PAPER – 1 : FINANCIAL REPORTING

QUESTIONS

Consolidated Financial Statements

1. Harsh Ltd. acquired control in Sukh Ltd. a few years back when Sukh Ltd. had ₹ 25,000 in Reserve and ₹ 14,000 profit in Profit and Loss Account. Plant Account (book value ₹ 66,000) of Sukh Ltd. was revalued at ₹ 62,000 on the date of acquisition. Equity dividend of ₹ 7,500 was received by Harsh Ltd. out of pre-acquisition profit and the amount was correctly treated by Harsh Ltd. Debenture interest has been paid up to date. Following are Balance Sheets of Harsh Ltd. and Sukh Ltd.

Balance Sheet as on 30-09-2011

	Harsh Ltd.	*Sukh Ltd.*
Liabilities	₹	₹
Equity Capital (₹ 10)	5,00,000	1,00,000
6% Preference Share Capital (₹ 100)	1,00,000	50,000
General Reserve	30,000	30,000
Profit and Loss account	40,000	12,000
6% Debentures	Nil	1,00,000
Sundry Creditors	90,000	60,000
Due to Sukh Ltd.	10,000	Nil
Bills Payable	20,000	25,000
Total	7,90,000	3,77,000
Assets		
Goodwill	50,000	30,000
Building	2,00,000	50,000
Plant & Machinery	1,05,000	1,00,000
Stock in trade	1,30,000	1,00,000
Sundry Debtors	90,000	50,000
Bills Receivable	30,000	10,000
Due from Harsh Ltd.	Nil	12,000
Bank	27,000	25,000
Investments in Sukh Ltd.		
300 Preference Share Capital	28,000	Nil
7,500 Equity Shares	85,000	Nil
Debentures (Face Value ₹ 50,000)	45,000	Nil
Total	7,90,000	3,77,000

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1. Cheque of ₹ 2,000 sent by Harsh Ltd. to Sukh Ltd. was in transit.
2. Balance Sheet of Sukh Ltd. was prepared before providing for 6 months dividend on Preference Shares. Dividend for the first half has already been paid.
3. Both the Companies have proposed preference dividend only, but no effect has been given in accounts.
4. Stock of Harsh Ltd. includes ₹ 6,000 stock purchased from Sukh Ltd. on which Sukh Ltd. made 20% profit on cost. Stock of Sukh Ltd. includes stock of ₹10,000 purchased from Harsh Ltd. on which Harsh Ltd. made 10% profit on selling price.
5. Since acquisition, Sukh Ltd. has written off 30% of the book value of Plant as on date of acquisition by way of depreciation.
6. Bills Receivable of Sukh Ltd. is due from Harsh Ltd.

Prepare Consolidated Balance Sheet as on 30.09.2011.

Corporate Restructuring - Amalgamation

2. Given below are the balance sheets of Hight Ltd. and Length Ltd. as on 31.12.2010. Length Ltd. was merged with Hight Ltd. with effect from 1.1.2011.

Balance Sheets as on 31.12.2010

Liabilities	*Hight Ltd.* ₹	*Length Ltd.* ₹	*Assets*	*Hight Ltd.* ₹	*Length Ltd.* ₹
Share capital :			Sundry fixed assets	9,50,000	4,00,000
Equity shares of ₹10 each	7,00,000	2,50,000	Investments (Non-trade)	2,00,000	50,000
General reserve	3,50,000	1,20,000	Stock	1,20,000	50,000
Profit and loss A/c	2,10,000	65,000	Debtors	75,000	80,000
Export profit reserve	70,000	40,000	Advance tax	80,000	20,000
12% Debentures	1,00,000	1,00,000	Cash and bank	2,75,000	1,30,000
Sundry creditors	40,000	45,000	Preliminary expenses	10,000	
Provision for taxation	1,00,000	60,000			
Proposed dividend	1,40,000	50,000			
	17,10,000	7,30,000		17,10,000	7,30,000

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Hight Ltd. would issue 12% Debentures to discharge the claims of the debenture holders of Length Ltd. at par. Non-trade investments of Hight Ltd. fetched interest @ 25% while those of Length Ltd. fetched @ 18%. Profits of Hight Ltd. and Length Ltd. during 2008, 2009 and 2010 were as follows:

Year	*Hight Ltd.* ₹	*Length Ltd.* ₹
2008	5,00,000	1,50,000
2009	6,50,000	2,10,000
2010	5,75,000	1,80,000

Goodwill may be calculated on the basis of capitalization method taking 20% as the normal rate of return. Purchase consideration is discharged by Hight Ltd. on the basis of intrinsic value per share. Both companies decided to cancel the proposed dividend.

Pass Journal Entries and prepare the Balance Sheet of Hight Ltd. after the merger.

Corporate Restructuring – Internal Reconstruction

3. Given below is the balance sheet of Restructure Ltd. as on 31.3.2011:

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Authorised and issued capital: 12,000, 7% Preference shares		Building at cost less depreciation	4,00,000
of ₹ 50 each (Note: Preference dividend is in arrear for five years)	6,00,000	Plant at cost less depreciation	2,68,000
15,000 Equity shares of ₹ 50 each	7,50,000	Trademarks and goodwill	
Loan	5,73,000	at cost	3,18,000
Sundry creditors	2,07,000	Stock	4,00,000
Other liabilities	35,000	Debtors	3,28,000
		Preliminary expenses	11,000
		Profit and loss A/c	4,40,000
	21,65,000		21,65,000

The Company is now earning profits short of working capital and a scheme of reconstruction has been approved by both the classes of shareholders. A summary of the scheme is as follows:

(a) The equity shareholders have agreed that their ₹ 50 shares should be reduced to ₹ 2.50 by cancellation of ₹ 47.50 per share. They have also agreed to subscribe for three new equity shares of ₹ 2.50 each for each equity share held.

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(b) The preference shareholders have agreed to cancel the arrears of dividend and to accept for each ₹ 50 share, 4 new 5% preference shares of ₹ 10 each, plus 6 new equity shares of ₹ 2.50 each, all credited as fully paid.

(c) Lenders to the company for ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹ 10 each and 12,000 new equity shares of ₹ 2.50 each.

(d) The directors have agreed to subscribe in cash for 40,000, new equity shares of ₹ 2.50 each in addition to any shares to be subscribed by them under (a) above.

(e) Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the company.

(f) The equity share capital cancelled is to be applied:

i. to write off the preliminary expenses;

ii. to write off the debit balance in the profit and loss A/c; and

iii. to write off ₹ 35,000 from the value of plant.

Any balance remaining is to be used to write down the value of trademarks and goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of the company after reconstruction. The nominal capital as reduced is to be increased to ₹ 6,50,000 for preference share capital and ₹ 7,50,000 for equity share capital.

Corporate Restructuring – Demerger

4. Part Ltd. has two divisions A and B and their respective shares of various assets and liabilities in the company's Balance Sheet as on 31st March, 2011 are given below:

			(₹ in lakhs)
	A division	*B division*	*Total*
Fixed assets:			
Cost	650	340	
Less: Depreciation	225	160	
Written down value	425	180	605
Investments			115
Current Assets	350	430	
Less: Current Liabilities	185	210	
Net Current Assets	165	220	385
			1,105

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Financed by:	
Loan Funds	400
Own Funds:	
Equity share capital- shares of ₹ 10 each	300
Reserves and Surplus	405
	1,105

Division B has been invariably suffering losses. The company sold this division B along with its assets and liabilities to a newly formed company Apart Ltd., which was incorporated with an authorized capital of ₹ 800 lakhs divided into shares of ₹ 10 each. Apart Ltd. allotted to Part Ltd's shareholders its two fully paid equity shares of ₹ 10 each at par for every fully paid equity shares of ₹10 each held in Part Ltd. as discharge of consideration for the division taken over.

Apart Ltd. recorded in its books the fixed assets at ₹ 280 lakhs, current assets at ₹ 320 lakhs and liabilities at the same value at which they appeared in the books of Part Ltd.

On 1st April, 2011 Part Ltd. sold all its investments for ₹ 135 lakhs and redeemed debentures liability of ₹ 150 lakhs at par, which was included in loan funds. The cash transaction being recorded in the Bank Account is pertaining to A division.

You are required to:

(i) Show Journal Entries in the books of Part Ltd.

(ii) Prepare Part Ltd.'s Balance Sheet immediately after the Demerger and

(iii) Initial Balance Sheet of Apart Ltd.

Valuation of Goodwill

5. The Balance Sheets of X- factor Ltd. are as follows:

		(₹ in lakhs)
Liabilities	As at 31.3.2010	As at 31.3.2011
Share Capital	1,000.0	1,000.0
General Reserve	800.0	850.0
Profit and Loss Account	120.0	175.0
Term Loans	370.0	330.0
Sundry Creditors	70.0	90.0
Provision for Tax	22.5	25.0
Proposed Dividend	200.0	250.0
	2,582.5	2,720.0

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Assets		
Fixed Assets and Investments (Non-trade)	1,600.0	1,800.0
Stock	550.0	600.0
Debtors	340.0	220.0
Cash and Bank	92.5	100.0
	2,582.5	2,720.0

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.2010 is ₹ 2,200 lakhs and on 31.3.2011 is ₹ 2,532.8 lakhs.
2. Current cost of stock on 31.3.2010 is ₹ 670 lakhs and on 31.3.2011 is ₹ 750 lakhs.
3. Non-trade investments in 10% government securities is ₹ 490 lakhs.
4. Debtors include foreign exchange debtors amounting to $ 70,000 recorded at the rate of $ 1 = ₹ 17.50 but the closing exchange rate was $ 1 = ₹ 21.50.
5. Creditors include foreign exchange creditors amounting to $ 1,20,000 recorded at the rate of $ 1 = ₹ 16.50 but the closing exchange rate was $ 1 = ₹ 21.50.
6. Profit included ₹ 120 lakhs being government subsidy which is not likely to recur.
7. ₹ 247 lakhs being the last instalment of R and D cost were written off to the profit and loss account. This expenditure is not likely to recur.
8. Tax rate during 2010-2011 was 50% effective future tax rate is estimated at 40%.
9. Normal rate of return is expected at 15%.

Based on the information furnished, Mr. Pessimist, a director contends that the company does not have any goodwill. Examine his contention.

Valuation of Shares

6. Capital structure of Happy Ltd. as at 31.3.2011 is as under:

	(₹ in lakhs)
Equity share capital	10
10% Preference share capital	5
15% Debentures	8
Reserves	4

Happy Ltd. earns a profit of ₹ 5 lakhs annually on an average before deduction of interest on debentures and income tax which works out to 40%.

Normal return on equity shares of companies similarly placed is 12% provided:

(a) Profit after tax covers fixed interest and fixed dividends at least 3 times.

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(b) Capital gearing ratio is 0.75.

(c) Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Happy Ltd. has been regularly paying equity dividend of 10%.

Compute the value per equity share of the company considering the paid up value of ₹ 100 per share.

Valuation of Brands

7. What are the difficulties in accounting of brands? Explain in brief.

Value Added Statement

8. The following is the Profit and Loss Account of Addition Ltd. for the year ended 31st March. 2011. Prepare a Gross Value Added Statement of Addition Ltd.

Profit and Loss Account for the year ended 31st March, 2011

		Amount (₹ in lakhs)
Income:		
Sales		890
Other Income		55
		945
Expenditure :		
Production and operational expenses (a)	641	
Administrative expenses (factory) (b)	33	
Interest	29	
Depreciation	17	720
Profit before tax		225
Provision for taxation		30
Profit after tax		195
Balance as per last Balance Sheet		10
		205
Transferred to General Reserve		45
Dividend paid		95
		140
Surplus carried to Balance Sheet		65
		205

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Notes:

		(₹ in lakhs)
(a)	Production and operational expenses:	
	Consumption of raw materials	293
	Consumption of stores	59
	Salaries, wages, gratuities etc., (Admn)	82
	Cess and local taxes of	98
	Other manufacturing expenses	109
		641
(b)	Administration expenses include salaries, commission to Directors ₹ 9.00 lakhs and Provision for doubtful debts ₹ 6.30 lakhs	
(c)	Interest on loan from bank for working capital	9
	Interest on fixed loan from bank	10
	Interest on loan from financial institution for fixed loan	8
	Interest on Debentures	2
		29
(d)	The charges for taxation include a transfer of ₹ 3.00 lakhs to the credit of Deferred tax account.	
(e)	Cess and local taxes include excise duty, which is equal to 10% of cost of bought-in-materials.	

Economic Value Added

9. From the following information of Value Ltd., compute the economic value added:

(i)	Share capital	₹ 2,000 lakhs
(ii)	Reserves and surplus	₹ 4,000 lakhs
(iii)	Long-term debt	₹ 400 lakhs
(iv)	Tax rate	30%
(v)	Risk free rate	9%
(vi)	Market rate of return	16%
(vii)	Interest	₹ 40 lakhs
(viii)	Beta factor	1.05
(ix)	Profit before interest and tax	₹ 2,000 lakhs

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NBFCs

10. While closing its books of account on 31st March, 2012 a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	16,800
Sub-standard assets	1,340
Secured positions of doubtful debts:	
- upto one year	320
- one year to three years	90
- more than three years	30
Unsecured portions of doubtful debts	97
Loss assets	48

Calculate the amount of provision, which must be made against the Advances.

Mutual Fund

11. A Mutual Fund company raised funds on 01.04.2011 by issuing 10 lakhs units @ ₹ 17.50 per unit. Out of this Fund, ₹ 160 lakhs invested in several capital market instruments. The initial expenses amount to ₹ 9 lakhs. During June, 2011, the company sold certain securities worth ₹ 100 lakhs for ₹ 125 lakhs and it bought certain securities for ₹ 90 lakhs. The Fund Management expenses amounting to ₹ 5 lakhs per month. The dividend earned was ₹ 3 lakhs. 80% of the realised earnings were distributed among the unit holders. The market value of the portfolio was ₹ 175 lakhs. Determine Net Asset value (NAV) per unit as on 30.06.2011.

Employee Stock Option Scheme

12. Cheers Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2008 for ₹ 20 depending upon the employees at the time of vesting of options. The market price of the option is ₹ 50. The options will vest at the end of year 1 if the earning of Cheers Ltd. increases 16% or it will vest at the end of the year 2 if the average earning of two years increases by 13% or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2008, 4,000 unvested options lapsed on 31.3.2009 and finally 3,500 unvested options lapsed on 31.3.2010.

    Following is the earning of Cheers Ltd. :

Year	Earning (in %)
Year 1	14%
Year 2	10%
Year 3	7%

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850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

Financial Instruments

13. On February 1, 2010, Future Ltd. entered into a contract with Son Ltd. to receive the fair value of 1000 Future Ltd.'s own equity shares outstanding as on 31-01-2011 in exchange for payment of ₹ 1,04,000 in cash i.e., ₹ 104 per share. The contract will be settled in net cash on 31.01.2011.

    The fair value of this forward contract on the different dates were:

(i)	Fair value of forward on 01-02-2010	Nil
(ii)	Fair value of forward on 31-12-2010	₹ 6,300
(iii)	Fair value of forward on 31-01-2011	₹2,000

    Presuming that Future Ltd. closes its books on 31st December each year, pass entries:

    (i) If net settled is in cash

    (ii) If net is settled by Son Ltd. by delivering shares of Future Ltd.

Investment in Associates

14. A Ltd. acquired 35% of the capital of B Ltd. on 1-7-2010 at ₹ 1,20,000, when the opening balance of the reserves and surplus stood at ₹ 40,000. On 31-3-2011, the reserve and surplus stood at ₹ 2,50,000 with revaluation reserve created after 1st July for ₹ 90,000. Equity share capital of B Ltd is ₹ 2,50,000. Give the extract of investment in B Ltd. in the Consolidated Financial Statement to be prepared by A Ltd. as on 31-3-2011, when B Ltd proposed dividend to the extent of ₹ 60,000 for the year 2010-2011 adjusted in the books.

IFRS

15. State the treatment of the following items with reference to Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS):

    (i) Impairment of assets

    (ii) Business combinations.

Corporate Financial Reporting

16. What are the disclosure requirements under the Companies Act, 1956 regarding Corporate Financial Reporting?

Accounting Standards

17. The Balance Sheets of a Company as on 31st March, 2009 and 2010 are given below:

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Liabilities	31.3.09 ₹	31.3.10 ₹	Assets	31.3.09 ₹	31.3.10 ₹
Equity Capital	15,00,000	17,00,000	Fixed Assets	15,30,000	20,60,000
General Reserve	1,80,000	2,10,000	9% Investments (Long term)	90,000	2,40,000
Profit & Loss A/c	1,50,000	6,00,000	Debtors	1,20,000	2,25,000
12% Debentures	3,00,000	4,50,000	Stock	5,70,000	5,55,000
Creditors	60,000	2,25,000	Cash in hand	1,80,000	5,40,000
Bills payables	60,000	50,000	Underwriting Commission	7,500	9,000
Bank overdraft	30,000	25,000	Discount on issue of debentures	22,500	6,000
Proposed dividend	1,80,000	2,25,000			
Provision for tax	30,000	60,000			
Provision for doubtful debts	30,000	45,000			
Unpaid interest on debentures		35,000			
Unpaid dividend	-	10,000			
Total	25,20,000	36,35,000	Total	25,20,000	36,35,000

Additional information:

During the year ended 31st March, 2010 :

(i) A machine costing ₹ 2,10,000 (depreciation provided thereon ₹ 90,000) was sold for ₹ 75,000. Depreciation charged during the year was ₹ 2,10,000.

(ii) New shares and debentures were issued on 31st March, 2010.

(iii) Tax paid during the year was ₹ 15,000.

(iv) An interim dividend @ 15% was paid on equity shares.

(v) On 31st March, 2010 some investments were purchased for ₹ 2,70,000 and some investments were sold at a profit of 20% on sale.

You are required to prepare cash flow statement as per AS 3.

18. (a) From the following details of an asset

(i) Find out impairment loss

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(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

Cost of asset	₹ 56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹ 27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹12 lakhs
Upward revaluation done in last year	₹14 lakhs

(b) An airline is required by law to overhaul its aircraft once in every three years. A company which operates aircrafts does not provide any provision as required by law in its final account. Discuss with reference to relevant Accounting Standard.

(c) NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹ 530 lakhs on research upto 31st March, 09.

The development of the process began on 1st April, 09 and Development phase expenditure was ₹ 360 lakhs upto 31st March, 10 which meets assets recognition criteria.

From 1st April, 10, the company will implement the new process design which will result in after tax saving of ₹ 80 lakhs per annum for the next five years.

The cost of capital of company is 10%.

Explain:

(1) Accounting treatment for research expenses.

(2) The cost of internally generated intangible asset as per AS 26.

(3) The amount of amortization of the assets. (The present value of annuity factor of ₹1 for 5 years @ 10% = 3.7908)

(d) X Limited has provided depreciation as per accounting records of ₹ 8,00,000 and as per tax records same is ₹14,00,000. Unamortised preliminary expenses as per tax records is ₹11,200. There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognised. Tax rate is 40%.

(e) "While calculating diluted earning per share, effect is given to all dilutive potential equity shares that were outstanding during that period." Explain. Also calculate the diluted earnings per share from the following information:

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Net profit for the current year	₹ 85,50,000
No. of equity shares outstanding	20,00,000
No. of 8% convertible debentures of ₹ 100 each	1,00,000
Each debenture is convertible into 10 equity shares	
Interest expenses for the current year	₹6,00,000
Tax relating to interest expenses	30%

19. (a) B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

   (i) Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years.

   (ii) The Fair market value is also ₹ 10,00,000.

   (iii) The property reverts back to the lessor on termination of the lease.

   (iv) The unguaranteed residual value is estimated at ₹ 1,00,000 at the end of the year 2011.

   (v) 3 equal annual payments are made at the end of each year.

   Consider IRR = 10%.

   The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513.

   The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

   State whether the lease constitute finance lease and also calculate unearned Finance income.

(b) Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2010 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 Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2011. Due to surplus fund out of ₹ 150 crores, an income of ₹ 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.

(c) A company purchased on April 1, 2010 a special purpose machinery for ₹ 1 crore, and received Central Government subsidy for 25% of the price. Effective life of the machinery is 8 years. Explain the accounting treatment and quote the relevant AS.

(d) The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.2011, calculate the actual return on plan assets :

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- Benefits paid	₹2,00,000
- Employer contribution	₹2,80,000
- Fair market value of plan assets on 31.03.2011	₹11,40,000
- Fair market value of plan assets as on 31.03.2010	₹8,00,000

(e) While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010, a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010.

20. (a) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2009. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2009-10.

In March, 2011, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2011.

(b) A Ltd. purchased fixed assets costing ₹ 2,544 lakhs on 1st April, 2010 and the same was fully financed by foreign currency loan in U.S. Dollars, repayable in four equal annual instalments. Exchange rate at the time of purchase was 1 US Dollar ₹ 42.40. The first instalment was paid on 31st March, 2011 when 1 US Dollar fetched ₹ 45.40. The entire loss on exchange was included in cost of goods sold of normal business operations. A Ltd. provides depreciation on their fixed assets at 20% on WDV basis.

Show the correct accounting treatment with reference to relevant accounting standards.

(c) Albert Finance Ltd. has made the following investments:

(i) Purchased the following equity shares from stock exchange on 1st June, 2009.

	Cost ₹
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

(ii) Purchased gold of ₹ 3,00,000 on 1st April, 2006.

(iii) Invested in mutual funds at a cost of ₹ 6,00,000 on 31st March, 2009.

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(iv) Purchased government securities at a cost of ₹ 5,00,000 on 1st April, 2009.

How will you treat these investments as per applicable AS in the books of the company for the year ended on 31st March, 2010, if the values of these investments are as follows:

Shares	₹	₹
Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	70,000	3,00,000
Gold		5,00,000
Mutual funds		4,50,000
Government securities		7,00,000

Also explain is it possible to off-set depreciation in investment in mutual funds against appreciation of the value of investment in government securities?

(d) Moon Ltd. entered into agreement with Sun Ltd. for sale of goods of ₹ 8 lakhs at a profit of 20 % on cost. The sale transaction took place on 1st February, 2011. On the same day Sun Ltd. entered into another agreement with Moon Ltd. to resell the same goods at ₹ 10.80 lakhs on 1st August, 2011. State the treatment of this transaction in the financial statements of Moon Ltd. as on 31.03.11. The pre-determined re-selling price covers the holding cost of Sun Ltd. Give the Journal Entries as on 31.03.11 in the books of Moon Ltd.

(e) The Chief Accountant of ANZ Ltd., gives the following data regarding its six segments:

							(₹ in lakhs)
Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that segments 'M' and 'N' alone should be reported. Is he justified in his view? Discuss.

(f) Can PT Ltd. a wire netting company, while valuing its finished stock at the year end include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses?

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SUGGESTED ANSWERS/HINTS

1. Consolidated Balance Sheet of Harsh Ltd. And its subsidiary Sukh Ltd. as on 30-09-2011

Liabilities		*Amount*	*Assets*		*Amount*
		₹			₹
Equity Share Capital		5,00,000	Goodwill		
6% Preference Share Capital		1,00,000	Harsh Ltd.	50,000	
Minority Interest (W.N.4)	54,775		Sukh Ltd.	30,000	
Less: Preference				80,000	
Dividend	(600)	54,175	*Less*: Capital		
General Reserve(W.N.6)		33,750	Reserve (W.N.5)	10,750	69,250
Profit & Loss Account (W.N.7)		43,925	Buildings		
6% Debentures		50,000	Harsh Ltd.	2,00,000	
(1,00,000 – 50,000)			Sukh Ltd.	50,000	2,50,000
Sundry Creditors			Plant & Machinery		
Harsh Ltd.	90,000		Harsh Ltd.	1,05,000	
Sukh Ltd.	60,000	1,50,000	Sukh Ltd.	1,00,000	
Bills Payable (W.N.8)		35,000		2,05,000	
Proposed Dividend			*Less*: Revaluation		
Harsh Ltd.	6,000		Loss	4,000	
Minority Interest	600	6,600		2,01,000	
			Add: Excess		
			Depreciation	1,200	2,02,200
			Stock (W.N.8)		2,28.000
			Debtors		
			Harsh	90,000	
			Sukh	50,000	1,40,000
			Bills Receivable (W.N.8)		30,000
			Remittance in transit		2,000
			(12,000 – 10,000)		
			Bank		
			Harsh Ltd.	27,000	
			Sukh Ltd.	25,000	52,000
		9,73,450			9,73,450

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Working Notes:

1. **Analysis of Profits and General Reserve of Sukh Ltd.**

			Pre-acquisition	Post-acquisition	
			Capital Profit	Revenue Reserve	Revenue Profit
General Reserve		30,000	25,000	5,000	
Profit and Loss account		12,000			
Pre-acquisition balance	14,000				
Less: Dividend (7,500/75%)	10,000	4,000	4,000		
Post acquisition		8,000			
Less: Preference dividend for 6 months		1,500			6,500
Revaluation loss			(4,000)		
Reversal of excess depreciation (due to downward revaluation)					1,200
			25,000	5,000	7,700
Harsh Ltd. (75%)			18,750	3,750	5,775
Minority Interest (25%)			6,250	1,250	1,925

2. **Stock Reserve [on sale by Sukh Ltd. to Harsh Ltd. (upstream)]**

Stock held by Harsh Ltd.	₹ 6,000
Profit %	20% on cost price
Stock reserve (₹ 6,000 x 20/120)	₹ 1,000
Attributable to Harsh Ltd. (75%)	₹ 750
Minority Interest (25%)	₹ 250

3. **Stock Reserve [on sale by Harsh Ltd. to Sukh Ltd. (downstream)]**

Stock held by Sukh Ltd.	₹ 10,000
Profit %	10% on selling price
Stock reserve (₹ 10,000 x 10%)	₹ 1,000
Attributable to Harsh Ltd.	₹ 1,000
Minority Interest	Nil

4. **Minority Interest**

	₹
Equity share capital (25%)	25,000
Preference share capital (40%)	20,000

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Capital profit	6,250
Revenue reserve	1,250
Revenue profit	1,925
Proposed preference dividend (₹ 1,500 x 40%)	600
	55,025
Less: Stock reserve (W.N.2)	250
	54,775

5. Cost of control

		₹
Investments in Equity Share Capital of Sukh Ltd.		85,000
Investments in Preference Share Capital of Sukh Ltd.		28,000
		1,13,000
Less: Nominal Value of Equity Share Capital of Sukh Ltd.	75,000	
Nominal Value of Preference Share Capital of Sukh Ltd.	30,000	
Capital Profit	18,750	1,23,750
Capital Reserve		10,750

6. Consolidated General Reserve

	₹
General Reserve of Harsh Ltd.	30,000
Add: Share of Revenue Reserve	3,750
	33,750

7. Consolidated Profit and Loss Account

			₹
Profit & Loss A/c			40,000
Less: Stock Reserve			
Upstream (W.N. 2)	750		
Downstream (W.N.3)	1,000	1,750	
Proposed preference dividend (6% x 1,00,000)*		6,000	7,750
			32,250
Add: Share of proposed dividend of Sukh Ltd. (₹1,500 x 60%)			900

* Preference dividend of Harsh Ltd. is assumed to be proposed for full year.

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Share of Profit from Sukh Ltd.			5,775
			38,925
Add: Gain on write off of Investment in Debentures of Sukh Ltd.** (50,000 – 45,000)			5,000
			43,925

8. **Elimination of Mutual Owings and Stock Reserve**

	Bills Receivable	*Bills Payable*	*Stock*
	₹	₹	₹
Harsh Ltd.	30,000	20,000	1,30,000
Sukh Ltd.	10,000	25,000	1,00,000
	40,000	45,000	2,30,000
Mutual Owings	(10,000)	(10,000)	-
Stock Reserve (1,000 + 1,000)	-	-	(2,000)
	30,000	35,000	2,28,000

2. **Balance Sheet of Hight Ltd. after merger**

Liabilities	₹	Assets	₹
Share capital :		Fixed assets:	
Issued, subscribed and paid up		Goodwill (W.N. 3C)	3,80,000
92,400 Equity shares of ₹ 10 each	9,24,000	Sundry fixed assets (9,50,000 + 4,00,000)	13,50,000
(of which 22,400 shares were issued for consideration other than cash)		Investment Current assets, loans and advances:	2,50,000
Reserves and surplus :		Stock (1,20,000 + 50,000)	1,70,000
Securities premium	6,80,960	Debtors (75,000 + 80,000)	1,55,000
General reserve	3,50,000	Advance tax	
Profit and Loss A/c 2,10,000		(80,000 + 20,000)	1,00,000

** It is assumed that debentures were acquired post acquisition therefore taken as intra-group balance. Accordingly, profit on elimination of debentures has been dealt with the Profit and Loss account.

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Add: Proposed dividend		Cash and bank balances	
cancelled 1,40,000	3,50,000	(2,75,000 + 1,30,000 – 40)	4,04,960
Export profit reserve			
(70,000 + 40,000)	1,10,000	Miscellaneous	
Secured loans:		Expenditure to the	
12% Debentures	2,00,000	extent not written off:	
(1,00,000 + 1,00,000)		Preliminary expenses	10,000
Current liabilities and provisions:		Amalgamation Adjustment A/c	40,000
Sundry creditors			
(40,000 + 45,000)	85,000		
Provision for tax			
(1,00,000 + 60,000)	1,60,000		
	28,59,960		28,59,960

Working Notes:

1. Calculation of purchase consideration

Equity shares of Length Ltd.	25,000 shares
Intrinsic value per share of Length Ltd. (W.N.2)	₹ 36.2
Value of shares	₹ 9,05,000
Intrinsic value per share of Hight Ltd. (W.N.2)	₹ 40.4

No. of shares to be issued by Hight Ltd. ₹ 9,05,000/₹ 40.4 = 22,400.99 shares

i.e 22,400 shares and cash for fraction i.e. .99 x ₹ 40.4= ₹ 40

Accounting for Amalgamations and Corporate Restructuring

Purchase consideration		₹
22,400 shares @ ₹ 40.4		
Capital [₹ 10 / Share]	2,24,000	
Premium [₹ 30.4 / Share]	6,80,960	9,04,960
Cash for fraction		40
Total purchase consideration payable		9,05,000

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2. **Intrinsic value per share**

	Hight Ltd.		*Length Ltd.*	
	₹	₹	₹	₹
Assets				
Goodwill (W.N.3)	13,65,000		3,80,000	
Sundry fixed assets	9,50,000		4,00,000	
Investments	2,00,000		50,000	
Stock	1,20,000		50,000	
Debtors	75,000		80,000	
Advance tax	80,000		20,000	
Cash and bank balance	2,75,000	30,65,000	1,30,000	11,10,000
Liabilities				
12% Debentures	1,00,000		1,00,000	
Sundry creditors	40,000		45,000	
Provision for tax	1,00,000	(2,40,000)	60,000	(2,05,000)
Net assets		28,25,000		9,05,000
No. of shares		70,000		25,000
Intrinsic value per share (upto one decimal)		40.4		36.2

3. **Valuation of goodwill**

A. **Capital Employed**

	Hight Ltd.		*Length Ltd.*	
	₹	₹	₹	₹
Assets				
Sundry fixed assets	9,50,000		4,00,000	
Investment (Non-trade)	-		-	
Stock	1,20,000		50,000	
Debtors	75,000		80,000	
Advance tax	80,000		20,000	
Cash and bank balance	2,75,000	15,00,000	1,30,000	6,80,000
Liabilities				
12% Debentures	1,00,000		1,00,000	
Sundry creditors	40,000		45,000	

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Provision for tax	1,00,000	(2,40,000)	60,000	(2,05,000)
Capital employed		12,60,000		4,75,000

B. **Average pre-tax profit**

Particulars	*Hight Ltd.* ₹	*Length Ltd* ₹
2008	5,00,000	1,50,000
2009	6,50,000	2,10,000
2010	5,75,000	1,80,000
	17,25,000	5,40,000
Simple average of 3 years	5,75,000	1,80,000
Less: Non-trading income		
(₹ 2,00,000 @ 25%)	(50,000)	
(₹ 50,000 @ 18%)		(9,000)
Average profit	5,25,000	1,71,000

C. **Computation of goodwill** ₹

Particulars	*Hight Ltd.*	*Length Ltd.*
Capitalised value of average profits		
$\left[\frac{5,25,000}{.20};\frac{1,71,000}{.20}\right]$	26,25,000	8,55,000
Capital employed	12,60,000	4,75,000
Goodwill	13,65,000	3,80,000

3. **In the books of Restructure Ltd.**

Journal Entries

	Particulars		Debit (₹)	Credit (₹)
1.	Equity share capital A/c (₹ 50)	Dr.	7,50,000	
	To Equity share capital A/c (₹ 2.50)			37,500
	To Reconstruction A/c			7,12,500
	(Being equity capital reduced to nominal value of ₹ 2.50 each)			
2.	Bank A/c	Dr.	1,12,500	
	To Equity share capital A/c			1,12,500
	(Being 3 right shares against each equity share was issued and subscribed)			

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3.	7% Preference share capital A/c (₹ 50)	Dr.	6,00,000	
	Reconstruction A/c	Dr.	60,000	
	To 5% Preference share capital A/c (₹ 10)			4,80,000
	To Equity share capital A/c (₹ 50)			1,80,000
	(Being 7% Preference shares of ₹ 50 each converted to 5% Preference shares of ₹ 10 each and also given to them 6 Equity shares for every share held)			
4.	Loan A/c	Dr.	1,50,000	
	To 5% Preference share capital A/c			1,20,000
	To Equity share capital A/c			30,000
	(Being loan to the extent of ₹ 1,50,000 converted into share capital)			
5.	Bank A/c	Dr.	1,00,000	
	To Equity share application money A/c			1,00,000
	(Being shares subscribed by the directors)			
6.	Equity share application money A/c	Dr.	1,00,000	
	To Equity share capital A/c			1,00,000
	(Being application money transferred to capital A/c)			
7.	Loan A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loan repaid)			
8.	Reconstruction A/c	Dr.	6,52,500	
	To Preliminary expenses A/c			11,000
	To Profit and loss A/c			4,40,000
	To Plant A/c			35,000
	To Trademarks and Goodwill A/c (Bal.fig.)			1,66,500
	(Being losses and assets written off to the extent required)			

Balance Sheet of Restructure Ltd. (and reduced)

as on 31.3.2011

Liabilities	₹	Assets	₹
Authorised capital:		Fixed assets	
65,000 Preference shares of ₹ 10 each	6,50,000	Building at cost less depreciation	4,00,000
3,00,000 Equity shares of ₹ 2.50 each	7,50,000	Plant at cost less depreciation	2,33,000

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Issued, subscribed and paid up:		Trademarks and Goodwill	1,51,500
1,80,000 equity shares of ₹ 2.5 each	4,60,000	Current assets:	
60,000, 5% Preference shares of ₹ 10 each	6,00,000	Stock	4,00,000
Loan	2,23,000	Debtors	3,28,000
Current liabilities and Provisions:		Bank (1,12,500 + 1,00,000 – 2,00,000)	12,500
Sundry creditors	2,07,000		
Other liabilities	35,000		
	15,25,000		15,25,000

4. (i) **Journal Entries* in the books of Part Ltd.**

		(₹ in lakhs)	
		Dr.	*Cr.*
(a)	Bank account (Current assets) Dr.	135	
	To Investments		115
	To Profit and loss account (Reserves & surplus)		20
	(Being sales of investments at a profit of ₹20 lakhs)		
(b)	Debentures account (Loan funds) Dr.	150	
	To Bank account (Current assets)		150
	(Being redemption of debentures at par)		
(c)	Current liabilities account Dr.	210	
	Provision for depreciation account Dr.	160	
	Reserves and surplus Dr.	400	
	To Fixed assets account		340
	To Current assets account		430
	(Being assets and liabilities pertaining to B division taken out of the books on transfer of the division to Apart Ltd.)		

* Any other alternative set of entries, with same net effect on various accounts may be given.

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(ii) **Part Ltd.'s Balance Sheet (After Demerger) as on 1.4.2011**

	₹ *in lakhs*	₹ *in lakhs*
Fixed assets		
Gross block	650	
Less: Depreciation	225	425
Net current assets		
Current assets (W.N.3)	335	
Less: Current liabilities	185	150
		575
Financed by		
Shareholders' funds		
Equity share capital	300	
Reserve and surplus (W.N.1)	25	325
Loan funds (W.N.2)		250
		575

(iii) **Initial Balance Sheet of Apart Ltd. as on 1.4.2011**

	₹ *in lakhs*	₹ *in lakhs*
Fixed assets		280
Goodwill (W.N.4)		210
Net current assets:		
Current assets	320	
Less: Current liabilities	210	110
		600
Financed by		
Shareholders' funds: (Authorised share capital ₹ 800)		
Equity share capital (issued for acquisition of business)		600
		600

Working Notes:

		₹ *in lakhs*
1.	Reserves and surplus of Part Ltd.	
	Balance as on 31st March, 2011	405

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	Add: Profit on sale of investments		20
			425
	Less: Adjustment for difference on demerger		400
	Balance shown in balance sheet after demerger		25
2.	**Loan funds of Part Ltd.**		
	Balance as on 31st March, 2011		400
	Less: Debentures redeemed		150
	Balance shown in balance sheet after demerger		250
3.	**Current assets of Part Ltd.**		
	Balance as on 31st March, 2011		350
	Add: Cash received from sale of investments		135
			485
	Less: Cash paid for redemption of debentures		150
	Balance shown in balance sheet after demerger		335
4.	**Calculation of goodwill for Apart Ltd.**		
	Purchase consideration (300 x 2)		600
	Less: Assets sold		
	Fixed assets	280	
	Current assets	320	
		600	
	Less: Current liabilities	210	390
	Goodwill		210

5.

			(₹ in lakhs)
(1)	**Average Capital employed**	As at 31.3.2010	As at 31.3.2011
	Current cost of fixed assets other than non-trade investments	2,200.0	2,532.8
	Current cost of stock	670.0	750.0
	Debtors	340.0	222.8
	Cash and Bank	92.5	100.0
		3,302.5	3,605.6

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	Less: Outside Liabilities:		
	Term loans	370.0	330.0
	Sundry creditors	70.0	96.0
	Tax provision	22.5	25.0
		462.5	451.0
	Capital Employed	2,840.0	3,154.6
	Average Capital Employed at current value = $\frac{2,840.0+3,154.6}{2}$		2,997.3
(2)	**Future maintainable profit**		
	Increase in General Reserve		50
	Increase in Profit and Loss Account		55
	Proposed Dividend		250
	Profit after tax		355
	Pre-tax profit = $\frac{355}{1-0.5}$		710.00
	Less: Non-trading income	49.00	
	Exchange loss on creditors		
	[1.2 lakhs ´ (21.5 – 16.5)]	6.00	
	Subsidy	120.00	
			(175.00)
			535.00
	Add: Exchange gain on debtors		
	[0.7 lakhs ´ (21.5 – 17.5)]	2.80	
	R & D costs	247.00	
	Stock adjustment	30.00	279.80
	Adjusted pre-tax profit		814.80
	Less: Tax @ 40%		325.92
	Future maintainable profit		488.88

Valuation of Goodwill

		(₹ in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{488.88}{0.15}\right)$	3,259.20
	Less: Average Capital Employed	2,997.30
	Goodwill	261.90

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(2)	Super Profit Method	
	Future Maintainable Profit	488.88
	Normal Profit @ 15% on average capital employed	449.60
	Goodwill	39.28

Under capitalization method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes:

		(₹ in lakhs)
(1)	Stock adjustment	
	Difference between current cost and historical cost of closing stock	150.00
	Difference between current cost and historical cost of opening stock	120.00
		30.00
(2)	Debtors' adjustment	
	Value of foreign exchange debtors at the closing exchange rate ($ 70,000 ´ 21.5)	15.05
	Value of foreign exchange debtors at the original exchange rate ($ 70,000 ´ 17.5)	12.25
		2.80
(3)	Creditors' adjustment	
	Foreign exchange creditors at the closing exchange rate ($ 1,20,000 ´ 21.5)	25.80
	Foreign exchange creditors at the original exchange rate ($ 1,20,000 ´ 16.5)	19.80
		6.00

6. (i) **Profit for calculation of interest and fixed dividend coverage**

	₹
Average profit of the Company (before interest and taxation)	5,00,000
Less: Debenture interest (15% on ₹ 8,00,000)	1,20,000
	3,80,000
Less: Tax @ 40%	1,52,000
Profit after interest and taxation	2,28,000
Add back: Debenture interest	1,20,000
Profit before interest but after tax	3,48,000

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(ii) **Calculation of interest and fixed dividend coverage**

	₹
Fixed interest and fixed dividend:	
Debenture interest	1,20,000
Preference dividend	50,000
	1,70,000

Fixed interest and fixed dividend coverage = $\frac{3,48,000}{1,70,000} = 2.05$

Interest and fixed dividend coverage 2.05 times is less than the prescribed three times.

(iii) **Capital gearing ratio**

	₹	₹
Equity share capital + Reserves	= 10,00,000 + 4,00,000	14,00,000
Preference share capital + Debentures	= 5,00,000 + 8,00,000	13,00,000

Capital Gearing Ratio = $\frac{13,00,000}{14,00,000} = 0.93$ (approximately)

Ratio 0.93 is more than the prescribed ratio of 0.75.

(iv) **Yield on equity shares**

		₹
Average profit after interest and tax		2,28,000
Less: Preference Dividend	50,000	
Equity Dividend (10% on ₹ 10,00,000)	1,00,000	1,50,000
Undistributed profit		78,000
50% of distributed profit (50% of ₹1,00,000)		50,000
5% of undistributed profit (5% of ₹ 78,000)		3,900
		53,900

Yield on equity shares = $\frac{53,900}{10,00,000} \times 100 = 5.39\%$

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(v) **Expected yield of equity shares**

	%
Normal return	12.00
Add: For low coverage of fixed interest and fixed dividend (2.05 < 3)	0.50*
Add: For high capital gearing ratio (0.93 > 0.75)	0.50**
	13.00

(vi) **Value per equity share**

$$= \frac{5.39}{13.00} \times 100^{***} = 41.46$$

Notes:

* When interest and fixed dividend coverage is low, riskiness of equity investors is high. So they should claim additional risk premium over and above the normal rate of return. Here, the additional risk premium is assumed to be 0.50%. Students may make any other reasonable assumption.

**Similarly, higher the ratio of fixed interest and dividend bearing capital to equity share capital plus reserves, higher is the risk and so higher should be risk premium. Here also the additional risk premium has been taken as 0.50%. The students may make any other reasonable assumption.

***Paid up value of a share has been taken as ₹ 100.

7. Intangibles are not easily measurable and it poses severe challenges in valuation of brands also. Some of the difficulties faced by the accountants in brand valuation are as follows:

   1. **Distinctiveness:** Brands need to be valued distinctively as different from other intangibles such as Goodwill etc. For instance, any attempt to commonly treat brand as a part of Goodwill as is done at present may create serious distortions in accounting position. Besides, this would create handicaps in brand accounting.

   2. **Disclosure:** There is always a problem of making disclosure of brand values in financial statements. This is because, there is no standard accounting practice requiring statement and disclosure of brand values in a particular way.

   3. **Uncertainty:** The problem that is associated with the brand, as an item of intangibles, is that its possible returns are uncertain, immeasurable and non-current in nature. Any expected cost on such intangibles are usually either written off or treated as Deferred Revenue Expenditure.

   4. **The Dilemma:** Another area of challenge posing brand accounting is whether to amortise or capitalise the value of brand. There is no question of amortising brand

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values as either the economic life of the brand cannot be determined in advance or its value depreciates over time.

5. **No Market:** The prevailing practice is that the intangibles are not required to be revalued according to some accounting standards on account of the non-existence of an active secondary market for them. In fact, the need for brand accounting arises mainly on account of conditions warranted by acquisition and merger.
6. **Joint Costs:** It is very difficult to segregate and account for joint costs that are incurred and the cost of brand developed as a result of general operations of the business.

8. **Addition Ltd.**

Gross Valued Added Statement for the year ended 31st March, 2011

	(₹ in lakhs)	*(₹ in lakhs)*	
Sales		890	
Less: Cost of bought in materials and services:			
Production and operational expenses* (293 + 59 +109)	461		
Administration expenses (33 – 9)	24		
Interest on working capital loan	9		
Excise duty (Refer W.N)	35.20	529.20	
Value added by manufacturing and trading activities		360.80	
Add: Other income		55	
Total Value Added		415.80	
Application of Value Added			%
To Employees			
Salaries, Wages, Gratuities etc.		82	19.72
To Directors			
Salaries and commission		9	2.16
To Government			
Cess and local taxes (98 - 35.20)	62.80		

* As no increase or decrease in stock is given in the question, therefore, it is assumed that whatever raw material and stores were bought, had been consumed.

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Income-tax	27		
		89.80	21.60
To Providers of capital			
Interest on Debentures	2		
Interest on Fixed loan (10+8)	18		
Dividend	95		
		115	27.66
To Provide for maintenance and expansion of the company			
Depreciation	17		
General Reserve	45		
Deferred tax	3		
Retained profits (65-10)	55		
		120	28.86
		415.80	100

Working Note:

Calculation of Excise duty

Excise duty is 10% of ₹ 352 lakhs (i.e. 293+59) = ₹ 35.20 lakhs

9. Value Limited

Computation of Economic Value Added

Economic Value Added	₹ in lakhs
Net Operating Profit after Tax (Refer W.N. 5)	1,372.00
Add: Interest on Long-term Fund (Refer W.N. 2)	28.00
	1,400.00
Less: Cost of Capital (₹ 6,400 lakhs × 15.77%) (Refer W.N. 3 and 4)	1,009. 28
Economic Value Added	390. 72

Working Notes:

(1) **Cost of Equity** = Risk free Rate + Beta factor (Market rate – Risk free rate)

9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%

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(2) Cost of Debt

	₹ in lakhs
Interest	40
Less: Tax (30%)	12
Interest after Tax	28

Cost of debt = $\frac{28}{400} \times 100 = 7\%$

(3) Weighted Average Cost of Capital

		₹ in lakhs
Cost of Equity	₹ 6,000 lakhs × 16.35% (W.N.1)	981
Cost of Debt	₹ 400 lakhs × 7% (W.N.2)	28
		1009

WACC = $\frac{1,009}{6,400} = 15.77\%$ (approx.)

(4) Capital Employed

	₹ in lakhs
Share Capital	2,000
Reserves and Surplus	4,000
Long-term debts	400
	6,400

(5) Net operating Profit after Tax

	₹ in lakhs
Profit before Interest + Tax	2,000
Interest	40
	1,960
Tax (30% on ₹ 1,960 lakhs)	588
Operating Profit after Tax	1,372

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10. **Calculation of provision required on advances as on 31st March, 2011**

	Amount ₹ in lakhs	*Percentage of provision*	*Provision ₹ in lakhs*
Standard assets	16,800	0.25*	42
Sub-standard assets	1,340	10	134
Secured portions of doubtful debts-			
- upto one year	320	20	64
- one year to three years	90	30	27
- more than three years	30	50	15
Unsecured portions of doubtful debts	97	100	97
Loss assets	48	100	48
			427

11. Total funds raised by a Mutual Fund company = 17.5 x10 lakhs = 175 lakhs

(₹ in lakhs)

		₹	₹
Opening bank balance (175-160-9)		6	
Add: Proceeds from sale of securities		125	
Add: Dividend received		3	
Less:			134
Cost of securities purchased	90		
Management expenses (₹ 5 lakhs x 3 months)	15		
Realised gains distributed [80% of (₹ 125 lakhs – ₹ 100 lakhs)]	20		
Dividend distributed (80% of ₹ 3 lakhs)	2.40		127.40
Closing Bank Balance			6.60
Closing Market value of portfolio			175.00
Closing Net Assets			181.60
No. of units (in lakhs)			10.00
Closing NAV = ₹ 181.60 lakhs divided by 10 lakh units	=		₹ 18.16

* RBI vide its notification no. DNBS.PD.CC.No. 207/03.02.002/2010-11 dated January 17, 2011 has introduced 0.25% provisioning for standard assets of NBFCs.

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12. **Journal Entries**

Date	Particulars		Rs.	Rs.
31.3.2009	Employees compensation expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of ₹ 30 each, amortised on straight line basis over vesting years (Refer W.N.)			
	Profit and Loss A/c	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being compensation expenses charged to P & L A/c)			
31.3.2010	Employees compensation expenses A/c	Dr.	3,95,000	
	To ESOS outstanding A/c			3,95,000
	(Being compensation expenses recognized in respect of the ESOS)			
31.3.2010	Profit and Loss A/c	Dr.	3,95,000	
	To Employees compensation expenses A/c			3,95,000
	(Being compensation expenses charged to P & L A/c)			
30.3.2011	Employees compensation expenses A/c	Dr.	8,05,000	
	To ESOS outstanding A/c			8,05,000
	(Being compensation expense recognized in respect of the ESOS)			
30.3.2011	Bank A/c (85,000 X ₹ 20)	Dr.	17,00,000	
	ESOS outstanding A/c [(26,25,000/87,500) x 85,000]	Dr.	25,50,000	
	To Equity share capital 600XRs. 10			8,50,000
	To Securities premium A/c (85,000 X ₹ 40)			34,00,000
	(Being 85,000 options exercised at an exercise price of ₹ 50 each)			

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	Profit and Loss A/c	Dr.	8,05,000	
	To Employees compensation expenses A/c			8,05,000
	(Being compensation expenses charged to P & L A/c)			
	ESOS outstanding A/c	Dr.	75,000	
	To General Reserve A/c			75,000
	(Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Note:

Particulars	*Year 1 (31.3.2009)*	*Year 2 (31.3.2010)*	*Year 3 (31.3.2011)*
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expenses accrued @ ₹ 30 (50-20)	₹ 28,50,000	₹ 7,30,000	₹ 26,25,000
Compensation expenses of the year	28,50,000 x 1/2 = ₹ 14,25,000	27,30,000 x 2/3 = ₹ 18,20,000	
Compensation expenses recognized previously	Nil	₹ 14,25,000	₹ 18,20,000
Compensation expenses to be recognized for the year	₹ 14,25,000	₹ 3,95,000	₹ 8,05,000

13. If net is settled in cash

				₹	₹
(i)	1.2.2010	No entry is required because fair value of derivative is zero and no cash is paid or received.			
(ii)	31.12.2010	Forward Contract (Asset) A/c	Dr.	6,300	
		To Profit and Loss A/c			6,300
		(Gain recorded due to increase in fair value of the forward contract)			

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(iii)	31.01.2011	Profit and Loss A/c	Dr.	4,300	
		To Forward Contract (Asset) A/c			4,300
		(Loss recorded due to decrease in fair value of the forward contract)			
(iv)		Cash A/c	Dr.	2,000	
		To Forward Contract (Asset) A/c			2,000
		(Being forward contract settled in cash)			

If net is settled by delivery of shares

First three entries will be same. Entry no. (iv) will change as under:

		Equity A/c	Dr.	2,000	
		To Forward Contract (Asset) A/c			2,000
		(Being forward contract settled by delivery of shares)			

14. **Consolidated Financial Statements (An Extract of an Asset side)**

		₹
Net worth of Investment		1,20,000
(including Goodwill identified ₹ 2,750)		
Add: Share of Revenue Profit	47,250	
Share of Revaluation Reserve	31,500	78,750
		1,98,750

Working Notes:

1. **Analysis of Profits of B Ltd.**

	₹	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
Reserve & Surplus (2,50,000 – 90,000)	1,60,000			
Add: Proposed dividend	60,000*			
	2,20,000			

* As per Accounting Standard Interpretation No. 16 (at present added as an explanation (b) to paragraph 6 of Accounting Standard (AS) 23, 'Accounting for Investments in Associates in Consolidated Financial Statements'), proposed dividend if any deducted from profit and loss account of Associates shall be reversed before the share of investor is computed.

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Less: Opening Balance	40,000	40,000		
	1,80,000			
Less: for 3 months	45,000	45,000		
	1,35,000			1,35,000
Revaluation Reserve			90,000	
		85,000	90,000	1,35,000
Share of Associates (35%)		29,750	31,500	47,250

2. **Goodwill/Capital Reserve**

		₹
Investments		1,20,000
Less: Nominal Value of share capital (2,50,000 x 35%)	87,500	
Capital Profit (W.N.1)	29,750	1,17,250
Goodwill		2,750

15. **Treatment under Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS)**

		AS	IFRS
(i)	Impairment of Assets	Assets are impaired if recoverable amount is less than the carrying amount. Recoverable amount will be calculated as higher of net selling price and value in use based on discounted cash flows.	Similar to Indian Accounting Standard.
		Impairment test is to be conducted every year and if there is upward increase in the value of asset, then reversal of impairment losses is required in certain circumstances.	
		Assets are not separately classified or disclosed as held for sale on the face of the balance sheet.	However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.

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(ii)	Business Combinations	No particular standard has been issued by ICAI till date. However, all business acquisitions are business combinations except pooling of interest method for certain amalgamations.	All business acquisitions are business combinations as per IFRS 3.

16. Mandatory information which is required to be disclosed in the corporate annual reports either by virtue of the provisions contained in the Companies Act, 1956 alone or by virtue of such provisions read with the provisions of applicable accounting standards may be grouped under following heads:

    1. **Balance Sheet:** The Companies Act requires that every Balance Sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year. It shall be in the form set out in Part 1 of the Schedule VI. In preparing the Balance Sheet, the preparers should follow the general instruction for preparations of Balance Sheet under. Part I of Schedule VI to the Companies Act provides the form and contents of the Balance Sheet.

    2. **Profit and Loss Account:** Like Balance Sheet, every Profit and Loss Account of a company is required to exhibit a true and fair view of the profit or loss of the company for the financial year. The Profit and Loss Account is required to be prepared as per the requirements of Part II of Schedule VI. [Section 211(2)].

    3. **Narrative Disclosures:** The narrative disclosures that are contained in published company accounts embrace both qualitative and quantitative information. In most cases narrative disclosures are presented in textual form wherein more emphasis is laid on words than on figures. Although most of the narratives disclosed in published company accounts relate to the items of basic financial statements, there are certain narrative disclosures, which focus on things that are not related to financial statement items. These requirements are discussed under the following two broad heads:

        A. Accounting Policies: Accounting policies often contain a large volume of narratives that have a significant bearing on the financial health and performance of the company. Accounting Standard 1 on *Disclosure of Accounting Policies* issued by the ICAI deals with the disclosure of significant accounting policies followed in the preparation and presentation of financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

        B. Notes on Accounts: Notes on Accounts are integral part of the financial statements. Some of the disclosures made under Notes on Accounts are truly speaking extensions of the items of the basic financial statements. Disclosure through notes is done either to comply with statutory requirements or because the company chooses voluntarily to provide details on certain items.

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4. **Cash Flow Statement:** The Companies Act has declared AS 3 as a specified accounting standard for the purpose of Section 211(3C) to be complied with by the companies. Moreover, as per the requirement of clause 32 of the Listing Agreement, it is mandatory for the listed companies to prepare and present a cash flow statement in accordance with AS 3 issued by the ICAI following the 'indirect' method. Apart from listed companies, any enterprise having turnover more than ₹ 50 crores in a year or an enterprise that intends to issue securities is required to prepare and present cash flow statement as a principal financial statements.

5. **Supplementary Statements:** Pursuant to the provisions Section 212 of the Companies Act, 1956 holding companies are required to provide certain pieces of information in respect of its subsidiary(s) in a supplementary statement in their annual reports.

   Under Section 212, the following documents must be attached to the Balance Sheet of a holding company: -

   (a) A copy of the recent Balance Sheet of the subsidiary company (or companies);

   (b) A copy of the recent Profit and Loss Account of the subsidiary (or subsidiaries);

   (c) A copy of the recent report of the Board of Directors of the subsidiary;

   (d) A copy of the recent report of the auditors of the subsidiary (or subsidiaries).

   The aforesaid documents have to be prepared in accordance with the requirements of this Act. The information to be attached to the Balance Sheet of a holding company in respect of the subsidiary companies cannot be more than 6 months old.

   In addition to these documents a holding company is required to provide a statement showing-

   (i) The extent of the holding company's interest in the subsidiary (or subsidiaries) at the end of the financial year or of the last financial year of the subsidiary (or subsidiaries);

   (ii) The net aggregate amount of profits (after deduction of losses) of the subsidiary (or subsidiaries) so far as they concern the holding company, separately for the current financial year and for previous financial years. The profits have to be segregated between profits already dealt with in the books of the holding company and not so dealt with.

17. **Cash Flow Statement**

			₹
I.	**Cash flow from operating activities**		
	Closing Balance as per Profit and Loss A/c	6,00,000	
	Less: Opening Balance as per Profit & Loss A/c	(1,50,000)	

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	Profit during the year		4,50,000	
	Add: Proposed dividend during the year		2,25,000	
	Add: Interim dividend paid during the year		2,25,000	
	Add: Transfer to general reserve		30,000	
	Add: Provision for Tax (W.N.3)		45,000	
	Add: Depreciation		2,10,000	
	Add: Interest on debentures		36,000	
	Add: Discount on issue of debentures (written off)		16,500	
	Add: Loss on Sale of machine		45,000	12,82,500
	Less: Income on Investment	(8,100)		
	Profit on Sale of Investment	(30,000)		(38,100)
	Funds from Operation			12,44,400
	Add: Decrease is Current Assets or Increase in Current Liabilities			
	Decrease in Stock		15,000	
	Increase in Creditors		1,65,000	
	Increase in Provision for doubtful debts		15,000	1,95,000
	Less: Increase in Current Assets			14,39,400
	Debtors		(1,05,000)	
	Decrease in B/P		(10,000)	(1,15,000)
				13,24,400
	Less: Tax Paid			(15,000)
	Net Cash From Operating Activities			13,09,400
II.	**Cash Flows from Investing Activities**			
	Sale of Machine		75,000	
	Sale of Investment		1,50,000	
	Income on investment		8,100	
	Purchase of Fixed Assets (W.N.1)		(8,60,000)	
	Purchase of Investment (W.N.2)		(2,70,000)	
	Cash used in Investing Activities			(8,96,900)
III.	**Cash flow from Financing Activities**			
	Issue of share capital (2,00,000 – 1,500*)		1,98,500	
	Issue of debentures		1,50,000	

* Underwriting commission is given in the form of shares only. It means that shares issued against cash will be of ₹ 1,98,500 only.

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	Less: Interest paid on debentures (36,000 – 35,000)	(1,000)	
	Interim dividend paid	(2,25,000)	
	Final dividend paid (1,80,000 – 10,000)	(1,70,000)	
	Cash used in Financing Activities		(47,500)
	Net Cash Flow (I + II + III)		3,65,000
	Add: Cash and cash equivalents at the beginning of the period (1,80,000 – 30,000)		1,50,000
	Cash and cash equivalents at the end of the period (5,40,000 – 25,000)		5,15,000

Working Notes:

1. Fixed Assets A/c

	₹		₹
To Balance b/d	15,30,000	By Bank	75,000
To Bank (Purchase) (B.f.)	8,60,000	By P & L A/c (loss on sale)	45,000
		By Depreciation	2,10,000
		By Balance c/d	20,60,000
	23,90,000		23,90,000

2. Investment A/c

	₹		₹
To Balance b/d	90,000	By Bank (W.N.4)	1,50,000
To Bank	2,70,000	By Balance c/d	2,40,000
To Profit & Loss (W.N.4)	30,000		
	3,90,000		3,90,000

3. Provision for Tax A/c

	₹		₹
To Bank	15,000	By Balance b/d	30,000
To Balance c/d	60,000	By Profit & Loss A/c (Provision) (Bal.fig.)	45,000
	75,000		75,000

4. Cost of investment sold =(₹ 90,000+₹ 2,70,000) – ₹ 2,40,000 = ₹ 1,20,000.

   Sales price = 1,20,000 x (100/80) = ₹ 1,50,000

   Profit on sale = ₹ 1,50,000 – ₹ 1,20,000 = ₹ 30,000

18. (a) (i) According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss.

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However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹ 14 lakhs)	27,30,000
Less: Current recoverable amount	12,00,000
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

(ii) After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

(iii) In the given case, the carrying amount of the asset will be reduced to ₹ 12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹ 4,00,000.

(b) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprises can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of three years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than three years.

(c) (i) **Research Expenditure -** According to para 41 of AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2008-09. Hence, it should be written off as an expense in that year itself.

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(ii) **Cost of internally generated intangible asset -** The question states that the development phase expenditure amounting ₹ 360 lakhs incurred upto 31st March, 2010 meets asset recognition criteria. As per AS 26 for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	80 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 80 lakhs x 3.7908)	303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 360 lakhs or present value of future net cash flows ₹ 303.26 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 303.26 lakhs.

The difference of ₹ 56.74 lakhs (i.e. ₹ 360 lakhs – ₹ 303.26 lakhs) will be amortized by the enterprise for the financial year 2009-10.

(iii) **Amortisation -** The company can amortise ₹ 303.26 lakhs over a period of five years by charging ₹ 60.65 lakhs per annum from the financial year 2010-11 onwards.

(d) As per AS 22 'Accounting for Taxes on Income', Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets. In the present case the timing difference i.e. difference between taxable income and accounting income is:-

	₹
Excess depreciation as per tax records (14,00,000 – 80,00,000)	6,00,000
Less : Expenses not amortised as per tax records	11,200
Timing difference	5,88,800

As tax expense is more than the current tax due to timing difference of ₹ 5,88,800 therefore deferred tax liability = 40% of ₹ 5,88,800 = ₹ 2,35,520 shall be credited in the profit and loss account.

(e) "In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period." As per para 26 of AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding* during the

* Weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

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period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Computation of diluted earnings per share

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$$

Adjusted net profit for the current year

	₹
Net profit for the current year (assumed to be after tax)	85,50,000
Add: Interest expense for the current year	6,00,000
Less: Tax relating to interest expense (30% of ₹ 6,00,000)	(1,80,000)
Adjusted net profit for the current year	89,70,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$$= \frac{1,00,000 \times 100}{10} = 10,00,000 \text{ Equity shares}$$

Weighted average number of equity shares used to compute diluted earnings per share

= [(20,00,000 x 12) + (10,00,000 x 9**)]/12 = 27,50,000 shares

Diluted earnings per share = $\frac{89,70,000}{27,50,000 \text{ shares}}$ = ₹ 3.26 per share

19. (a) (i) **Computation of annual lease payment to the lessor**

	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10% (₹ 1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (₹ 10,00,000 – ₹ 75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment = ₹ 9,24,870/ 2.4868	3,71,911.70

** Interest on debentures for full year amounts to ` 8,00,000 (i.e. 8% of ` 1,00,00,000). However, interest expense amounting ` 6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

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The present value of lease payment i.e., ₹ 9,24,870 equals 92.48% of the fair market value i.e., 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(ii) **Computation of Unearned Finance Income**

	₹
Total lease payments (₹ 3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of investment (lease payments and residual value) (₹ 75,130 + ₹ 9,24,870)	(10,00,000)
Unearned finance income	2,15,735

(b) 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 Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2010-2011 should be calculated as follows:

	₹ in crores
Actual interest for 2010-2011 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	3.50
Borrowing costs to be capitalized during year 2010-2011	13.00

(c) As per para 8 of AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

According to the first alternative, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Therefore, on the basis of this alternative, the cost of special purpose machinery will be recorded in the books after reducing it by the amount of government subsidy of ₹ 25 lakhs. Thus the depreciable value of the machinery recorded in the books will be ₹ 75 lakhs (i.e. ₹ 1

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crore – ₹ 25 lakhs). Depreciation of ₹ 9.375 lakhs (i.e. ₹ 75 lakhs / 8 years) will be charged on it every year on straight line method.

Under the second alternative, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, machinery will be recorded in the books by ₹ 1 crore and depreciation will be charged on it for ₹ 12.5 lakhs (i.e. ₹ 1 crore / 8 years) per year on straight line method. Government subsidy of ₹ 25 lakhs will be treated as deferred income which will be recognized as income in the statement of profit and loss every year by ₹ 3.125 lakhs (i.e. ₹ 25 lakhs / 8 years).

(d) **Calculation of Actual Return on Plan Assets**

		₹
Fair value of plan assets on 31.3.2010		8,00,000
Add: Employer contribution		2,80,000
Less: Benefits paid		(2,00,000)
	(A)	8,80,000
Fair market value of plan assets at 31.3.2011	(B)	11,40,000
Actual return on plan assets	(B-A)	2,60,000

(e) As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹ 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.

20. (a) As per the provisions, of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss.

In the given situation, it is clearly a case of error in preparation of financial statements for the financial year 2009-10. Hence claim received in the financial

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year 2010-11 is a prior period item and should be separately disclosed in the statement of profit and loss for the year ended 31st March, 2011.

(b) As per AS 11 'The Effects of Changes in Foreign Exchange Rates', foreign currency non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction and exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expense in the period in which they arise. Foreign Currency loss will be computed as ₹ 180 lakhs {$ 60 lakhs $\left[\frac{2544 \text{ lakhs}}{42.40}\right]$ x (₹ 45.40 – ₹ 42.40)}.The entire loss on exchange difference of ₹ 180 lakhs should be recognized as an expense for the year ended 31st March 2011 and should not be included in the cost of goods sold. Depreciation on fixed assets amounting ₹ 508.80 lakhs (20% of ₹ 2,544 lakhs) should be provided for in the financial statements for the year ended 31st March 2011.

(c) As per AS 13 'Accounting for Investments', current investments should be carried in the financial statements at lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis and long-term investments are carried at cost except when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognize the decline.

(i) *If the investment in shares is intended to be held for not more than one year from the date on which such investment is made:* Scrip X should be valued at cost i.e. ₹ 1,80,000 (lower of cost and fair value); Scrip Y should be valued at fair value i.e. ₹ 40,000 (lower of cost and fair value) and scrip Z should be valued at fair value i.e. ₹ 70,000 (lower of cost and fair value). The total loss of ₹ 1,00,000 (₹ 4,00,000 – ₹ 3,00,000) on scrips purchased on 1st June, 2009, is to be charged to profit and loss account for the year ended 31st March, 2010.

If investment is intended to be held for long term period: Investment 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 investments, such reduction being determined and made for each investment individually.

(ii) Investment in gold (purchased in April, 2006) shall continue to be shown at cost of ₹ 3,00,000 in the balance sheet as on 31.3.2010.

(iii) If mutual funds are intended to be held for short term period it will be valued at ₹ 4,50,000 as on 31st March, 2010 and if it is intended to be held for long term,

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then it should be valued at its cost i.e. ₹ 6,00,000.

(iv) Value of government securities (purchased on 1st April, 2009) is to be shown at cost of ₹ 5,00,000 in the balance sheet as on 31.3.2010.

Inter category adjustments of appreciation and depreciation in value of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation in value of investment in government securities.

(d) In the given case, Moon Ltd. concurrently agreed to repurchase the same goods from Sun Ltd. on 1st February, 2011. Also the re-selling price is pre-determined and covers purchasing and holding costs of Sun Ltd. Hence, the transaction between Moon Ltd. and Sun Ltd. on 1st February, 2011 should be accounted for as financing rather than sale. The resulting cash flow of ₹ 9.60 lakhs received by Moon Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Moon Ltd.

			₹ *in lakhs*	
1.02.11	Bank Account	Dr.	9.60	
	To Advance from Sun Ltd*.			9.60
	(Being advance received from Sun Ltd amounting [₹ 8 lakhs + 20% of ₹ 8 lakhs= 9.60 lakhs] under sale and re-purchase agreement)			
31.03.11	Financing Charges Account	Dr.	0.40	
	To Sun Ltd.			0.40
	(Financing charges for 2 months at ₹ 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.11	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P& L Account)			

(e) As per para 27 of AS 17 "Segment Reporting", a business segment or geographical segment should be identified as a reportable segment, if

(i) Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments; or

* The balance of Sun Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of Moon Ltd. as on 31st March, 2011.

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(ii) Its segment result whether profit or loss is 10% or more of

(1) The combined result of all segments in profit; or

(2) The combined result of all segments in loss,

whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments.

Further, if the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% threshold until atleast 75% of total enterprise revenue is included in reportable segments.

(a) On the basis of 'Revenue' criteria, segments M and N are reportable segments.

(b) On the basis of 'Result' criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 lakhs)

(c) On the basis of 'Asset' criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence the opinion of chief accountant that segments 'M' and 'N' alone should be reported is wrong.

(f) As per AS 2 "Valuation of Inventories", cost of inventories comprise of all costs of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Interest and other borrowing costs are usually considered as overheads that don't contribute to bringing the inventories to their present location and condition. Therefore, the proposal of PT Ltd., to include interest on bank over draft as an element of cost is not acceptable. Interest on bank overdraft will not form part of cost of production.

Appendix

Announcements and Notifications applicable for November, 2011 examination

A. Application of AS 30, Financial Instruments: Recognition and Measurement, for the accounting periods ending on or before 31st March 2011

1. Accounting Standard Board of ICAI has recently issued a clarification regarding applicability of AS 30 (dated 11th February, 2011). It is clarified that in respect of the financial statements or other financial information for the accounting periods commencing on or after 1st April 2009 and ending on or before 31st March 2011, the status of AS 30 would be as below:

(i) To the extent of accounting treatments covered by any of the existing notified

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accounting standards (for eg. AS 11, AS 13 etc,) the existing accounting standards would continue to prevail over AS 30.

(ii) In cases where a relevant regulatory authority has prescribed specific regulatory requirements (eg. Loan impairment, investment classification or accounting for securitizations by the RBI, etc), the prescribed regulatory requirements would continue to prevail over AS 30.

(iii) The preparers of the financial statements are encouraged to follow the principles enunciated in the accounting treatments contained in AS 30. The aforesaid is, however, subject to (i) and (ii) above.

2. From 1st April 2011 onwards,

(i) the entities to which converged Indian accounting standards will be applied as per the roadmap issued by MCA, the Indian Accounting Standard (Ind AS) 39, *Financial Instruments; Recognition and Measurement,* will apply*.

(ii) for entities other than those covered under paragraph 2(i) above, the status of AS 30 will continue as clarified in paragraph 1 above.

3. The abovementioned clarifications would also be relevant to the existing AS 31, *Financial Instruments: Presentation* and AS 32, *Financial Instruments: Disclosures* as well as for Ind AS 32, *Financial Instruments: Presentation* and Ind AS 107, *Financial Instruments: Disclosures* , after 1st April 2011 onwards.

B. Provision of 0.25% for standard assets of all NBFCs

RBI has issued a notification no. DNBS.PD.CC.No.207/03.02.002/2010-11 dated January 17, 2011. As per the notification, in terms of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, and Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, all NBFCs are required to make necessary provisions for non performing assets. In the interests of counter cyclicality and so as to ensure that NBFCs create a financial buffer to protect them from the effect of economic downturns, it has been decided to introduce provisioning for standard assets also.

Accordingly,

(i) NBFCs should make a general provision at 0.25 per cent of the outstanding standard assets.

(ii) The provisions on standard assets should not be reckoned for arriving at net NPAs.

(iii) The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

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* At present, Ministry of Corporate Affairs has not announced the date of applicability of Ind ASs.

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(iv) NBFCs are allowed to include the 'General Provisions on Standard Assets' in Tier II capital which together with other 'general provisions/ loss reserves' will be admitted as Tier II capital only up to a maximum of 1.25 per cent of the total risk-weighted assets.

Notifications No. DNBS. 222 CGM(US)2011 and No. DNBS. 223 CGM (US) 2011 both dated January 17, 2011 are also issued for meticulous compliance of the said norms.

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

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

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

D Amendment to Accounting Standard 11 of Companies (Accounting Standards) Rules, 2006

Ministry of Corporate Affairs vides its notification number G.S.R. (E).- dated 11th May, 2011, has partially amended the notification number GSR No. 225(E) dated 31.03.2009. Through this notification, the MCA has extended the option (for the enterprises) to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March 2012 instead of 31st March 2011.

Note: Revised Schedule VI and Ind ASs have not been made applicable for November, 2011 examination.

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