00,000</i>
<i>12% Secured Debentures</i>		<i>5,00,000</i>
<i>Reserves</i>		<i>5,00,000</i>
<i>Profit earned before Interest and Taxes during the year</i>		<i>7,20,000</i>
<i>Tax Rate</i>		<i>40%</i>
<i>Generally the return on equity shares of this type of Industry is 15%.</i>		

Subject to:

- (a) *The profit after tax covers Fixed Interest and Fixed Dividends at least 4 times.*

- (b) The Debt Equity ratio is at least 2;
 (c) Yield on shares is calculated at 60% of distributed profits and 10% of undistributed profits;

The Company has been paying regularly an Equity dividend of 15%.

The risk premium for Dividends is generally assumed at 1%.

Find out the value of Equity shares of the Company.

(16 marks)

Answer

Calculation of profit after tax (PAT)		Rs.
Profit before interest & tax (PBIT)		7,20,000
Less: Debenture interest (Rs. 5,00,000 × 12/100)		<u>60,000</u>
Profit before tax (PBT)		6,60,000
Less: Tax @ 40%		<u>2,64,000</u>
Profit after tax (PAT)		3,96,000
Less: Preference dividend $\left(\text{Rs. } 5,00,000 \times \frac{12}{100} \right)$	60,000	
Equity dividend $\left(\text{Rs. } 18,00,000 \times \frac{15}{100} \right)$	<u>2,70,000</u>	<u>3,30,000</u>
Retained earnings (undistributed profit)		<u>66,000</u>

Calculation of Interest and Fixed Dividend Coverage

$$\begin{aligned}
 &= \frac{\text{PAT} + \text{Debenture interest}}{\text{Debenture interest} + \text{Preference dividend}} \\
 &= \frac{\text{Rs. } 3,96,000 + 60,000}{\text{Rs. } 60,000 + 60,000} \\
 &= \frac{\text{Rs. } 4,56,000}{\text{Rs. } 1,20,000} = 3.8 \text{ times}
 \end{aligned}$$

Calculation of Debt Equity Ratio

$$\begin{aligned}
 \text{Debt Equity Ratio} &= \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}} \\
 &= \frac{\text{Debentures}}{\text{Preference share capital} + \text{Equity share capital} + \text{Reserves}}
 \end{aligned}$$

$$= \frac{\text{Rs. 5,00,000}}{\text{Rs. 5,00,000} + 18,00,000 + 5,00,000}$$

$$\text{Debt Equity Ratio} = \frac{\text{Rs. 5,00,000}}{\text{Rs. 28,00,000}} = .179$$

The ratio is less than the prescribed ratio.

Calculation of Yield on Equity Shares

Yield on equity shares is calculated at 60% of distributed profits and 10% of undistributed profits:

60% of distributed profits (60% of Rs. 2,70,000)	1,62,000
10% of undistributed profits (10% of Rs. 66,000)	<u>6,600</u>
	<u>1,68,600</u>

$$\begin{aligned} \text{Yields on equity shares} &= \frac{\text{Yield on shares}}{\text{Equity share capital}} \times 100 \\ &= \frac{\text{Rs. 1,68,600}}{\text{Rs. 18,00,000}} \times 100 \\ &= 9.37\% \end{aligned}$$

Calculation of Expected Yield on Equity Shares

Normal return expected	15%
Add: Risk premium for low interest and fixed dividend coverage (3.8 < 4)	1%*
Risk for debt equity ratio not required	<u>Nil**</u>
	<u>16%</u>

Value of an Equity Share

$$\begin{aligned} &= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid up value of a share} \\ &= \frac{9.37}{16} \times 100 = \text{Rs. 58.56} \end{aligned}$$

* When interest and fixed dividend coverage is lower than the prescribed norm, the riskiness of equity investors is high. They should claim additional risk premium over and above the normal rate of return. Hence, the additional risk premium of 1% has been added.

** The debt equity ratio is lower than the prescribed ratio, that means outside funds (Debts) are lower as compared to shareholders' funds. Therefore, the risk is less for equity shareholders. Therefore, no risk premium is required to be added in this case.

Question 4

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

(Accounting year 1.1.2002 – 31.12.2002)

Net Profit	:	Year 2002 : Rs. 20,00,000
	:	Year 2003 : Rs. 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 – Rs. 20 Last date of exercise rights – 31.3.2003.

Fair rate of one Equity share immediately prior to
exercise of rights on 31.3.2003 : Rs. 25

- (b) A Ltd. Leased a machinery to B Ltd. on the following terms:

	(Rs. in Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

- (c) The following particulars are stated in the Balance Sheet of M/s Exe Ltd. as on 31.03.2003:

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

The following transactions were reported during the year 2003-04:

(i) Tax Rate	50%
(ii) Depreciation – As per Books	50.00

	<i>Depreciation – for Tax purposes</i>	30.00
	<i>There were no addition to Fixed Assets during the year.</i>	
(iii)	<i>Items disallowed in 2002-03 and allowed for Tax purposes in 2003-04</i>	10.00
(iv)	<i>Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2004</i>	20.00
(v)	<i>Donations to Private Trusts made in 2003-04</i>	10.00
(vi)	<i>Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2003-04 (1/10th of Rs. 50.00 lakhs incurred in 1999-2000)</i>	5.00
(vii)	<i>Repairs to Plant and Machinery Rs. 100.00 lakhs was spread over the period 2003-04 and 2004-05 equally in the books. However, the entire expenditure was allowed for Income-tax purposes.</i>	

*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 31.03.2004.
(8 + 8 + 4 = 20 marks)*

Answer

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

	Year 2002	Year 2003
	Rs.	Rs.
<i>EPS for the year 2002 as originally reported</i>		
= $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (Rs. 20,00,000 / 10,00,000 shares)	2.00	
<i>EPS for the year 2002 restated for rights issue</i>		
= [Rs. 20,00,000 / (10,00,000 shares × 1.04*)]	1.92 (approx.)	
<i>EPS for the year 2003 including effects of rights issue</i>		
$\frac{\text{Rs. 30,00,000}}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$		
$\frac{\text{Rs. 30,00,000}}{11,97,500 \text{ shares}}$	2.51 (approx.)	

* Refer working note 2.

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\begin{aligned} & \frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}} \\ &= \frac{(\text{Rs. } 25 \times 10,00,000 \text{ shares}) + (\text{Rs. } 20 \times 2,50,000 \text{ shares})}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}} \\ &= \frac{\text{Rs. } 3,00,00,000}{12,50,000 \text{ shares}} = \text{Rs. } 24 \end{aligned}$$

2. Computation of adjustment factor

$$\begin{aligned} &= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} \\ &= \frac{\text{Rs. } 25}{\text{Rs. } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)} \end{aligned}$$

(b) Computation of Unearned Finance Income

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

where :

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

$$\begin{aligned} \text{Gross investment} &= \text{Minimum lease payments} + \text{Unguaranteed residual value} \\ &= (\text{Total lease rent} + \text{Guaranteed residual value}) + \text{Unguaranteed residual value} \\ &= [(\text{Rs. } 5,00,000 \times 5 \text{ years}) + \text{Rs. } 1,00,000] + \text{Rs. } 1,00,000 \\ &= \text{Rs. } 27,00,000 \end{aligned}$$

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

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value
	Rs.		Rs.
1	5,00,000	.8696	4,34,800
2	5,00,000	.7561	3,78,050

3	5,00,000	.6575	3,28,750	
4	5,00,000	.5718	2,85,900	
5	5,00,000	.4972	2,48,600	
	1,00,000	.4972	49,720	
	(guaranteed residual value)			
			<u>17,25,820</u>	(i)
	1,00,000	.4972	49,720	(ii)
	(unguaranteed residual value)			
		(i) + (ii)	<u>17,75,540</u>	(b)

Unearned Finance Income = (a) – (b)
 = Rs. 27,00,000 – Rs. 17,75,540
 = Rs. 9,24,460

Journal Entries in the books of B Ltd.

		Rs.	Rs.
<i>At the inception of lease</i>			
Machinery account	Dr.	17,25,820*	
To A Ltd.'s account			17,25,820*
(Being lease of machinery recorded at present value of MLP)			
<i>At the end of the first year of lease</i>			
Finance charges account (Refer Working Note)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			

* As per para 11 of AS 19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 20,00,000 is more than the present value amounting Rs. 17,25,820, the machinery has been recorded at Rs. 17,25,820 in the books of B Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

A Ltd.'s account	Dr.	5,00,000	
To Bank account			5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of Rs. 2,41,127 and finance charge of Rs. 2,58,873)			
Depreciation account	Dr.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	4,31,455	
To Depreciation account			1,72,582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

Year	Outstanding liability (opening balance)	Lease rent	Finance charge	Reduction in outstanding liability	Outstanding liability (closing balance)
	Rs.	Rs.	Rs.	Rs.	Rs.
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	<u>78,267</u>	<u>5,21,783</u>	1,00,050*
			<u>8,74,230</u>	<u>17,25,820</u>	

* The difference between this figure and guaranteed residual value (Rs. 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

(c) 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	Rs. 20 lakhs × 50% = Rs. 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	Rs. 10 lakhs × 50% = Rs. 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, 2004).	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	Rs. 5 lakhs × 50% = Rs. 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	Rs. 50 lakhs × 50% = Rs. 25 lakhs

Deferred Tax Liability Account

Dr.				Cr.			
Rs. in lakhs				Rs. in lakhs			
31.3.2004	To	Profit and Loss account (Depreciation)	10.00	1.4.2003	By	Balance b/d	20.00
					By	Profit and Loss Account	25.00
	To	Balance c/d	<u>35.00</u>			(Repairs to plant)	_____
			<u>45.00</u>				<u>45.00</u>
				1.4.2004	By	Balance b/d	35.00

Deferred Tax Asset Account

Dr.				Cr.			
Rs. in lakhs				Rs. in lakhs			
1.4.2003	To	Balance b/d	10.00	31.3.2004	By	Profit and Loss Account:	
						Items disallowed in 2002-03 and allowed as per I.T. Act in 2003-04	5.00
						Share issue expenses	2.50
			_____		By	Balance c/d	<u>2.50</u>
			<u>10.00</u>				<u>10.00</u>
1.4.2004	To	Balance b/d	2.50				

Question 5

- (a) From the following details of Loan Fund of Kanpur Institute of Technology for the year 2003-2004, you are required to prepare a statement showing changes in the Loan Fund Balance :

	Rs.
Fund balance as on 1.4.2003	25,00,000
Grants from the Government and Society	12,00,000
Grants from Revenue Fund	50,000
Other transfer from Unrestricted Fund	70,000
Investment income	60,000

<i>Interest on Loan</i>	40,000
<i>Refund to Granters</i>	25,000
<i>Bad Debts written off</i>	15,000
<i>Administration and collection costs</i>	25,000

- (b) Mr. Investor buys a stock option of ABC Co. Ltd. in July, 2003 with a strike price on 30.07.2003 of Rs. 250 to be expired on 30.08.2004. The premium is Rs. 20 per unit and the market lot is 100. The margin to be paid is Rs. 120 per unit.

Show the accounting treatment in the books of Buyer when:

- (i) the option is settled by delivery of the asset, and
(ii) the option is settled in cash and the index price is Rs. 260 per unit.

(4 + 12 = 16 marks)

Answer

- (a) **Kanpur Institute of Technology**
Statement of changes – Loan funds

		<i>Rs.</i>
Balance as on 1st April, 2003		25,00,000
<i>Additions during the year 2003-2004:</i>		
Grants from government and society	12,00,000	
Investment income	60,000	
Interest on loan	40,000	
Grants from revenue fund	50,000	
Other transfer from unrestricted funds	<u>70,000</u>	14,20,000
<i>Deductions during the year 2003-04:</i>		
Refund to granters	25,000	
Bad debts written off	15,000	
Administration and collection costs	<u>25,000</u>	<u>(65,000)</u>
Balance as on 31st March, 2004		<u>38,55,000</u>

- (b) Accounting entries in the books of buyer

2003	<i>At the time of inception</i>		<i>Rs.</i>	<i>Rs.</i>
July	Stock option premium account	Dr.	2,000	
	To Bank account			2,000
	(Being premium paid to buy a stock option)			

	Deposit for margin money account	Dr.	12,000	
	To Bank account			12,000
	(Being margin money paid on stock option)			
	<i>At the time of settlement</i>			
	(i) <i>Option is settled by delivery of the asset</i>			
August	Shares of ABC Ltd. account	Dr.	25,000	
	To Deposit for margin money account			12,000
	To Bank account			13,000
	(Being option exercised and shares acquired, Rs. 12,000 margin money adjusted and the balance amount was paid)			
	Profit and loss account	Dr.	2,000	
	To Stock option premium account			2,000
	(Being the premium transferred to profit and loss account on exercise of option)			
	(ii) <i>Option is settled in cash</i>			
	Profit and loss account	Dr.	2,000	
	To Stock option premium account			2,000
	(Being the premium transferred to profit and loss account)			
	Bank account (Rs. 100 × 10)	Dr.	1,000	
	To Profit and loss account			1,000
	(Being profit on exercise of option)			
	Bank account	Dr.	12,000	
	To Deposit for margin money account			12,000
	(Being margin on equity stock option received back on exercise of option)			

Question 6

Write short notes on the following:

- (a) "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.
- (b) Some key differences between IAS, US GAAP and Indian AS with respect to
 - (i) Fixed Assets
 - (ii) Changes in Accounting Policy and Prior period items.

- (c) *Environmental Accounting.*
- (d) *Advantages and disadvantages of setting of Accounting Standards. (4 × 4 = 16 marks)*

Answer

(a) “Non–Performing Asset” as per NBFC Prudential Norms (RBI) directions means:

- (i) An asset, in respect of which, interest has remained past due for six months;
- (ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;
- (iii) A bill which remained overdue for six months;
- (iv) The interest in respect of a debt or the income on receivables under the head ‘other current assets’ in the nature of short term loans/advances that remained overdue for a period of six months;
- (v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;
- (vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;
- (vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

(b)

	IAS	US GAAPs	Indian AS
(i) Fixed Assets	Fixed assets are carried at historical cost. Revaluation of fixed assets is allowed but the capitalisation of exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets is not permitted.	Fixed assets are carried at historical cost. Only downward revaluation is permitted for impairment. Exchange fluctuations on loans taken for purchase of fixed assets are expensed when incurred.	Fixed assets are usually carried at historical cost, revaluations of Fixed Assets are permitted in AS 10. AS 28 permits impairment of assets if specified conditions are satisfied. AS 11 (Revised 2003) requires that exchange differences arising on repayment of liabilities incurred for acquiring fixed assets should be recognized in the statement of profit and loss.

(ii) Changes in Accounting Policy and Prior period items.	Prior period items are accounted by restating to prior years and making adjustments to retained profits. The effect of change in accounting policies is disclosed separately in the profit and loss statement.	Prior period items are accounted by restating to prior years and adjustments to retained profits. Changes in accounting policies are not accounted by restating prior years but the effect of such changes is separately disclosed in the Profit and Loss statement in the same manner as in IAS.	As per AS 5, changes in accounting policies and prior period items are reported on prospective basis, if material, beginning with the year of change. Unlike in US GAAPs and IAS, AS 5 requires the restatement of comparatives to account for accounting errors, the adjustment is required to be made in the current year with disclosures of the prior period amounts.
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- (c) The term 'environment' includes everything in all its manifest forms, on the earth, beneath the earth and above the earth. A business enterprise takes support of social and ecological system in order to maximize wealth. Economic activity, social welfare and a diverse environment, all are linked and ultimately depend on each other. The functioning of an enterprise may have some favourable and some adverse effects on the environment. Hence, it is felt that there is a need for maintaining accounts of the effects of activities of business entity on the environment. Environmental accounting can be defined as a system (methodology) for measuring environmental performance and communicating the results of these measurements to users. It helps in presenting the utilization of natural resources by an enterprise, the costs incurred to use them and the income earned therefrom in a transparent manner. Environmental accounting, entirely a new concept, is a faithful attempt to identify the resources exhausted and the costs rendered reciprocally to the enterprise by a business corporation. Thus environmental accounting stands for recording and documenting environmental performance to facilitate effectiveness of environmental management system with reference to compliance, safety and quality control. It provides a data base for taking corrective steps and future action for developing organisation's environmental strategy and for identifying environmentally based opportunities for gaining an edge over one's competitors. If proper environmental accounting system is established, the enterprise will be able to anticipate environmental damage and therefore can prevent it from happening.

Of course environmental accounting is still in an early stage of evolution and it is being groomed under the voluntary leadership of a variety of enterprises around the world. Recognising the importance of protecting and preserving the environment, a number of laws have been enacted throughout the world.

- (d) The Accounting Standards seek to describe the accounting principles, the valuation

techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance. The setting of accounting standards has the following advantages:

- (i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
- (ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
- (iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

However, there are some disadvantages of setting of accounting standards:

- (i) Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.
- (ii) There may be a trend towards rigidity and away from flexibility in applying the accounting standards.
- (iii) Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.