PAPER – 1: FINANCIAL REPORTING

QUESTIONS

Consolidated Financial Statements of Group Companies

1. The following information has been extracted from the Books of 'X' Limited group (as at 31st December, 2009):

	X Ltd.	Y Ltd.	Z Ltd.		X Ltd.	Y Ltd.	Z Ltd.
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
Share capital				Fixed Assets Less			
(Fully paid equity shares of Rs.10 each)	8,00,000	6,00,000	4,00,000	Depreciation	4,20,000	3,76,000	5,22,000
				Investment at Cost	6,30,000	4,00,000	---
Profit and Loss Account	2,10,000	1,90,000	1,28,000	Current Assets	1,20,000	60,000	40,000
Dividend received:							
From Y Ltd. in 2005	60,000						
From Y Ltd. in 2006	60,000						
From Z Ltd. in 2006		36,000					
Current Liabilities	40,000	10,000	34,000				
	11,70,000	8,36,000	5,62,000		11,70,000	8,36,000	5,62,000

All the companies pay dividends of 12 percent of paid-up share capital in March following the end of the accounting year. The receiving companies account for the dividends in their books when they are received.

'X' Limited acquired 50,000 equity shares of Y Ltd. on 31st December, 2007.

'Y' Limited acquired 30,000 equity shares of Z Ltd. on 31st December, 2008.

The detailed information of Profit and Loss Accounts is as follows:

	X Ltd.	Y Ltd.	Z Ltd.
	Rs.	Rs.	Rs.
Balance of Profit and Loss Account on 31st December, 2007 after dividends of 12% in respect of calendar year 2007, but excluding dividends received	86,000	78,000	60,000

Net profit earned in 2008	1,20,000	84,000	56,000
	2,06,000	1,62,000	1,16,000
Less – Dividends of 12% (paid in 2009)	96,000	72,000	48,000
	1,10,000	90,000	68,000
Net profit earned in 2009 (Before taking into account proposed dividends of 12% in respect of calendar year 2009)	1,00,000	1,00,000	60,000
	2,10,000	1,90,000	1,28,000

Taking into account the transactions from 2007 to 2009 and ignoring taxation, you are required to prepare:

(i) The Consolidated Balance Sheet of X Limited group as at 31st December, 2009.

(ii) The Consolidated Profit and Loss Account for the year ending 31st December, 2009.

(iii) Cost of control.

(iv) Minority shareholders interest.

Disposal of Shares in Subsidiary – Gain/Loss

2. Vertical Ltd owns 80% of voting power of Horizon Ltd., its only investment, acquired on 01.04.2008 for Rs.1,00,000. The Net Assets of Horizon Ltd on 01.04.2008 was Rs.1,00,000. On 01.10.2009, the investment in Horizon Ltd was sold for Rs. 2,00,000. The Net Assets of Horizon Ltd on 31.03.2009 and 30.09.2009 were Rs.1,50,000 and Rs.1,80,000, respectively the difference representing the profit for the period. Compute the Gain/Loss on disposal of the subsidiary.

Valuation of Shares

3. The balance sheet of Major Ltd. has been given to you for the purpose of valuation of shares:

Balance Sheet of Major Ltd. as on 31st December, 2009

Liabilities		Rs.		Rs.
Share Capital:			Fixed Assets:	
Equity Shares of Rs.10 each	5,00,000		Goodwill	50,000
			Machinery	2,30,000
Less: Call in arrear (Rs.2 on final call)	10,000	4,90,000	Factory shed	3,00,000
8% preference shares of Rs.10 each, fully paid		2,00,000	Vehicles	60,000
			Furniture	25,000
			Investments	1,00,000

Reserve and Surplus:		Current Assets:	
General Reserve	2,00,000	Stock in trade	2,10,000
Profit and Loss Account	1,40,000	Sundry Debtors	3,50,000
Current Liabilities:		Cash at Bank	50,000
Bank Loan	1,00,000	Preliminary expenses	25,000
Sundry Creditors	2,70,000		
	14,00,000		14,00,000

Additional Information:

1. Fixed Assets are worth 20% above their actual book value. Depreciation on appreciated value of fixed assets to be ignored for valuation of goodwill.
2. Of the investments 80% is non-trading and the balance is trading. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.
3. For the purpose of valuation of shares, Goodwill is to be considered on the basis of 4 years purchase of the super-profits based on average profit of the last 3 years. Profit are as follows:

	Rs.
2007	1,90,000
2008	2,00,000
2009	2,10,000

In a similar business return on capital employed is 15%. In year 2007 new furniture costing Rs.10,000 was purchased but wrongly charged to revenue. (No effect has been yet been given for rectifying the same). Depreciation is charged on furniture @ 10%. Find out the value of each fully-paid and partly-paid equity share, assuming tax rate of 50%.

Valuation of Goodwill

4. From the following information supplied to you, ascertain the value of goodwill of A Ltd., which is carrying on business as retail trader, under Super Profit Method (at 5 years' purchase of Super Profits):-

Balance Sheet as on 31st March, 2009

	Rs.		Rs.
Paid up capital:		Goodwill at cost	50,000
5,000 shares of Rs.100 each fully paid	5,00,000	Land and Building at cost	2,20,000
Bank Overdraft	1,16,700	Plant and Machinery at cost	2,00,000
Sundry Creditors	1,81,000	Stock in trade	3,00,000
Provision for taxation	39,000	Book debts less provision for bad debts	1,80,000

Profit & Loss Appropriation A/c	1,13,300		
	9,50,000		9,50,000

The company commenced operations in 1990 with a paid up capital of Rs.5,00,000. Profits for recent years (after taxation) have been as follows:-

Year ended 31st March	Rs.	
2005	40,000	(Loss)
2006	88,000	
2007	1,03,000	
2008	1,16,000	
2009	1,30,000	

The loss in 2005 occurred due to a prolonged strike.

The income-tax paid so far has been at the average rate of 40%, but it is likely to be 50% from 2010 onwards. Dividends were distributed at the rate of 10% on the paid up capital in 2006 and 2007 and the rate of 15% in 2008 and 2009. The market price of shares is ruling at Rs.125 at the end of the year ended 31st March, 2009. Profits till 2009 have been ascertained after debiting Rs.40,000 as remuneration to the managing director. The government has approved a remuneration of Rs.60,000 with effect from 1st April, 2009. The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at Rs.40,000 per annum for the next five years.

Corporate Restructuring

5. The Balance Sheet of Y Limited as on 31st March, 2009 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
5,00,000 Equity Shares of Rs. 10 each fully paid	50,00,000	Goodwill	10,00,000
		Patent	5,00,000
9% 20,000 Preference shares of Rs. 100 each fully paid	20,00,000	Land and Building	30,00,000
		Plant and Machinery	10,00,000
10% First debentures	6,00,000	Furniture and Fixtures	2,00,000
10% Second debentures	10,00,000	Computers	3,00,000
Debentures interest outstanding	1,60,000	Trade Investment	5,00,000
Trade creditors	5,00,000	Debtors	5,00,000
Directors' loan	1,00,000	Stock	10,00,000
Bank O/D	1,00,000	Discount on issue of	

Outstanding liabilities	40,000	debentures	1,00,000
Provision for Tax	1,00,000	Profit and Loss Account (Loss)	15,00,000
	96,00,000		96,00,000

Note: Preference dividend is in arrears for last three years.

A holds 10% first debentures for Rs. 4,00,000 and 10% second debentures for Rs. 6,00,000. He is also creditors for Rs. 1,00,000. B holds 10% first debentures for Rs. 2,00,000 and 10% second debentures for Rs. 4,00,000 and is also creditors for Rs. 50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

(i) All the equity shares be converted into fully paid equity shares of Rs. 5 each.

(ii) The preference shares be reduced to Rs. 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. 'A' is to cancel Rs. 6,00,000 of his total debt including interest on debentures and to pay Rs. 1 lakh to the company and to receive new 12% debentures for the Balance amount.

(iv) Mr. 'B' is to cancel Rs. 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

(v) Trade creditors (other than A and B) agreed to forego 50% of their claim.

(vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

(vii) There were capital commitments totalling Rs. 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(viii) The Directors refund Rs. 1,10,000 of the fees previously received by them.

(ix) Reconstruction expenses paid Rs. 10,000.

(x) The taxation liability of the company is settled at Rs. 80,000 and the same is paid immediately.

(xi) The assets are revalued as under:

	Rs.
Land and Building	28,00,000
Plant and Machinery	4,00,000
Stock	7,00,000

Debtors	3,00,000
Computers	1,80,000
Furniture and Fixtures	1,00,000
Trade Investment	4,00,000

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures. Prepare Bank Account and working of allocation of Interest on Debentures between A and B.

6. The following is the Balance Sheet of A Ltd. as at 31st March, 2009:

Liabilities	Rs.	Assets	Rs.
8,000 equity shares of Rs.100 each	8,00,000	Building	3,40,000
10% debentures	4,00,000	Machinery	6,40,000
Loan from A	1,60,000	Stock	2,20,000
Creditors	3,20,000	Debtors	2,60,000
General Reserve	80,000	Bank	1,36,000
		Goodwill	1,30,000
		Misc. Expenses	34,000
	17,60,000		17,60,000

B Ltd. agreed to absorb A Ltd. on the following terms and conditions:

(1) B Ltd. would take over all Assets, except bank balance at their book values less 10%. Goodwill is to be valued at 4 year's purchase of super profits, assuming that the normal rate of return be 8% on the combined amount of share capital and general reserve.

(2) B Ltd. is to take over creditors at book value.

(3) The purchase consideration is to be paid in cash to the extent of Rs.6,00,000 and the balance in fully paid equity shares of Rs.100 each at Rs.125 per share.

The average profit is Rs.1,24,400. The liquidation expenses amounted to Rs.16,000. B Ltd. sold prior to 31st March, 2009 goods costing Rs.1,20,000 to A Ltd. for Rs.1,60,000. Rs.1,00,000 worth of goods are still in stock of A Ltd. on 31st March, 2009. Creditors of A Ltd. include Rs.40,000 still due to B Ltd.

Show the necessary Ledger Accounts to close the books of A Ltd. and prepare the Balance Sheet of B Ltd. as at 1st April, 2009 after the takeover.

Employee Share Based Payments

7. S Ltd. grants 1,000 options to its employees on 1.4.2005 at Rs.60. The vesting period is two and a half years. The maximum exercise period is one year. Market price on that date is Rs.90. All the options were exercised on 31.7.2008. Journalize, if the face value of equity share is Rs.10 per share.

Financial Instruments

8. (a) What is embedded derivative and when should it be accounted as derivative? How is the embedded derivative measured?

   (b) What is meant by 'De-recognition of a financial liability'? Explain in brief.

   (c) Certain callable convertible debentures are issued at Rs.120. The value of similar debentures without call or equity conversion option is Rs. 114. The value of call as determined using Black and Scholes model for option pricing is Rs. 4.

   Determine values of liability and equity component.

Economic Value Added

9. (a) Pilot Ltd. supplies the following information using which you are required to calculate the economic value added.

• Financial Leverage	1.4 times	
• Capital (equity and debt)	Equity shares of Rs.1,000 each	34,000 (number)
	Accumulated profit	Rs. 260 lakhs
	10 percent Debentures of Rs.10 each	80 lakhs (number)
• Dividend expectations of equity shareholders	17.50%	
• Prevailing Corporate Tax rate	30%	

   (b) What is economic value added and how is it calculated? Discuss.

Value Added Statement

10. (a) What are the advantages of preparation of Value Added (VA) statements?

    (b) From the following Profit and Loss account of New Mode Reporting Ltd., prepare a gross value added statement for the year ended 31st March,2009. Show also the reconciliation between GVA and Profit before taxation.

Profit and Loss Account

	Rs.'000s	Rs.'000s
Income		
Sales	12,480	

Other income	110	12,590
Expenditure		
Production and Operational expenditure	8,640	
Administrative expenses	360	
Interest and other charges	1,248	
Depreciation	32	10,280
Profit before tax		2,310
Less: Provision for tax		110
Profit after tax		2,200
Add: balance as per last Balance Sheet		120
		2,320
Less:Transfer to Fixed assets replacement Reserve	800	
Dividend paid	320	1,120
Surplus carried to Balance Sheet		1,200

Additional information:

(i) Production and Operational expenses consists of

	Rs.
Consumption of Raw materials	64,20,000
Consumption of Stores	80,000
Local tax	16,000
Salaries to Administrative staff	12,40,000
Other Manufacturing expenses	8,84,000

(ii) Administrative expenses include salaries and commission to directors – Rs.10,000

(iii) Interest and other charges include-

(a) Interest on bank overdraft (overdraft is of temporary nature)	2,18,000
(b) Fixed loan from SIDBI	1,02,000
(c) Working capital loan from IFCI	40,000
(d) Excise duties	?

(iv) Excise duties amount to one-tenth of total value added by manufacturing and trading activities.

Market Value Added

11. What is meant by market value added (MVA)? What is the objective of calculating MVA?

Human Resource Accounting

12. (a) Why Human Resources Asset is not recognised in the Balance sheet?

    (b) Briefly describe the method of valuation of human resources as suggested by Jaggi and Lau. Also point out the special merit and demerit of this method.

Financial Reporting for Financial Institutions

13. (a) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on "mark to market basis". For the financial year ended March, 2009 the investments which were acquired at a cost of Rs.109 crores were reflected in the Balance Sheet at Rs.89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.

    (b) What do you mean by "Net asset value" (NAV) in case of mutual fund units?

14. Syria Finance Ltd.,a non-banking finance company provides to you the costs and market price of various investments held by it as on 31.3.2009:

(Figures in Rs. Lakhs)

			Cost	Market Price
Scripts:				
A.	Equity Shares-			
		A	60.00	61.20
		B	31.50	24.00
		C	60.00	36.00
		D	60.00	120.00
		E	90.00	105.00
		F	75.00	90.00
		G	30.00	6.00
B.	Mutual funds-			
		MF-1	39.00	24.00
		MF-2	30.00	21.00
		MF-3	6.00	9.00
C.	Government securities-			
		GV-1	60.00	66.00
		GV-2	75.00	72.00

(i) Can the company adjust depreciation of a particular item of investment within a category?

(ii) What should be the value of investments as on 31.3.2009?

15. (a) For what purposes inspection of records and documents of stock broker is ordered by SEBI?

(b) What is meant by merchant bankers? What books of accounts are required to be maintained by a merchant banker?

Corporate Financial Reporting

16. (a) What are the objectives of financial reporting? Explain in brief.

(b) Explain the role of auditors in the area of financial reporting of companies.

Indian ASs, IFRSs/ IASs and US GAAPs

17. Explain the treatment of the following items with reference to Indian AS, IAS/IFRS and US GAAPs:

(a) Presentation of associate results;

(b) Definition of joint venture;

(c) Definition of subsidiary.

Inflation Accounting

18. Nidhi Ltd. is adopting historical cost system. From the following details furnished, prepare current cost Profit and Loss account for the year ended on 31.3.2009:

Statement of Profit and Loss:		(Rs.)
Sales		24,00,000
Cost of sales:		
Opening stock	1,80,000	
Add : Purchases	15,60,000	
Less: closing stock	2,40,000	15,00,000
Gross Profit		9,00,000
Operating expenses		3,60,000
Depreciation		1,20,000
Interest on loan		1,80,000
Provision for tax		90,000
Net profit		1,50,000
Dividend (proposed)		30,000
Retained profit		1,20,000

The chief finance officer of Nidhi Ltd. furnished the additional information as below:

(a)	Gearing adjustment for the year	Rs.20,232
(b)	Cost of sales adjustment for the year	Rs.37,998
(c)	Depreciation adjustment for the year	Rs.18,000
(d)	Monetary working capital adjustment for the year	Rs.13,500

Theory Questions based on Accounting Standards and Guidance Notes

19. (i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

    (ii) What are the different forms of joint ventures? Elucidate the presentation and disclosure norms of Joint Ventures under AS 27.

    (iii) Discuss the provisions relating to recognition of impairment loss.

    (iv) Explain the provisions relating to combining of construction contracts.

    (v) Beta Ltd., with a turnover of Rs.35 lakhs and borrowings of Rs.10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2009. Advise the management the exemptions that are available as per Companies (AS) Rules, 2006.

    If Beta is a partnership firm is there any other exemptions additionally available.

    (vi) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?

20. Write short notes on :

    (i) NACAS.

    (ii) Impairment of asset and its application to inventory

    (iii) Restatement of shares as per AS 20.

    (iv) Provisions of AS 26 relating to retirement and disposal of intangible assets.

    (v) Servicing asset in the context of Securitisation.

Practical Problems based on Accounting Standards and Guidance Notes

21. (i) Gamma Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of apparels business and sales increased 5 times. One of the conditions for sales that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with references to AS 9.

    (ii) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of

certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

(iii) Mayur Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2007 for Rs.60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs.41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs.36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs.54 crore per annum and has a carrying amount of Rs.3.46 crore. All such machines put together could fetch a sum of Rs.4.44 crore if disposed. Discuss the applicability of Impairment loss.

(iv) A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

22. (i) Krishna Limited borrowed an amount of Rs.150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Krishna Ltd. capitalized Rs.19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of Rs.150 crores, an income of Rs.3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(ii) Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2006, 2007 and 2008 for Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs.7,00,000, Rs.18,00,000 and Rs.23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

(iii) B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. the cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?

(iv) EXOX Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2008. The company seeks your advice on the following:

(a) The Company's sales tax assessment for assessment year 2005-06 has been completed on 14th February, 2008 with a demand of Rs.2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(b) The Company has entered into a wage agreement in May, 2008 whereby the labour union has accepted a revision in wage from June, 2007. The agreement provided that the hike till May, 2008 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2008.

23. (i) A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

(ii) A Ltd., owns 30% of the equity capital of B Ltd. B Ltd. in turn owns 35% of equity capital C Ltd., and 40% of equity capital in D Ltd. You are required to answer the following questions.

(a) Whether B Ltd. is a related party to A Ltd?

(b) Whether C Ltd., is a related party to A Ltd.?

(c) Whether C Ltd. and D Ltd. are related parties?

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

(iv) Induga Company has at its financial year ended 31st March, 2009 fifteen law suits outstanding none of the which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

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

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

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

24. From the following information, prepare cash flow statement as at 31st December, 2008 by using direct method:

Balance Sheets

Liabilities	2007	2008	Assets	2007	2008
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Profit & Loss A/c	4,25,000	5,00,000	Stock	3,40,000	3,50,000
Long Term Loans	5,00,000	5,30,000	Debtors	3,60,000	3,30,000
Creditors	1,75,000	2,00,000	Cash	30,000	35,000
			Bills Receivable	20,000	15,000
	16,00,000	17,30,000		16,00,000	17,30,000

Income Statement for the year ended 31st December, 2008

Sales		20,40,000
Less:	Cost of Sales	13,60,000
Gross Profit		6,80,000
Less:	Operating Expenses:	
	Administrative Expenses	(2,30,000)
	Depreciation	(1,10,000)
Operating Profit		3,40,000
Add:	Non-Operating Incomes (dividend received)	25,000
		3,65,000
Less:	Interest Paid	(70,000)
		2,95,000
Less:	Income Tax	1,30,000
Profit after Tax		1,65,000

Statement of Retained Earnings

Opening Balance		4,25,000
Add:	Profit	1,65,000
		5,90,000
Less:	Dividend paid	90,000
Closing Balance		5,00,000

25. (i) ABCLtd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

The company securitises the principal component of the loan plus the right to receive interest at 14% to Segovia Corporation, a special purpose vehicle, for Rs.1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to ABC Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. the remaining half of the interest is due to ABC Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

(ii) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

SUGGESTED ANSWERS/HINTS

1. (i) Consolidated Balance Sheet of X Ltd. and its subsidiaries Y Ltd. and Z Ltd. as on 31st December, 2009

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
80,000 Equity shares of Rs.10 each fully paid	8,00,000	Goodwill [Refer (iii)]	18,000
Minority Interest [Refer (iv)] Reserves and Surplus:	2,47,167	Other Fixed Assets less depreciation	13,18,000
Profit and Loss Account [Refer (ii)]	3,04,833	Current Assets, Loans and Advances:	
Current Liabilities and Provision:		Current Assets	2,20,000
Current Liabilities	84,000		
Proposed Dividend:			
X Ltd.	96,000		
Minority Interest [Refer (iv)]	24,000		
	15,56,000		15,56,000

(ii) Consolidated Profit and Loss Account for the year ending 31st December, 2009 (in Rs.)

Particulars	X Ltd.	Y Ltd.	Z Ltd.	Adjust-ments	Total		Particulars	X Ltd.	Y Ltd.	Z Ltd.	Adjust ments	Total
To Dividend (paid for 2008)	96,000	72,000	48,000	96,000	1,20,000	By	Balance b/d	2,06,000	1,62,000	1,16,000	-	4,84,000
To Minority Interest	-	39,167	32,000	-	71,167	By	Dividend received in 2008 (for 2007)	60,000	-	-	-	60,000
To Capital Reserve (Cost of Control)	-	65,000	51,000	-	1,16,000	By	Dividend received in 2009 (for 2008)	60,000	36,000	-	96,000	-
To Investments Accounts						By	Profit for the year	1,00,000	1,00,000	60,000	-	2,60,000
(Dividend received out of	60,000*	36,000*	-	-	96,000							

capital profit)											
To Proposed Dividend	96,000	-	-	-	96,000						
To Balance c/d	1,74,000	85,833	45,000	-	3,04,833						
	4,26,000	2,98,000	1,76,000	96,000	8,04,000		4,26,000	2,98,000	1,76,000	96,000	8,04,000

Notes:

(1) X Ltd. receives from Y Ltd., dividend amounting to Rs.60,000 for the year 2007 in the year 2008 for shares acquired in 2007. It is a capital profit, therefore it has been transferred to cost of control to reduce the cost of investment.

(2) Y Ltd. receives a dividend of Rs.36,000 from Z Ltd. for the year 2008 in the year 2009. The shares were acquired by Y Ltd on 31st December, 2008. The entire amount is therefore, a capital profit and hence transferred to cost of control to reduce the cost of investment.

(iii) Cost of Control:

		Rs.	Rs.
Cost of Investment in Y Ltd. on 31st December 2007		6,30,000	
Less:	Dividend of the year 2007 received in 2008 out of Pre-acquisition profit	60,000	5,70,000
Cost of Investment in Z Ltd.		4,00,000	
Less :	Dividend of the year 2008 received in 2009 out of Pre-acquisition Profit	36,000	3,64,000
			9,34,000
Less:	Paid up value of shares in Y Ltd.	5,00,000	
	Paid up value of shares in Z Ltd.	3,00,000	
	Capital Profits in Y Ltd. (Refer W.N. 2)	65,000	
	Capital Profits in Z Ltd. (Refer W.N. 2)	51,000	9,16,000
Goodwill			18,000

(iv) Minority shareholders' interest:

	Y Ltd.	Z Ltd.
	Rs.	Rs.
Share Capital (Y Ltd. – 1/6 and Z Ltd. – 1/4)	1,00,000	1,00,000
Capital Profits (Refer W.N. 2)	13,000	17,000
Revenue Profits (Refer W.N. 2)	26,167	15,000
	1,39,167	1,32,000
Total (1,39,167 + 1,32,000)		2,71,167
Less: Minority shareholders' share of proposed dividend (shown separately in the Balance Sheet)		

$\left(\frac{1}{6}\text{of Rs.}72{,}000+\frac{1}{4}\text{of Rs.}48{,}000\right)$	24,000
Balance	2,47,167

Working Notes:

1. Shareholding Pattern

	Number of shares	share of holding
In Y Ltd.		
X Ltd.	50,000	5/6
Minority Interest	10,000	1/6
In Z Ltd.		
Y Ltd.	30,000	3/4
Minority Interest	10,000	1/4

2. Analysis of Profits

	Pre - acquisition Capital Profit	Post - acquisition Revenue Profit
Z Ltd.	Rs.	Rs.
Balance on 31st December, 2008 after dividend for 2008 (1,16,000 – 48,000)	68,000	-
Profit for the year ending 31st December, 2009 before proposed dividends for 2009	-	60,000
	68,000	60,000
Share of Y Ltd. (3/4)	51,000	45,000
Minority Interest (1/4)	17,000	15,000
Y Ltd.		
Balance on 31st December, 2007	78,000	-
Profit for the year 2008 after payment of dividend for 2008 (84,000 – 72,000)	-	12,000
Profit for the year 2009 (before payment of dividend of the year 2009)	-	1,00,000
Revenue Profit from Z Ltd.	-	45,000
	78,000	1,57,000

Share of X Ltd. (5/6)	65,000	1,30,833
Share of Minority Shareholders' Interest (1/6)	13,000	26,167

Note: The problem has been solved by following 'direct approach'.

2. Cost of Control

Particulars	Rs.
Cost of Investment	1,00,000
Less:Share in Net Assets as on date of acquisition (Rs.1,00,000 × 80%)	80,000
Goodwill on Consolidation (Goodwill shown in Balance Sheet)	20,000

Gain/Loss on disposal of investment in Subsidiary

Particulars	01.10.09
Sale Consideration	2,00,000
Less: Share in Net Assets as on date of sale (1,80,000 × 80%)	(1,44,000)
Less: Goodwill on Consolidation	(20,000)
Gain on Disposal	36,000

3.

(i)

Capital Employed on 31.12.2009		Rs.	Rs.
Machinery			2,30,000
Factory Shed			3,00,000
Vehicles			60,000
Furniture (25,000+7,290)			32,290
			6,22,290
Add:	20%		1,24,458
			7,46,748
Trade Investments			16,000
Stock in Trade			2,10,000
Sundry Debtors			3,50,000
Cash at Bank			50,000
			13,72,748
Less:	Bank Loan	1,00,000	
	Sundry Creditors	2,70,000	3,70,000
			10,02,748

(ii) Average profits for the last three years

	2007	2008	2009
	Rs.	Rs.	Rs.
Reported Profit (taking the figures given in the question as profit after tax)	1,90,000	2,00,000	2,10,000
Add: furniture purchased charged to revenue (net of tax)	5,000	-	-
	1,95,000	2,00,000	2,10,000
Less: Depreciation on furniture purchased (net of tax)	500	450	405
	1,94,500	1,99,550	2,09,595
Less: Dividend on non-trading investments less tax	4,000	4,000	4,000
	1,90,500	1,95,550	2,05,595
Average Profit			1,97,215

(iii) Calculation of Super Profits

	Rs.
Capital employed	10,02,748
Average profit	1,97,215
Normal profit @ 15% on capital employed	1,50,412
Super profit	46,803
Goodwill at four years' purchase	1,87,212

Valuation of Equity Shares	Rs.
Value of Net Tangible Assets [Refer (i)]	10,02,748
Add: Goodwill [Refer (iii)]	1,87,212
Add: Non-trade investments	80,000
Add: Notional Calls	10,000
	12,79,960
Less: Preference Share Capital	2,00,000
	10,79,960
Number of shares	50,000
Intrinsic value of fully paid share	Rs.21.60
Intrinsic value of partly paid share (Rs.21.60-2.00)	Rs.19.60

4. Valuation of Goodwill of A Ltd.

(i) Capital employed:

		Rs.	Rs.
Land and Building at Cost			2,20,000
Plant and Machinery at Cost			2,00,000
Stock in trade			3,00,000
Sundry Debtors			1,80,000
			9,00,000
Less:	Sundry Liabilities:		
	Bank overdraft	1,16,700	
	Sundry Creditors	1,81,000	
	Provision for taxation	39,000	3,36,700
Capital employed at the end of the year			5,63,300
Add Back:	Dividend paid for the year	75,000	
	Less: Half of the profits	65,000	10,000
Average Capital employed			5,73,300

(ii) Normal Rate of Return

Average Dividends for the last 4 years 12 ½ %

Market price of shares on 31st March Rs.125.

Normal Rate of Return: $\frac{12.5\times100}{125}=10\%$

(iii) Normal Profit on average capital employed @ 10% on Rs.5,73,300 — Rs. 57,330

(iv) Future maintainable profit-weighted average

Year	Profit Rs.	Weight	Product Rs.
2006	88,000	1	88,000
2007	1,03,000	2	2,06,000
2008	1,16,000	3	3,48,000
2009	1,30,000	4	5,20,000
		10	11,62,000
Average annual profit (after tax)			1,16,200
Average annual profit (before tax)			

$1{,}16{,}200 \times \frac{100}{60}$		1,93,667
Adjustments		
Increase in remuneration	-20,000	
Saving in cost of materials	+40,000	20,000
		2,13,667
Less: Taxation @ 50%		1,06,833
Super Profits		1,06,834

5. Journal Entries in the Books of Y Ltd.

	Particulars		Dr. Rs.	Cr. Rs.
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (Rs. 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (Rs.100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (Rs.50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% First Debentures A/c	Dr.	4,00,000	
	10% Second Debentures A/c	Dr.	6,00,000	
	Trade Creditors A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	1,00,000	
	Bank A/c	Dr.	1,00,000	
	To 12% New Debentures A/c			7,00,000
	To Reconstruction A/c			6,00,000
	(Being Rs. 6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			

	Particulars		Dr. (Rs.)	Cr. (Rs.)
(iv)	10% First Debentures A/c	Dr.	2,00,000	
	10% Second Debentures A/c	Dr.	4,00,000	
	Trade Creditors A/c	Dr.	50,000	
	Interest on Debentures Outstanding A/c	Dr.	60,000	
	To 12% New Debentures A/c			4,10,000
	To Reconstruction A/c			3,00,000
	(Being Rs. 3,00,000 due to B (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(v)	Trade Creditors A/c	Dr.	1,75,000	
	To Reconstruction A/c			1,75,000
	(Being remaining creditors sacrificed 50% of their claim)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (Rs. 5) A/c			60,000
	To Reconstruction A/c			40,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made for cancellation of capital commitments.)			
(viii)	Bank A/c	Dr.	1,10,000	
	To Reconstruction A/c			1,10,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being payment of reconstruction expenses.)			

			Dr. (Rs.)	Cr. (Rs.)
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			80,000
	To Reconstruction A/c			20,000
	(Being payment of tax for 80% of liability in full settlement)			
(xi)	Reconstruction A/c	Dr.	47,20,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			15,00,000
	To Discount on issue of Debentures A/c			1,00,000
	To Land and Building A/c			2,00,000
	To Plant and Machinery A/c			6,00,000
	To Furniture & Fixture A/c			1,00,000
	To Computers A/c			1,20,000
	To Trade Investment A/c			1,00,000
	To Stock A/c			3,00,000
	To Debtors A/c			2,00,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)			

Working Notes:

(1) Outstanding interest on debentures have been allocated between A and B as follows:

			Rs.
A's Share			
10% First Debentures	4,00,000		
10% Second Debentures	6,00,000	10,00,000	
10% on Rs. 10,00,000 i.e.			1,00,000
B's Share			
10% First Debentures	2,00,000		
10% Second Debentures	4,00,000	6,00,000	
10% on Rs. 6,00,000 i.e.			60,000
Total			1,60,000

(2) Bank Account

		Rs.			Rs.
To	A (reconstruction)	1,00,000	By	Balance b/d	1,00,000
To	Reconstruction A/c (paid by directors)	1,10,000	By	Reconstruction A/c (capital commitment penalty paid)	15,000
			By	Reconstruction A/c (reconstruction expenses paid)	10,000
			By	Provision for tax A/c (tax paid)	80,000
			By	Balance c/d	5,000
		2,10,000			2,10,000

6. Books of A Limited

Realisation Account

		Rs.			Rs.
To	Building	3,40,000	By	Creditors	3,20,000
To	Machinery	6,40,000	By	B Ltd.	12,10,000
To	Stock	2,20,000	By	Equity Shareholders (Loss)	76,000
To	Debtors	2,60,000			
To	Goodwill	1,30,000			
To	Bank (Exp.)	16,000			
		16,06,000			16,06,000

Bank Account

To	Balance b/d	1,36,000	By	Realisation (Exp.)	16,000
To	B Ltd.	6,00,000	By	10% debentures	4,00,000
			By	Loan from A	1,60,000
			By	Equity shareholders	1,60,000
		7,36,000			7,36,000

10% Debentures Account

To	Bank	4,00,000	By	Balance b/d	4,00,000
		4,00,000			4,00,000

Loan from A Account

		Rs.			Rs.
To	Bank	1,60,000	By	Balance b/d	1,60,000
		1,60,000			1,60,000

Misc. Expenses Account

		Rs.			Rs.
To	Balance b/d	34,000	By	Equity shareholders	34,000
		34,000			34,000

General Reserve Account

		Rs.			Rs.
To	Equity shareholders	80,000	By	Balance b/d	80,000
		80,000			80,000

B Ltd. Account

		Rs.			Rs.
To	Realisation A/c	12,10,000	By	Bank	6,00,000
			By	Equity share in B Ltd.(4,880 shares at Rs.125 each)	6,10,000
		12,10,000			12,10,000

Equity Shares in B Ltd. Account

		Rs.			Rs.
To	B Ltd.	6,10,000	By	Equity shareholders	6,10,000
		6,10,000			6,10,000

Equity Share Holders Account

		Rs.			Rs.
To	Realisation	76,000	By	Equity share capital	8,00,000
To	Misc. Expenses	34,000	By	General reserve	80,000
To	Equity shares in B Ltd.	6,10,000			
To	Bank	1,60,000			
		8,80,000			8,80,000

B Ltd

Balance Sheet as on 1st April, 2009 (An extract)*

Liabilities	Rs.	Assets	Rs.
4880 Equity shares of Rs.100 each	4,88,000	Goodwill	2,16,000
(Shares have been issued for consideration other than cash)		Building	3,06,000

* In the absence of the particulars of assets and liabilities (other than those of A Ltd.), the complete Balance Sheet of B Ltd. after takeover cannot be prepared.

Securities Premium	1,22,000	Machine	5,76,000
Profit and Loss A/c .... Less: unrealized profit 15,000			
Creditors (3,20,000 - 40,000)	2,80,000	Stock (1,98,000 -15,000)	1,83,000
Bank Overdraft	6,00,000	Debtors (2,60,000 – 40,000) 2,20,000	
		Less: Provision for bad debts 26,000	1,94,000

Working Notes:

1. Valuation of Goodwill

	Rs.
Average profit	1,24,400
Less: 8% of Rs.8,80,000	70,400
Super profit	54,000
Value of Goodwill = 54000 x 4	2,16,000

2. Net Assets for purchase consideration

Goodwill as valued in W.N.1		2,16,000
Building		3,06,000
Machinery		5,76,000
Stock		1,98,000
Debtors		2,60,000
Total Assets		15,56,000
Less: Creditors	3,20,000	
Provision for bad debts	26,000	3,46,000
Net Assets		12,10,000

Out of this, Rs.6,00,000 is to be paid in cash and remaining i.e., (12,10,000 – 6,00,000) Rs. 6,10,000 in shares of Rs.125/-. Thus, the number of shares to be allotted 6,10,000/125 = 4,880 shares.

3. Unrealised Profit on Stock

	Rs.
The stock of A Ltd. includes goods worth Rs.1,00,000 which was sold by B Ltd. on profit. Unrealized profit on this stock will be $\frac{40,000}{1,60,000} \times 1,00,000$	25,000
As B Ltd purchased assets of A Ltd. at a price 10% less than the book value, 10% need to be adjusted from the stock i.e., 10% of Rs.1,00,000.	(-10,000)
Amount of unrealized profit	15,000

7.

Books of S Ltd.

Journal Entries

Date	Particulars		Debit Rs.	Credit Rs.
31.3.06	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of Rs.30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.07	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of Rs.30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.08	Employees Compensation Expense	Dr.	6,000	
	To Employees Stock Option Outstanding Account			6,000
	(Being balance of compensation expense amortized Rs.30,000 less Rs. 24,000)			
	Profit and Loss Account	Dr.	6,000	
	To Employees Compensation Expense Account			6,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.7.08	Bank Account (Rs. 60 × 1,000)	Dr.	60,000	
	Employees Stock Option Outstanding Account (Rs.30×1,000)	Dr.	30,000	
	To Equity Share Capital Account			10,000
	To Securities Premium Account			80,000
	(Being exercise of 1,000 options at an exercise price of Rs.60 each)			

Working Notes:

1. Total employees compensation expense = 1,000 x (Rs.90 – Rs.60) = Rs.30,000
2. Employees compensation expense has been written off during 2½ years on straight line basis as under:

   I year = Rs.12,000 (for full year)

   II year = Rs.12,000 (for full year)

   III year = Rs.6,000 (for half year)

8. (a) An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative should be separated from the host contract and accounted for as a derivative if (i) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract and (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. However, a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss need not be separated. Where fair value of an embedded derivative cannot be measured reliably on the basis of terms and conditions of the contract, e.g. when the embedded derivative is based on an unquoted equity instrument, then the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) instrument and the fair value of the host contract. If the fair value of the embedded derivative cannot be reliably measured using the method described above, the hybrid (combined) instrument is designated as at fair value through profit or loss.

   (b) An entity should remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires.

   An exchange between an existing borrower and lender of debt instruments with substantially different terms should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

   The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, should be recognised in the statement of profit and loss.

If an entity repurchases a part of a financial liability, the entity allocates the previous carrying amount of the financial liability between the part that continues to be recognised and the part that is derecognised based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognised and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognised is recognised in the statement of profit and loss.

(c) A callable bond is one that gives the issuer a right to buy the bond from the bondholders at a specified price. This feature in effect is a call option written by the bondholder. The option premium (value of call) is payable by the issuer.

Liability component (disregarding the call) = Rs. 114

Value of call payable by issuer = Rs. 4

Liability component = Rs. 114 – Rs. 4 = Rs. 110

Equity component = Rs. 120 – Rs. 110 = Rs. 10

9. (a) Computation of EVA

	Rs. in lakhs
Net profit after tax (Refer Working Note 1)	140
Add: Interest adjusted for tax effect (800 × 10% × .70)	56
Return to Providers of Funds	196
Less: Cost of Capital (Refer Working Note 2)	161
Economic Value Added (EVA) =	35

Working Notes:

1. Interest and Net Profit

$$\text{Financial Leverage} = \frac{\text{Profit before Interest \& Taxes (PBIT)}}{\text{Profit before Tax (PBT)}}$$

Interest on Borrowings = Rs. 800,00,000 × 10% = Rs.80 lakhs

Therefore,

$$1.40 = \frac{PBIT}{PBIT - Interest}$$

$$1.40 = \frac{PBIT}{PBIT - 80}$$

$$1.40\,(PBIT - 80) = PBIT$$

$$1.40\,PBIT - 112 = PBIT$$

$$1.40\,(PBIT - PBIT) = 112$$

$$0.40\,PBIT = 112$$

PBIT	=	112/0.40
PBIT	=	Rs. 280 Lakhs
PBIT	=	Rs. 280 lakhs
PBIT = PBIT- 1 =280 – 80	=	Rs. 200 lakhs
Tax (30%)	=	Rs.60 lakhs
Net profit after tax	=	Rs. 140 lakhs

2. Cost of Capital

	(Rs. in lakhs)
Equity Shareholders' funds	600
10% Debenture holders' funds	800
Total	1400

Weights assigned to Equity shareholders fund = $\frac{600}{1400}$ =0.4286

Weights assigned to Debenture holders = $\frac{800}{1400}$ =0.5714

Source of Funds	Amount Rs.(in lakhs)	Weight	Cost %	WACC %
(1)	(2)	(3)	(4)	(5)=(3 × 4)%
Equity share holders' funds	600	0.4286	17.50	7.50
Debenture holders' funds	800	0.5714	7.00*	4.00
Total	1400	1.0000	----	11.50

Cost of Capital = Average Capital Employed × Weighted Average cost of Capital (WACC)

= Rs.1400 lakhs × 11.50% = Rs.161 lakhs

(b) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically EVA= OPBT – Tax – (TCE × COC)

* Rate of interest net of corporate tax of 30%.

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

To better align managers interests with shareholders' - the EVA framework needs to be holistically applied in an integrated approach - simply measuring EVA is not enough; it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

However, EVA as a strategic tool has the following limitations:

1. Not easy to use; too complicated for small businesses.
2. Recommends inexpensive debts in order to reduce the cost of capital.
3. A passive tool, measures past performance.

10. (a) Various advantages of preparation of Value Added (VA) Statements are as under:

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.

4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour–intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

(b) New Mode Reporting Ltd.

Value Added Statement

for the year ended 31st March, 2009

(Figures in Rs.'000)

Sales			12,480
Less:	Cost of Materials and Services:		
	Production and Operational Expenses (8,640 – 16-1,240)	7,384	
	Administrative Expenses (360 – 10)	350	
	Interest on Bank Overdraft	218	
	Interest on Working Capital Loan	40	
	Excise Duties (Refer to working note)	360	
	Other/miscellaneous charges (888 – 360)	528	8,880
Value added by manufacturing and trading activities			3,600
Add:	Other Income		110
Gross value added from operations			3,710

Application of Gross Value Added

		Rs. in '000	Rs.in'000	%
To	Pay Employees:			
	Salaries to Administrative Staff		1240	33.42
To	Pay Directors:			
	Salaries and Commission		10	0.27
To	Pay Government:			
	Local Taxes	16		
	Income Tax	110	126	3.40

To	Pay Providers of Capital:			
	Interest on Fixed Loan	102		
	Dividend	320	422	11.37
To	Provide for maintenance and expansion of the company:			
	Depreciation	32		
	Fixed Assets Replacement Reserve	800		
	Retained Profit (1200 – 120)	1080	1912	51.54
			3,710	100.00

Reconciliation between Gross Value Added and Profit Before Taxation

		Rs.in'000
Profit before Tax		2,310
Add Back: Depreciation	32	
Salaries to Administrative Staff	1240	
Directors' Salaries and Commission	10	
Interest on Fixed Loan	102	
Local Tax	16	1400
Total value added		3710

Working Note:

Calculation of excise duty	Rs.'000	Rs.'000
Interest and other charges		1,248
Less: Interest on bank overdraft	218	
Interest on SIDBI loan	102	
Interest on IFCI loan	40	360
Excise duty and other charges		888

Assuming that these other /miscellaneous charges will be deducted for arriving at the value added, the excise duty will be calculated as follows:-

Let Excise Duties be denoted by - E

Then, other charges = 888 - E

Excise duty are $\frac{1}{10th}$ of value added

Hence E = $\frac{1}{10th}$ [12,480 – {7,384+ 350+218 + 40+E + (888 – E)}]

= $\frac{1}{10th}$ [12,480 – 8,880]

= $\frac{1}{10th} \times 3,600 = 360$

Other/miscellaneous charge 888 – 360 = Rs.528

The above solution has been given accordingly.

Alternatively, if other/miscellaneous charges are considered as application of value added (i.e., not deducted for deriving the value added), calculation of Excise Duties (E) will be as follows:

$E = \frac{1}{10th}$ [12,480 – (7,384 + 350 + 218+40+E)]

$E = \frac{1}{10th} \times (4,488 - E)$

11E = 4,488

E = Rs.408

And thus other/miscellaneous charges will be Rs.888 – 408 = Rs.480

Gross Value added in this case will be Rs. 4,080 + 110 (Other income) = Rs.4,190

And accordingly, application part will be prepared after taking other/miscellaneous charges.

11. Market Value Added (MVA) is the difference between the current market value of a firm and the capital contributed by investors. If MVA is positive, the firm has added value. If it is negative the firm has destroyed value.

    To find out whether management has created or destroyed value since its inception, the firm's MVA can be used:

    MVA = Market Value of Capital - Capital employed

    This calculation shows the difference between the market value of a company and the capital contributed by investors (both bondholders and shareholders). In other words, it is the sum of all capital claims held against the company plus the market value of debt and equity.

    Calculated as:

    The higher the MVA, the better. A high MVA indicates the company has created substantial wealth for the shareholders. A negative MVA means that the value of the actions and investments of management is less than the value of the capital contributed to the company by the capital markets, meaning wealth or value has been destroyed.

    The aim of the company should be to maximize MVA. The aim should not be to maximize the value of the firm, since this can be easily accomplished by investing ever-increasing amounts of capital.

12. (a) Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resources. Human resources are not recognized in balance sheet as there are no measurement criteria for recognition of human resources. Human resource accounting is at developing stage and no accounting principles have been established for valuation of human assets. Costs incurred on human resources are recognised as expenses in profit and loss account. Leading public sector units like

OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information.

(b) Jaggi and Lau suggested a model for valuation of human resources. According to them, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as basis of valuation. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

Merit

Jaggi and Lau model approached the valuation of human resources on the basis of grouping of employees. Under this method, calculations get simplified and the chances of errors get reduced.

Demerit

This model ignores individual skills of the employees. The varied skills of the employees is not recognized in the valuation process under Jaggi and Lau model.

13. (a) The Guidance note on "Accounting for Investments in Financial Statements of Mutual Funds" provides that Investments should be marked to market on balance sheet date with provision for depreciation, if any, in the value of investments debited to revenue account. The provision so created should be shown as a deduction from the value of investments in the Balance Sheet. The Guidance notes further states that the depreciation or appreciation should be worked out on individual basis or by category of investment but not on an overall basis. Keeping in view 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of

depreciation on investments, the Guidance Note states that the gross value of depreciation on investments should be reflected in the revenue account rather than the same being netted off with the appreciation in the value of other investments. Thus the claim of Amigo Mutual Fund Ltd. is not correct.

(b) Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV) which is calculated as under:–

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (Rs. 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

14. (i) Quoted current investments for each category shall be valued at cost or market value, whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Therefore, depreciation of a particular item of investments can be adjusted within the same category of investments.

(ii) Value of Investments as on 31.3.2009

Type of Investment	Valuation Principle	Value Rs. in lakhs
Equity Shares (Aggregated)	Lower of cost or market Value	406.50
Mutual Funds	NAV (Market value, assumed)	54.00
Government securities	Cost	135.00
		595.50

As per para 14 of AS 13 "Accounting for Investments", the carrying amount for current investments is the lower of cost and market price. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly, the investments may be computed at the lower of cost and market value computed category wise.

15. (a) SEBI may appoint one or more persons as inspecting authority to undertake inspection of the books of account, other records and documents of the stock brokers for any of the following purposes:

    (a) to ensure that the books of the account and other books are being maintained in the manner required;

    (b) that the provisions of the Act, rules, regulations and the provisions of the Securities Contract (Regulation) Act, and the rules made thereunder are being complied with;

    (c) to investigate into the complaints received from investors, other stock brokers, sub-brokers or any other person on any matter having a bearing on the activities of the stock brokers; and

    (d) to investigate suo motu, in the interest of securities business or investors' interest into the affaris of the stock-brokers.

    (b) A merchant banker is an organisation that acts as an intermediary between the issuers and the ultimate purchasers of securities in the primary security market. In addition to managing an issue for a client, the services offered by a merchant banker includes underwriting and providing advice on complex financings arrangements, mergers and acquisitions, and at times direct equity investments in corporations. In exercise of the powers conferred vide Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board, with the previous approval of the Central Government made the SEBI (Merchant Bankers) Regulations, 1992 which specify various requirements. These regulations specify the norms which SEBI takes into account for considering the grant of a certificate of registration and its renewal.

    Every merchant banker shall keep and maintain the following books of account, records and documents as per regulation 14 :

    (a) a copy of balance sheet as at the end of the each accounting period;

    (b) a copy of profit and loss account for that period;

    (c) a copy of the auditor's report on the accounts for that period;

    (d) a statement of financial position.

16. (a) The following are the objectives of financial reporting:

    (i) To provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.

    (ii) To provide information to help investors, creditors, and others to assess the amount, timing and uncertainly of prospective net cash inflows to the related enterprise.

    (iii) To provide information about the economic resources of an enterprise, the

claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events and circumstances that change resources and claims to those resources.

(iv) To provide information about an enterprise's financial performance during a period.

(v) To give information about an enterprise's performance provided by measures of earnings and its components.

(vi) To provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise's resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.

(vii) To provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it.

(viii) To provide information that is useful to managers and directors in making decisions in the interest of owners.

(b) The audit of financial statements is a legal requirement. The audit provides an external and objective check on the measurement and disclosure aspects of corporate financial reporting. An auditor is appointed by the shareholders, but effectually his appointment is subject to will of management or promoter group. Nevertheless, the auditor is supposed to be independent of management and to serve the shareholders and other users of financial statements. Although, Management is responsible for the preparation of financial statement including the notes, the auditor through the auditor's report states whether financial statements presents fairly, in all material respects the financial position, the results of operations and the cash flows for the accounting period. The auditor is responsible for seeing that the financial statements issued conform with generally accepted accounting principles. Thus, the auditor must agree that accounting policies adopted by the management is appropriate and all estimates are reasonable. Any departure from generally accepted accounting principles (including non-compliance with the measurement and disclosure requirements of the accounting standards) would results in a qualified opinion. Auditor's report is an important accompaniment of financial statements. Because of boilerplate nature of these reports, there is tendency to skip over them while analyzing financial statements. However, such failure to give attention to the auditor's report may cause the user to miss significant information.

17. (a) Presentation of associate results

ASs	IFRS/IAS	US GAAPs
In consolidated financial statements; equity method is used. Share of post-tax results is shown. In standalone financials; at cost less impairment.	In consolidated financial statements; equity method is used. Share of post-tax results is shown. In standalone financial; at cost or at fair value in accordance with IAS 39.	In consolidated financial statements; similar to IFRS.

(b) Definition of joint venture

ASs	IFRS/IAS	US GAAPs
Contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. Exclusion if it meets the definition of a subsidiary	Contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. Exclusion if investment is held-for-sale.	A corporation owned and operated by small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group.

(c) Definition of subsidiary

ASs	IFRS/IAS	US GAAPs
Definition of subsidiary is based on voting control or control over the composition of the board of directors. The existence of currently exercisable potential voting rights is not taken into consideration.	Control is presumed to exist when parent owns, directly or indirectly through subsidiaries, more than one half of an entity's voting power. The existence of currently exercisable potential voting rights is also taken into considerations. A parent could have control over an entity in circumstances where it holds less than 50% of the voting rights of an entity.	Similar to IFRS. However, a bipolar consolidation model is used, which distinguishes between a variable interest model and a voting interest model. Control can be direct or indirect and may exist with a lesser percentage of ownership (voting interest model).

18. Current Cost Profit and Loss Account of Nidhi Ltd. For the year ended 31.3.2009

	Rs.	Rs.
Trading profit before interest and tax under historical cost system		
Gross profit less (Operating expenditure + Depreciation)		
Rs. 9,00,000 less (Rs. 3,60,000 + Rs.1,20,000)		4,20,000

Less: Current cost adjustments		
Depreciation adjustment	18,000	
Cost of sales adjustment	37,998	
Monetary working capital adjustment	13,500	69,498
Current cost operating profit		3,50,502
Less: Interest on loan	1,80,000	
Gearing adjustment	20,232	1,59,768
Current cost profit before tax		1,90,734
Less: Provision for tax		90,000
Current cost profit after tax		1,00,734
Less: Dividend		30,000
Retained current cost profit for the year		70,734

19. (i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;

(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

(ii) Joint ventures take many different forms and structures. This Statement identifies three broad types – jointly controlled operations, jointly controlled assets and jointly controlled entities – which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control.

A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

(a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

(b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and

(c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

(a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and

(b) its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.

A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

(iii) An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.

In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:

External sources of information

(a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;

(b) significant changes with an adverse effect on the enterprise have taken place

during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated;

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;

(d) the carrying amount of the net assets of the reporting enterprise is more than its market capitalisation;

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset;

(f) significant changes with an adverse effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date; and

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

(iv) When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

(v) Beta Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

1. AS 3 "Cash Flow Statements" is not mandatory.

2. AS 17 "Segment Reporting" is not mandatory.

3. SMEs are exempt from some paragraphs of AS 19 "Leases".

4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).

5. SMEs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 "Impairment of Assets".

6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67of AS 29 "Provisions , Contingent Liabilities and Contingent Assets".

7. SMEs are exempt from certain requirements of AS 15 "Employee Benefits".

8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

If Beta is not a company, it will be treated as a level III enterprise instead of level II enterprise; Beta Ltd. will be exempt from requirements of AS 18 "Related Party Disclosures" and AS 24 "Discontinuing Operations".

(vi) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

(i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include 'other income'.

(ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.

(iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

20. (i) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006.

(ii) The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7,

Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

(iii) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

(iv) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

(v) Servicing asset is a contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges and other related revenues are expected to more than adequately compensate the servicer (who may be the originator) for performing the services. A servicing contract can be either undertaken together with selling or securitizing the financial assets being serviced or purchased or assumed separately.

21. (i) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

In the case of the Jewellery Business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

(ii) The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS I5 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

(iii) As per provisions of Para 91(b) of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

(iv) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

22. (i) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Krishna Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-09 should be calculated as follows:

Actual interest for 2008-09 (11% of Rs.150 crores)	Rs.16.50 crores
Less: Income on temporary investment from specific borrowings	Rs. 3.50 crores
Borrowing costs to be capitalized during year 2008-09	Rs.13.00 crores

(ii) Omega Limited.

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

(iii) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

(iv) (a) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2008. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs.2.10 crore.

(b) The arrears for the period from June, 2007 to March, 2008 are required to be provided for in the accounts of the company for the year ended on 31st March, 2008.

23. (i) Computation of earnings per share

	Earnings	Shares	Earnings per share
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	*	(60,000)	
Diluted earnings per share	Rs. 15,00,000	6,40,000	Rs. 2.34 (approx.)

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

(ii) (a) As per AS 18, associates and joint ventures of the reporting enterprise are related parties. Since A Ltd. holds more than 20% of the voting power in B Ltd. by virtue of this it has substantial interest and significant influence in B Ltd. Therefore B Ltd. is an associate and is related party to A Ltd.

(b) An associate of an associate is not a related party. Only in the case of a holding company a subsidiary of a subsidiary (sub-subsidiary) also becomes a related party.

(c) C Ltd. and D Ltd. are co-associates. Co-subsidiaries become related parties because of common control. In the case of this common control is missing and therefore they are not related parties.

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

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

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

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

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

Expected loss in first ten cases	=	Rs.90,000 × 0.3 + Rs.1,60,000 × 0.1
	=	Rs.43,000 × 10
	=	Rs.4,30,000
Expected loss in remaining five cases	=	Rs.60,000 × 0.3 + Rs.95,000 × 0.2
	=	Rs.37,000 × 5
	=	Rs.1,85,000
Total Contingent Liability	=	Rs.4,30,000 + Rs.1,85,000= Rs.6,15,000

24. Cash Flow Statement for the year ended December 31, 2008

Cash Flows from Operating Activities (direct method)		Rs.	Rs.
Received from customers: Sales		20,40,000	
Add:	Decrease in Debtors	30,000	
	Decrease in B/R	5,000	20,75,000
Less:	Payments to suppliers: Cost of sales	13,60,000	
	Add: Increase in stock	10,000	
	Less: Increase in creditors	(25,000)	(13,45,000)
			7,30,000
Less:	Payment for expenses		(2,30,000)
	Tax paid		(1,30,000)

Cash provided by operating activities		3,70,000
Cash Flows from Investing Activities		
Purchase of Fixed Assets (10,00,000 + 1,10,000 – 8,50,000)	(2,60,000)	
Dividend on Investments	25,000	
Cash used in Investing Activities		(2,35,000)
Cash Flows from Financing Activities		
Long term loan taken	30,000	
Interest paid	(70,000)	
Dividend Paid	(90,000)	
Income from Financing Activities		(1,30,000)
Net Increase in Cash during the year		5,000
Add: Opening Cash Balance		30,000
Closing Cash Balance		35,000

25. (i) Journal Entries in the Books of Originator

S.No.	Particulars		Debit Rs.	Credit Rs.
1.	Bank A/c	Dr.	1,00,000	
	To Loans (Cost of Securitised Component)			90,910
	To Profit on Securitisation			9,090
	(Being securitization of principal amount and right to receive interest at 14% interest rate)			
2.	Servicing Asset A/c	Dr.	3,180	
	Interest Strip A/c	Dr.	5,910	
	To Loans			9,090
	(Being creation of servicing asset and interest strip receivable)			

Working Notes:

1.	Fair value of securitized component of loan		Rs.
	Fair value of Loan		1,10,000
	Less:Fair value of servicing asset	3,500	

Fair value of interest strip	6,500	10,000
		1,00,000

2. Appropriation of carrying amount based on Fair Value

Particulars	Fair Value	% to Fair Value	Proportionate Carrying Amount
	Rs.	Rs.	Rs.
Fair value of securities component of the loan	1,00,000	90.91%	90,910
Fair value of servicing asset	3,500	3.18%	3,180
Fair value of interest strip	6,500	5.91%	5,910
	1,10,000	100.00%	1,00,000

3. Profit on Securitisation

	Rs.
Net proceeds from securitisation	1,00,000
Less: Apportioned carrying amount	90,910
	9,090

(ii) The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.

Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

Note: AS 1 to AS 29 are applicable for November, 2009 Examination.

Annexure

List of Institute's Publications relevant for November, 2009 Examinations

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2009. Students may kindly take it into consideration while preparing for the examinations.

Final Examination

Paper 1: Financial Reporting

I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards – AS 1 to AS 29.

II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
2. Guarantees and Counter-Guarantees Given by Companies.
3. Guidance Note on Accrual Basis of Accounting.
4. Guidance Note on Accounting Treatment for Excise Duty.
5. Guidance Note on Accounting for Depreciation in Companies.
6. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
7. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
8. Guidance Note on Accounting for Securitisation.
9. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
10. Guidance Note on Accounting for Corporate Dividend Tax.
11. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
12. Guidance Note on Accounting for Employee Share-based Payments.
13. Guidance Note on Accounting for Fringe Benefits Tax.
14. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
15. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25.