Paper-16: Advanced Financial Accounting & Reporting

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

The figures in the margin on the right side indicate full marks.

Working Notes should form part of the answer.

"Whenever necessary, suitable assumptions should be made and indicated in answer by the candidates."

Part A questions are compulsory. Attempt all of them.

Part B has seven question. Attempt any five of them.

Part A (25 marks)

1. **(a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark)and give workings/reasons briefly in support of your answer (= 1 mark):** **[10×2=20]**

(i) Ramayana Ltd. presents interim financial report quarterly. On 01-04-2013. Ramayana Ltd. has carried forward loss of ₹ 800 lakhs for income-tax purpose for which deferred tax asset has not been recognized. The Ramayana Ltd. earns ₹1,000 lakhs in each for quarter ending on 30. 06.2013, 30.09.2013, 31.12.2013 and 31.03.2014 excluding the loss carried forward. Income-tax rate is expected to be 40%. The amount of tax expense to be reported in each quarter will be:
(A) ₹1,000 lakhs;
(B) ₹1,280 lakhs;
(C) ₹320 lakhs;
(D) ₹4,000 lakhs.

Answer: (B) — ₹ 320 lakhs.

The estimated payment of the annual tax on ₹ 4,000 lakhs earnings for the current year.
(4,000 lakhs - ₹ 800 lakhs) = ₹ 3,200 lakhs

₹ 3,200 × 40/100 = ₹ 1,280 lakhs.

Average annual effective tax rate = (1,280/4,000) ×100 = 32%
Tax expense to be shown each quarter will be 1,000 × 32/ 100 = ₹ 320 lakhs.

(ii) On January 2, 2014 Ekta Ltd. bought a trademark from Mukut Ltd. for ₹ 10,00,000. Ekta retained an independent consultant, who estimated the trademark's remaining life to be 20 years. Its unamortised cost on Mukut's accounting records was ₹ 7,60,000. Ekta decided to amortize the trademark over the maximum period allowed. In Ekta's December 31, 2014 balance sheet, what amount should be reported as accumulated amortization?
(A) ₹ 76,000
(B) ₹ 38,000
(C) ₹ 50,000
(D) ₹ 1,00,000.

Answer: (D) — ₹1,00,000.

As per AS-26 intangible assets should be measured initially at cost therefore, Ekta Ltd. should amortize the trademark at its cost of ₹ 10,00,000. The unamortised cost on the seller's books (₹ 7,60,000) is irrelevant to the buyer. Although the trademark has a remaining useful life of 20 years, intangible assets are generally amortized over a maximum period of 10 years per AS-26. Therefore, the 2014 amortization expense and accumulated amortization is 1,00,000 (₹ 10,00,000 ÷ 10 years).

(iii) In a production process, normal waste is 5% of input. 10,000 MT of input were put in process resulting in a wastage of 600 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. If waste has Nil realizable value. The cost per unit is:
(A) ₹1,05,263;
(B) ₹1063.83;
(C) ₹105.26;
(D) ₹1052.63.

Answer: (D) — ₹1052.63.

As per AS-2, abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

In this case, normal waste is 500 MT and abnormal waste is 100 MT.
The cost of 500 MT will be included in determining the cost of inventories (finished goods) at the year-end.
And the Cost per unit will be = 10,000 × ₹1000/9,500 = ₹1052.63.

(iv) Mayur Ltd. purchased a machine costing ₹1,25,000 for its manufacturing operations and paid shipping costs of ₹ 40,000. Mayur Ltd. spent an additional amount of ₹ 20,000 for testing and preparing the machine for use. Mayur Ltd. will record the machine at a cost of:
(A) ₹1,85,000;
(B) ₹1,25,000;
(C) ₹1,65,000;
(D) None of the above

Answer: (A) — ₹1,85,000.

As AS-10, the cost of fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. In this case the cost of machinery includes all expenditures incurred in acquiring the asset and preparing it for use. Cost includes the purchase price, freight and handling charges, insurance cost on the machine while in transit, cost of special foundations, and costs of assembling, installation and testing. Therefore the cost to be recorded is ₹1,85,000 (₹1,25,000 + ₹40,000 + ₹20,000).

(v) Akash Ltd. wants to re-classify its investments in accordance with AS-13.

A portion of current investments purchased for ₹30 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ₹ 13 lakhs. After transfer the investment should be carried at :
(A) ₹30 lakhs;
(B) ₹13 lakhs;

(C) ₹17 lakhs;
(D) None of the above.

Answer: (B) — ₹13 lakhs.

The transfers should be made at lower of (a) Cost, and (b) Fair value at the date of transfer.

In the second case, the transfer should be made at Market Value (being lower of ₹30 lakhs and ₹13 lakhs) and hence the long term investments should be carried at ₹13 lakhs. The loss of ₹30 - ₹13= ₹17 lakhs should be provided for in the profit and loss account.

(vi) X Ltd. holds 61% of Y Ltd., Y Ltd. holds 51% of W Ltd., Z Ltd. holds 49% of W. Ltd. As per AS 18, Related Parties are :

(A) X Ltd., Y Ltd. & W Ltd;
(B) X Ltd. & Z Ltd;
(C) Y Ltd. & Z Ltd;
(D) X Ltd. & Y Ltd. only.

Answer: (A) — X Ltd., Y Ltd. & W Ltd.

X Ltd., YLtd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of Associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa.

(vii) B & T Ltd. obtained a Loan from a bank for ₹ 480 lakhs on 30.04.2013. It was utilized for : Construction of a shed ₹ 210 lakhs, Purchase of a machinery ₹ 150 lakhs, Working Capital ₹ 80 lakhs, Advance for purchase of truck ₹ 40 lakhs, Construction of shed was completed in March 2014. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31.03.2014 was ₹ 72 lakhs. As per AS 16, Interest to be debited to Profit & Loss account will be :
(A) ₹ 31.50 lakhs;
(B) ₹ 40.50 lakhs;
(C) ₹ 210 lakhs;
(D) None of the above.

Answer: (B) — ₹40.50 lakhs.

Qualifying Asset as per AS-16	= ₹ 210 lakhs (construction of a shed).
Borrowing cost to be capitalized = 72 × 210/480	= ₹31.50 lakhs
Interest to be debited to Profit or Loss account	= ₹ (72 – 31.50) lakhs
	= ₹ 40.50 lakhs.

(viii) The fair value of Plan assets of Vipul Ltd. at beginning and end of the year 2013-2014 were ₹ 4,00,000 and ₹ 5,70,000 respectively. The employer's contribution to the plan during the year was ₹ 1,40,000. If benefit payments to retirees were ₹ 1,00,000. what would be the actual return on plan assets (as per AS- 15) ?
A. ₹ 1,50,000 lakhs
B. ₹ 1,30,000 lakhs
C. ₹ 1,20,000 lakhs
D. Insufficient Information

Answer: (B) — ₹1,30,000.

Actual Return = Fair value of assets (end of year) - Fair Value of assets (beginning of year) - Employer's contribution + benefit payments = (5,70,000 – 4,00,000 – 1,40,000 + 1,00,000) = ₹ 1,30,000.

(ix) White Ltd. has imported $ 100,000 worth of goods from Chicago Traders of USA on 30.2.2013 when exchange rate was ₹ 54.60 per US $. The payment for imports was made on 30.6.2013 when exchange rate was ₹ 55.50 per US $. If the rate of exchange on 31.3.2013 is ₹ 55.00 per US $, the exchange difference to be charged/debited to Profit & Loss Account for the year 2013-14 as per AS-11 will be –

(A) ₹ 50,000 ;

(B) ₹ 45,000 ;

(C) ₹ 20,000 ;

(D) None of the above.

Answer: (A) — ₹ 50,000.

As per AS-11, exchange difference on settlement on monetary items should be transferred to Profit & Loss Account as gain or loss. Therefore (₹55.50 - ₹55.00) x $100,000 = ₹ 50,000 will be debited to Profit & Loss Account for the year 2013-14.

(x) A company follows a policy of refunding money to the dissatisfied customers if they claim within thirty days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.30% of the customers claim refunds. The company sold goods amounting to ₹50 lakhs during the last month of the financial year. The amount of contingency is:

(A) ₹50 lakhs;
(B) ₹15 lakhs;
(C) ₹35 lakhs;
(D) None of the above.

Answer: (B) — ₹15 lakhs.

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of product. Provision should be recognized as per AS-29. The best estimate for provision is ₹ 15,00,000 (50,00,000 x 0.30%).

(b) State the objectives of IFRS – 5 (Non-Current Assets Held for Sale and Discontinued Operations). [2]

Answer:

The objective of this IFRS is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the IFRS requires:

(i) Assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and

(i) Assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

(c) List the types of share based transaction as per IFRS - 2 (Share Based Payments). **[3]**

Answer:

Types of Share Based Transactions as per IFRS – 2 (Share Based Payments):

These are of three types –
(i) Equity-settled transactions for goods or services acquired by an entity
(ii) Cash settled but price or value of the goods or services is based on equity instruments of the entity and.
(iii) Transactions for goods or services acquired by the entity in which either the entity can settle or supplier can claim settlement by equity instruments of the entity.

Part B (75 marks)

2. A Ltd. and M Ltd. decide to amalgamate and to form a new company AM Ltd. The following are their summarised balance sheets as at 31.3.2014:

Equity and Liabilities	A Ltd. (₹)	M Ltd. (₹)
(1)Shareholders' funds		
(a)Share Capital (₹ 100) each	10,00,000	6,00,000
(b) Reserves and Surplus		
General Reserve	1,00,000	50,000
Investment Allowance Reserve	40,000	30,000
Non-Current Liabilities		
12% Debentures (₹100 each)	3,00,000	1,00,000
Current Liabilities		
Trade payables	60,000	20,000
Total	15,00,000	8,00,000
Assets		
Non-current Assets		
Fixed Assets	7,50,000	2,00,000
Non-current investments		
1,500 Shares in M	3,50,000	—
4,000 Shares in A	—	5,00,000
Current Assets	4,00,000	1,00,000
Total	15,00,000	8,00,000

Calculate the amount of purchase consideration for A Ltd. and M Ltd. and draw up the balance sheet of AM Ltd. after considering the following:

(i) Assume amalgamation is in the nature of purchase.
(ii) Fixed assets of A Ltd. are to be reduced by ₹ 50,000 and that of M Ltd. are to be taken at ₹ 3,00,000.
(iii) 12% debentureholders of A Ltd. and M Ltd. are discharged by AM Ltd. by issuing such number of its 15% debentures of ₹ 100 each so as to maintain the same amount of interest.

(iv) Shares of AM Ltd. are of ₹ 100 each.
Also show, how the investment allowance reserve will be treated in the Financial Statement assuming the Reserve will be maintained for 3 years. [15]

Answer:

Calculation of Purchase consideration

Value of Net Assets of A Ltd. and M Ltd. as on 31st March, 2014

		A Ltd. (₹)		**M Ltd. (₹)**
Assets taken over:				
Fixed Assets	7,00,000		3,00,000	
Current Assets	4,00,000	11,00,000	1,00,000	4,00,000
Less: Liabilities taken over:				
Debentures (WN)	2,40,000		80,000	
Trade payables	60,000	(3,00,000)	20,000	(1,00,000)
		8,00,000		3,00,000

Value of Shares of A Ltd. and M Ltd.

A Ltd. holds 1,500 shares in M Ltd. i.e. 1/4th of the shares of M Ltd.
The value of shares of A Ltd. is ₹ 8,00,000 plus 1/4 of the value of the shares of M Ltd.
M Ltd. holds 4,000 shares in A Ltd. i.e. 2/5th of the shares of A Ltd.
Similarly, the value of shares of M Ltd. is ₹ 3,00,000 plus 2/5 of the value of shares of A Ltd.
Let 'a' denote the value of shares of A Ltd. and 'm' denote the value of shares of M Ltd. then
a = 8,00,000 + 1/4 m; and
m = 3,00,000 + 2/5 a.
Substituting the value of m,
a = 8,00,000 + 1/4 (3,00,000 + 2/5 a)
a =8,00,000 + 75,000 + 1/10 a
9/10 a =8,75,000
a = 9,72,222
m = 3,00,000 + 2/5 (9,72,222)
m = 6,88,889

Amount of Purchase Consideration

	A Ltd. ₹	M Ltd. ₹
Total value of shares (as determined above)	9,72,222	6,88,889
Less: Internal investments:		
2/5 for shares held by M Ltd.	(3,88,889)	----
1/4 for shares held by A Ltd.	----	(1,72,222)
Amount due to outsiders	5,83,333	5,16,667

Purchase Consideration will be satisfied by AM Ltd. as follows:

	A Ltd. ₹	M Ltd. ₹
In shares (of ₹ 100 each)	5,83,300	5,16,600
In cash	33	67

Net Amount of Goodwill/Capital Reserve

	₹	₹
Total Purchase Consideration		
A Ltd.	5,83,333	
M Ltd.	5,16,667	11,00,000
Less: Net Assets taken over		
A Ltd.	8,00,000	
M Ltd.	3,00,000	(11,00,000)
		Nil

(Alternatively, the calculations may be made separately for both the companies)

Balance Sheet of AM Ltd.
as at 31st March, 2014

Particulars	Note No.	Amount (₹)
I. Equity and Liabilities		
(1)Shareholder's Funds		
(a) Share Capital	1	10,99,900
(b) Reserves and Surplus	2	70,000
(2) Non-Current Liabilities		
Long-term borrowings	3	3,20,000
(3) Current Liabilities		
Trade payables		80,000
Total		15,69,900
II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	10,00,000
(b) Other non-current assets	5	70,000
(2) Current assets		4,99,900
Total		15,69,900

Notes to Accounts

		(₹)	(₹)

1.	Share Capital 10,999 shares of ₹ 100 each (All the above shares are allotted as fully paid-up for consideration other than cash)		10,99,900
2.	Reserves and surplus Investment Allowance Reserve		70,000
3.	Long Term Borrowings 15% Debentures (W.N.)		3,20,000
4.	Other non-current assets Amalgamation Adjustment Account		70,000
5.	Current assets [4,00,000 + 1,00,000] Less. Purchase consideration paid in cash ₹ (33+67)	5,00,000 (100)	4,99,900

Working Note:

Calculation of Debentures to be issued

	A Ltd.	M Ltd.
12% Debentures	3,00,000	1,00,000
Interest on Debentures @ 12 % (a)	36,000	12,000
AM Ltd. Debentures rate of interest (b)	15%	15%
	2,40,000	80,000
Debenture Value to earn above calculated interest (a / b)		

3. (a) The business of H Ltd. was carried on continuously at losses. The following are the extracts from the Balance Sheet of the company as on 31st March,2014

Equity and Liabilities	**H Ltd. (₹)**
(1)Shareholders' funds	
(a)Share Capital (₹ 100) each	
30,000 Equity Shares of ₹10 fully paid	**3,00,000**
2,000 8% Cum Pref. Shares of ₹100 fully paid	**2,00,000**
(b) Reserves and Surplus	
Securities Premium Account	**90,000**
Profit & Loss Account	**(2,05,000)**
Non-Current Liabilities	
Long Term Borrowings	
Unsecured Loan (From Directors)	**50,000**
Current Liabilities	
Trade payables	**3,00,000**
Outstanding Expenses (incl Directors Remuneration ₹ 20,000)	**70,000**
Total	**8,05,000**
Assets	
Non-current Assets	
Fixed Assets	
Tangible Assets	
Plant	**3,00,000**
Loose Tools	**10,000**
Intangible Assets	

Goodwill	**50,000**
Current Assets	
Inventories	**1,50,000**
Trade Receivables - Debtors	**2,50,000**
Cash & Cash Equivalents	
Cash	**10,000**
Bank	**35,000**
Total	**8,05,000**

Note: Dividends on Cumulative Preference Shares are in arrears for 3 years.

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

- **Equity Shares to be converted into 1,50,000 Shares of ₹ 2 each.**
- **Equity Shareholders to surrender to the Company 90% of their holding.**
- **Preference Shareholders agree to forego their right to arrears of Dividends in consideration of which 8% Preference Shares are to be converted into 9% Preference Shares.**
- **Sundry Creditors agree to reduce their claim by one fifth in consideration of their getting Shares of ₹ 35,000 out of the surrendered Equity Shares.**
- **Directors agree to forego the amounts due on account of Unsecured Loan and Directors Remuneration.**
- **Surrendered Shares not otherwise utilized to be cancelled.**
- **Assets to be reduced as under:**

	₹
Goodwill by	**50,000**
Plant by	**40,000**
Tools by	**8,000**
Sundry Debtors by	**15,000**
Stock by	**20,000**

- **Any surplus after meeting the losses should be utilized in writing down the value of the Plant further.**
- **Expenses of Reconstruction amounted to ₹10,000.**
- **Further 50,000 Equity Shares were issued to the existing members for increasing the Working Capital. The issue was fully subscribed and paid-up.**

A Member holding 100 Equity Shares opposed the scheme and his Shares were taken over by the Director on payment of ₹ 1,000 as fixed by the Court.

Pass Journal Entries for giving effect to the above arrangement. **[12]**

Answer:

Particulars	**Debit** ₹	**Credit** ₹

a.	Sub Division of Shares			
	Equity Share Capital (₹ 10 each) A/c	Dr.	3,00,000	
	To Equity Share Capital (₹ 2 each) A/c			3,00,000
	(Being Equity shares of ₹10 each converted into Equity shares of ₹2 each as per Company's Resolution dated and approved By the court)			
b.	Surrender of Shares			
	Equity Share Capital (₹ 2) A/c	Dr.	2,70,000	
	To Shares Surrendered A/c			2,70,000
	(Being 90% of Equity shares surrendered as per scheme of reconstruction)			
c.	Conversion of Preference Share Capital			
	8% Cumulative Preference Share Capital A/c	Dr.	2,00,000	
	To 10% Cumulative Preference Share Capital A/c			2,00,000
	(Being 8% cumulative preference shares converted into 10% cumulative preference shares under the scheme of Reconstruction)			
d.	Surrendered shares issued to creditors under reconstruction scheme			
	Shares Surrendered A/c	Dr.	35,000	
	To Equity Share Capital(₹ 2) A/c			35,000
	(Being 17,500 equity shares, out of those surrendered, issued to sundry creditors on their surrendering 1/5th of their claim as per the scheme of reconstruction)			
e.	Expenses Paid			
	Expenses A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being expenses of reconstruction paid)			
f.	Cancellation of unissued surrendered shares			
	Shares Surrendered A/c	Dr.	2,35,000	
	To Capital Reduction A/c			2,35,000
	(Being cancellation of remaining surrendered shares According to scheme of reconstruction.)			
g.	Amount sacrificed by Directors			
	Unsecured Loan A/c	Dr.	50,000	
	Sundry Creditors A/c	Dr.	60,000	
	Outstanding Expenses A/c	Dr.	20,000	
	To Capital Reduction A/c			1,30,000
	(Being amounts sacrificed by various parties as per the reconstruction scheme transferred to Capital reduction account)			
h.	Assets Written off			
	Capital Reduction A/c	Dr.	3,65,000	

To Goodwill A/c			50,000
To Loose tools A/c			8,000
To Sundry debtors A/c			15,000
To Stock - in - trade A/c			20,000
To Profit and Loss A/c			2,05,000
To Expenses A/c			10,000
To Plant A/c			57,000
(Being expenses of reconstruction, various losses and amounts written off Various assets debited to capital reduction account as per scheme of Reconstruction balance amount credited to Plant account.)			
i. Issue of Shares			
Applications received			
Bank A/c	Dr.	1,00,000	
To Share Application A/c			1,00,000
Allotment of Shares			
Share Application A/c	Dr.	1,00,000	
To Share Capital A/c			1,00,000
(Being 50,000 equity shares of ₹ 2 each issued as fully paid as per Board's Resolution dated...)			

Note 1 : a. Cancellation of Preference dividend need not be journalised; on cancellation it cease to be contingent liability and hence no further disclosure.

b. Preference shareholders have to forego policy rights presently enjoyed at par with Equity Shareholders.

Note 2 : The transfer of 100 shares by the dissentient shareholders to the director concerned need not be journalised.

Note 3 : It has been assumed that the share premium account is to be kept infact since the scheme is silent about it.

(b) Explain Negative Goodwill in case of amalgamation in the nature of purchase. [3]

Answer:

If the consideration paid for amalgamation is less than the Net Assets of the transferor company, the difference is called Negative Goodwill. This should be recognised in the transferee company's financial statements as Capital Reserve,

Example: Mitra Ltd. acquired the Net Assets of Uma Ltd. for a total consideration of ₹500 lakhs. The fair value of Net Assets of Uma Ltd. is ₹800 lakhs. In the above case, the difference of ₹300 lakhs constitutes Negative Goodwill. This should be recognised as Capital Reserve in the Financial Statement of Mitra Ltd.

4. (a) From the following information, calculate the value of a share if you want to

(i) Buy a small lot of Shares;
(ii) Buy a controlling interest in the Company

Year	Profit (₹)	Capital Employed (₹)	Dividend %
2011	27,50,000	1,71,87,500	12
2012	80,00,000	4,00,00,000	15
2013	1,10,00,000	5,00,00,000	18
2014	1,25,00,000	5,00,00,000	20

The market Expectation is 12%. **[8]**

Answer:

(i) Buy a small lot of Shares

If the purpose of valuation is to provide data base to aid decision of buying a small (non-controlling) position of the equity of a company, dividend yield method is most appropriate. Dividend rate is rising continuosly, weighted average will be more appropriate for calculation of average dividend.

Year	Rate of Dividend	Weight	Product
2011	12	1	12
2012	15	2	30
2013	18	3	54
2014	20	4	80
		10	**176**

Average Dividend = $\frac{176}{10} = 17.6\%$

Value of share on the basis of dividend for buying a small lot of shares will be

$\frac{\text{Average dividend rate}}{\text{Market expectation rate}} \times 100 = \frac{17.6}{12} \times 100 =$ ₹146.67 per share

(ii) Buy a controlling interest in the Company

If the purpose of valuation is to provide data base to aid a decision of buying controlling interest in the company, total profit will be relevant to determine the value of shares as the shareholders have capacity to influence the decision of distribution of profit. As the profit is rising, weighted average will be more appropriate for calculation of average profit/ yield.

Year	Yield % (Profit/ capital employed) X 100	Weight	Product
2011	16	1	16
2012	20	2	40
2013	22	3	66
2014	25	4	100
		10	**222**

Average yield = $\frac{222}{10} = 22.2\%$

If controlling interest in the company is being taken over, then the value per share will be

$$= \frac{\text{Average yield rate}}{\text{Market expectation rate}} \times 100 = \frac{22.2}{12} \times 100 = ₹185 \text{ per share}.$$

(b) Discuss the major accounting issues that are involved in Environmental Accounting. [7]

Answer:

Major accounting issues involved in Environmental Accounting are as follows:

(i) Distinction between environmental expenditure and normal business expenditure:
Many new machines may incorporate state-of-the-art environmental technology and accordingly, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. It is necessary to frame guidelines indicating whether the reporting entity should properly allocate the capital and revenue expenditures between environmental expenditure and normal business expenditure or not.

(ii) Capitalization of environmental expenditures vis-a-vis expensing them during the current accounting period:
Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is persuaded to follow environmental accounting, the adverse impact in EPS is a major concern. Accordingly many Western Corporations prefer to capitalize environment costs instead of immediate expensing and adopt an amortization policy extending up to 10 years. Although this accounting practice has no theoretical support and rather contradicts the well established accounting concept of "prudence", it is considered as a practical solution to off-load burden of accumulated environmental costs without abruptly disturbing the cash flows attributable to the lenders, Government and finally to the shareholders. However, recognition of environmental costs should not necessarily be restricted to the expenses accrued in view of the applicable environmental laws. It should be guided by ethical consideration.

(iii) Recognition of environment related contingent liabilities:
Environmental contingent liabilities are a matter of increasing concern throughout the world. Recognizing a liability of hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably.
In fact, identification and measurement of contingent liabilities are highly debatable accounting aspects. The United Nations Conference on Environment and Development (UNCEAD) papers raise the basic question why environmental contingencies should not be merged with other business contingencies. There is an urgent need for tightening the

reporting rules on contingencies incorporating specific requirements for disclosure of environmental contingencies along with other contingencies.

5. Red Ltd. and Blue Ltd. propose to amalgamate. Their balance sheets as at 31st March,2014 were as follows:

Equity and Liabilities	Note	Red Ltd. (₹)	Blue Ltd. (₹)
Shareholders' funds			
Share Capital			
Equity share capital (in shares of ₹10 each)		15,00,000	6,00,000
Reserves and Surplus	1	9,00,000	1,50,000
Current Liabilities:			
Trade Payables - Creditors		3,00,000	1,50,000
Total		27,00,000	9,00,000
Assets			
Non-current Assets:			
Fixed Assets (less depreciation)		12,00,000	3,00,000
Investments (Face value of ₹ 3 lakhs ,6% Tax free G.P notes)		3,00,000	
Current Assets:			
Inventories		6,00,000	3,90,000
Trade receivables - Debtors		5,10,000	1,80,000
Cash and cash equivalents		90,000	30,000
Total		27,00,000	9,00,000

Note 1: Reserves and Surplus	Red Ltd. (₹)	Blue Ltd. (₹)
General Reserves	6,00,000	60,000
Profit and Loss Account	3,00,000	90,000
	9,00,000	1,50,000

Their Net Profit (after taxation) were as follows:

Year	Red Ltd.	Blue Ltd.
2011-12	(₹)3,90,000	(₹)1,35,000
2012-13	(₹)3,75,000	(₹)1,20,000
2013-14	(₹)4,50,000	(₹)1,68,000

Normal trading profit may be considered as 15% on closing capital invested. Goodwill may be taken as 4 year's purchase of average super profit. The stock of Red Ltd. and Blue Ltd. are to be taken at ₹ 6,12,000 and ₹ 4,26,000 respectively for the purpose of amalgamation. Green Ltd. is formed for the purpose of amalgamation of two companies. Assume Tax Rate 40%.

(i) Ascertain the number of shares to be issued by Green Ltd. in the form of equity shares of ₹10 each.
(ii) Draft the opening balance sheet of Green Ltd. after amalgamation. [15]

Answer:

(i) Computation of shares to be issued by Green Ltd.

Computation of Net Assets of amalgamating companies

	Red Ltd. (₹)	**Blue Ltd. (₹)**
Goodwill (W.N 2) Fixed Assets 6% investments (Non- trade) Inventories Debtors Cash and cash equivalents	3,19,200 12,00,000 3,00,000 6,12,000 5,10,000 90,000	1,21,200 3,00,000 ---- 4,26,000 1,80,000 30,000
	30,31,200	10,57,200
Less: Creditors	3,00,000	1,50,000
Net Assets	27,31,200	9,07,200
No. of Equity Shares	1,50,000	60,000
Intrinsic value of a share	₹18.208	₹15.12
No of shares to be issued by Green Ltd. to		
Red Ltd. 1,50,000 X 18.208/10	2,73,120 shares	
Blue Ltd. 60,000 X 15.12/10		90,720 shares

In total 2,73,120+ 90,720 i.e. 3,63,840 shares will be issued by Green Ltd.

Ratio of exchange of shares will be as follows:
A. Holders of 1,50,000 equity shares of Red Ltd. will get 2,73,120 shares in Green Ltd.
B. Similarly, holders of 60,000 equity shares of Blue Ltd. will get 90,720 shares in Green Ltd.

(ii) **Green Ltd. (Opening Balance Sheet) as on 01.04.2014**

Equity and Liabilities	**Note**	**Current Year**	**Previous Year**
Shareholders' funds			
Share Capital			
Equity share capital (in shares of ₹10 each)		36,38,400	
Current Liabilities:			
Trade Payables-Creditors(3,00,000+1,50,000)		4,50,000	
Total		**40,88,400**	
Assets			
Non-current Assets:			
Fixed Assets (less depreciation)			
Tangible assets(12,00,000+ 3,00,000)		15,00,000	
Intangible assets(3,19,200+ 1,21,200)		4,40,400	
Investments (Face value of ₹ 3 lakhs ,6% Tax free G.P notes)		3,00,000	
Current Assets:			
Inventories(6,12,000+4,26,000)		10,38,000	
Trade receivables-debtors(5,10,000+ 1,80,000)		6,90,000	
Cash and cash equivalents(90,000+30,000)		1,20,000	

Total		**40,88,400**	

Working Notes:

A. Calculation of Closing trading capital employed on the basis of net assets

	Red Ltd. (₹)	Blue Ltd. (₹)
Fixed Assets	12,00,000	3,00,000
Inventories	6,12,000	4,26,000
Debtors	5,10,000	1,80,000
Cash and cash equivalents	90,000	30,000
	24,12,000	9,36,000
Less: Creditors	3,00,000	1,50,000
Net Assets	21,12,000	7,86,000

B. Calculation of value of Goodwill

Average trading profit

	Red Ltd. (₹)	Blue Ltd. (₹)
2011-12	3,90,000	1,35,000
2012-13	3,75,000	1,20,000
2013-14	4,50,000	1,68,000
Profit after tax	12,15,000	4,23,000
Profit before tax	20,25,000	7,05,000
Add: Under valuation of closing stock	12,000	36,000
	20,37,000	7,41,000
Average of 3 years' profit before tax	6,79,000	2,47,000
Less: Income from non-trade investments (3,00,000 X 6%)	18,000	--
Average profit before tax	6,61,000	2,47,000
Less: 40% tax	2,64,400	98,800
Average profit after tax	3,96,600	1,48,200

Super Profits

	Red Ltd. (₹)	Blue Ltd. (₹)
Average trading profit	3,96,600	1,48,200
Less: Normal Profit		
Red Ltd. ₹21,12,000 X 15%	3,16,800	--
Blue Ltd. ₹ 7,86,000 X 15%	--	1,17,900
	79,800	**30,300**

Value of Goodwill

	Red Ltd. (₹)	Blue Ltd. (₹)
Value of Goodwill at 4 years' purchase of super profits	3,19,200	1,21,200

6. (a) The Balance Sheet of Golden and Silver Limited as on 31.3.2014 are given below:

Equity and Liabilities	Note	Golden Ltd. (₹)	Silver Ltd. (₹)
Shareholders' funds			
Share Capital			
Equity share capital		2,40,000	2,40,000
Reserves and Surplus	1	64,000	71,000
Current Liabilities:			
Trade Payables - Creditors		8,000	15,000
Other current liabilities		4,000	10,000
Total		3,16,000	3,36,000
Assets			
Non-current Assets:			
Fixed Assets		88,000	1,68,000
Investments		1,80,000	10,000
Current Assets:			
Inventories		20,000	80,000
Trade receivables - Debtors		12,000	30,000
Cash and cash equivalents		8,000	16,000
Other current assets		8,000	32,000
Total		3,16,000	3,36,000

Note 1: Reserves and Surplus	Golden Ltd. (₹)	Silver Ltd. (₹)
General Reserves	40,000	32,000
Profit and Loss Account	24,000	39,000
	64,000	71,000

Additional information:
(i) On 1.10.2011, Golden Ltd. acquired 16,000 shares of ₹10 each at the rate of ₹11 per share.
(ii) Balances to General reserve and Profit and Loss account of Silver Ltd. stood on 1.4.2011 at ₹60,000 and ₹32,000 respectively.
(iii) All the dividends declared and paid relating to the past years had been properly adjusted for to arrive at the Profit and Loss Account Balance.
(iv) On 1.3.2014, bonus shares were issued by Silver Ltd. at the rate of one fully paid share for every five held and effect has been given to that in the above accounts. The bonus was declared from general reserves from out of profits earned prior to 1.4.2011.
(v) On 1.10.2011, Fixed assets was revalued at ₹2,16,000, but no adjustment had been made in the books.
(vi) Depreciation had been charged @ 10% p.a. on the book value as on 1.4.2011 (on straight line method), there being no addition or sale since then.
(vii) Out of Current profits ₹4,000 have been transferred to General reserve every year.
(viii) Bills receivable of Golden Ltd. include ₹4,000 bills accepted by Silver Ltd. Bills discounted by Golden Ltd., but not yet matured include ₹3,000 accepted by Silver Ltd.
(ix) Sundry creditors of Golden Ltd. include ₹4,000 due to Silver Ltd. Sundry debtors of Silver Ltd. include ₹8,000 due from Golden Ltd.
(x) It is found that Golden Ltd. has remitted a cheque of ₹4,000, which has not yet been received by Silver Ltd.

Show the analysis of pre and post acquisition profit and reserves as on 31.03.2014 for the purpose of consolidation. [8]

Answer:

Interest of Golden Ltd in Silver Ltd.	₹
Share capital of Silver Ltd. on 31.3.2014	2,40,000
Less: Issue of Bonus Shares $\frac{1}{6} \times ₹2,40,000$	40,000
Share capital before Bonus issue	2,00,000
No. of Equity Shares before Bonus issue $\frac{2,00,000}{10}$	20,000
No. of shares held by Golden Ltd.	16,000
Interest of Golden Ltd. in Silver Ltd $\frac{16,000}{20,000} \times 100$	
Minority shareholders' Interest	20%

(ii) Analysis of Profit of Silver Ltd.

	₹	**Capital Profit** ₹	**Revenue Reserve** ₹	**Revenue Profit** ₹
General Reserve on 31.3.2014 (After Bonus issue)	32,000			
Add: Bonus issue	40,000			
Balance (before bonus issue) ₹ 1,80,000 – (16,000 shares x ₹ 11)	72,000			
General Reserve on 1.4.2011	60,000			
Less: Bonus issue	40,000	20,000		
Increase in General Reserve (Transfer of ₹4000 p.a. for 3 years) (72,000 – 60,000)	12,000	2,000	10,000	
Profit and Loss Account (39,000 – 12,000)	27,000	4,500		22,500
Additional depreciation written back due to revaluation of fixed assets $12,000 \times \frac{10}{100} \times 2.5$				3,000
		26,500	10,000	25,500
Share of Golden Ltd. (80%)		21,200	8,000	20,400
Share of Minority Shareholders (20%)		5,300	2,000	5,100
		26,500	10,000	25,500

Loss on Revaluation has been calculated as follows:	
Value of Assets on 1.4.2011 (1,68,000 X$\frac{100}{70}$)	2,40,000
Less : Depreciation for 6 months (2,40,000X$\frac{10}{100}$X$\frac{1}{2}$)	12,000
Valuation of Assets on 1.10.2011	2,28,000

Less: Re-valued value of Assets	2,16,000
Loss on Revaluation	12,000

It has been assumed that Profit of ₹27,000 for the year 2012-2013, has been earned evenly in 3 years, (year 2011-12, 2012-13 and 2013-14) hence profit per year would be $\frac{27,000}{3}$ = ₹9000.Half of the profit of ₹9,000 for the year 2011-12 would be pre-acquisition (Capital Profit) and Remaining half i.e. ₹4500 would be post-acquisition profit (Revenue profit).

(b) Find out the average capital employed of Nida Ltd. from its Balance Sheet as at 31st March, 2014:

Equity and Liabilities	**Note**	**31st March, 2014 (₹)**	**31st March, 2013 (₹)**
Shareholders' funds			
Share Capital:			
Equity share capital (in shares of ₹10 each)		**50,00,000**	
9% preference Shares fully paid up		**10,00,000**	
Reserves and Surplus:			
General Reserves		**12,00,000**	
Profit and Loss Account		**20,00,000**	
Non-current Liabilities			
16% Debenture		**5,00,000**	
16% Term Loan		**31,30,000**	
Current Liabilities:			
Trade Payables - Creditors		**2,70,000**	
Short-term provision:			
Equity Dividend ₹10,00,000			
9% Preference Dividend ₹90,000		**10,90,000**	
Provision for taxation		**6,40,000**	
Total		**148,30,000**	
Assets			
Non-current Assets:			
Fixed Assets – Tangible assets			
Land and Buildings		**25,00,000**	
Plant and machinery		**80,25,000**	
Vehicles		**10,50,000**	
Investments		**10,00,000**	
Other non-current assets – Preliminary expenses		**50,000**	
Current Assets:			
Inventories		**6,75,000**	
Trade receivables - Debtors		**4,90,000**	
Cash and cash equivalents		**10,40,000**	
Total		**148,30,000**	

Non-trade investments were 30% of the total investments.
Balances as on 01.04.2013 to the following accounts were:
Profit and Loss account ₹ 10.70 lakhs, General reserve ₹ 7.50 lakhs. **[7]**

Answer:

Computation of Average Capital employed **(₹ in Lakhs)**

Total Assets as per Balance Sheet		148.30
Less: Preliminary Expenses	0.50	
Non- trade investments (30% of 10 lakhs)	3.00	3.50
		144.80
Less: Outside Liabilities:		
16% debentures	5.00	
16% term Loan	31.30	
Sundry Creditors	2.70	
Provision for taxation	6.40	45.40
Capital Employed as on 31.03.2014		99.40
Less: ½ of profit earned:		
Increase in reserve balance	4.50	
Increase in Profit & Loss A/c	9.30	
Proposed Dividend	10.90	
	24.70 × 50%	12.35
Average capital employed		87.05

7. (a) Mitra Corporation had been preparing value added statements for the past five years. The personnel manager of the company has suggested that a value added incentive scheme when introduced will motivate employees to better performance. To introduce the scheme, it is proposed that the best index performance, i.e, employee costs to added value for the last 5 years will be used as the target index for future calculations of the bonus to be earned.

After the target index is determined, any actual improvement in the index will be rewarded the employer and employees sharing any such bonus in the ratio 1:2. The bonus is given at the end of the year, after the profit for the year is determined. From the following details, find out the bonus to be paid to the employees, if any, for 2014.

Value Added Statement for 5 years

Year	2009 ₹ '000	2010 ₹'000	2011 ₹'000	2012 ₹'000	2013 ₹'000
Sales	**2,800**	**3,800**	**4,600**	**5,200**	**6,000**
Less: Bought in goods & services	**1,280**	**2,000**	**2,500**	**2,800**	**3,200**
Added Value	**1,520**	**1,800**	**2,100**	**2,400**	**2,800**
Employees Cost	**650**	**760**	**840**	**984**	**1,120**

Dividend	**100**	**150**	**200**	**240**	**300**
Taxes	**320**	**380**	**420**	**500**	**560**
Depreciation	**260**	**310**	**360**	**440**	**560**
Debenture Interest	**40**	**40**	**40**	**40**	**40**
Retained earnings	**150**	**160**	**250**	**196**	**200**
Added value	**1,520**	**1,800**	**2,100**	**2,400**	**2,800**

Summarized P & L for 2012

	₹ '000	₹'000
Sales		**7,300**
Cost of material	**2,500**	
Wages	**700**	
Prod. Salaries	**200**	
Prod. Expenses	**700**	
Depreciation of machinery	**500**	
Adm. Salaries	**300**	
Adm. Expenses	**300**	
Adm. Depreciation	**200**	
Deb. Interest	**40**	
Salaries (Sales Deptts)	**60**	
Sales Expenses	**200**	
Dep. (Sales Deptt. Assets)	**60**	
Profit		**1,540**

[8]

Answer:

Statement Showing Added Value and Amount of Bonus Paid to Employees

(₹'000)

Year	2009	2010	2011	2012	2013
Employees Cost	650	760	840	984	1,120
Added Value	1,520	1,800	2,100	2,400	2,800
Percentage	42.76%	42.20%	40%	41%	40%
Target Index=40%					

Value Added Statement

		(₹'000)
Sales		7,300
Less: Cost of bought –out goods and services:		
Materials	2,500	
Production Expenses	700	
Admn. Expenses	300	
Selling Expenses	200	3,700
Added Value		**3,600**
Employees Costs:		
Wages	700	
Production salaries	200	
Admn. Cost	300	
Selling Salaries	60	1,260

Calculation showing the bonus for 2014	₹ '000
Employees cost as per Target Index $(3,600 \times 40\%)$	1,440
Annual Employees Cost	1,260
Saving/ Improvement	180
Employees share = ₹ $1,80,000 \times \frac{2}{3}$ **=₹1,20,000**	

(b) Nidhiram Investment Ltd. deals in equity derivatives. Their current portfolio comprises of the following instruments:
Infsys ₹ 5600 Call Expiry June 2014 2,000 unit bought at ₹ 197 each (cost)
Infsys ₹ 5700 Call Expiry June 2014 3,600 unit bought at ₹ 131 each (cost)
Infsys ₹ 5400 Put Expiry June 2014 4,000 unit bought at ₹ 81 each (cost)

What will the profit or loss to Nidhiram Investments Ltd. in the following situations?
i. Infsys closes on the expiry day at ₹ 6,041
ii. Infsys closes on the expiry day at ₹ 5,812
iii. Infsys closes on the expiry day at ₹ 5,085 **[7]**

Answer:

Profit ₹ 9,20,000, Loss ₹ 362400, Profit ₹ 70400

Payoff/unit at Infsys Closing price

Instrument	**Infsys Units**	**Closing Cost**	**Price Strike**	**Infsys (i) At 6,041**	**Closing (ii) At 5,812**	**Price (iii) At 5,085**
5600 Call	2000	197	5,600	441	212	NIL
5700 Call	3600	131	5,700	341	112	NIL
5400 Put	4000	81	5,400	NIL	NIL	315

	Profit per unit			**Profit Amount**		
	Infsys	**Closing**	**Price**	**Infsys**	**Closing**	**Price**
Instrument	6,041	5,812	5,085	6,041	5,812	5,085
5600 Call	244	15	-197	4,88,000	30,000	-3,94,000
5700 Call	210	-19	-131	7,56,000	-68,400	-4,71,600
5400 Put	-81	-81	234	-3,24,000	-3,24,000	9,36,000
				9,20,000	-3,62,400	70,400

8. Write short notes on any three of the following: **[5x3=15]**

(a) Impairment of asset and its application to inventory;
(b) Disclosure requirement as per AS – 11;
(c) Basic Structure of the form of the Government Accounts;
(d) Advantages of preparation of Value Added (VA) statements.

Answer:

(a) Impairment of asset and its application to inventory:

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

(b) Following are the matters to be disclosed as per AS – 11:

- Amount of exchange difference included in the net profit or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- A change in classification of significant foreign operation needs following disclosures —

  - Nature of change in classification;
    The reason for the change;
  - Effect of such change on shareholders fund;
  - Impact of change on net profit or loss for each prior period presented;
  - The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

(c) Basic Structure of the Form of the Government Accounts:

i. Period of Accounts : the annual accounts of the central, state and union territory Government shall record transactions, which take place during financial year running from 1" April to 31₅₹ March.
ii. Cash Basis Accounts: With exception of such book adjustment as may be authorized by these rules on the advice of the comptroller and Auditor General of India(CAG), the transaction in Government Accounts shall represent the actual cash receipt and disbursement during a financial year.
iii. Form of Accounts: There are three parts i.e. Consolidated Fund, Contingency Fund and Public Account. In Consolidated fund, there are two divisions i.e. revenue consisting of section for receipt heads and expenditure heads(Revenue Accounts) capital, Public debt, loan consisting of section of receipt heads (Capital Accounts), whereas, Contingency Fund Accounts shall be recorded for the transactions connected with the Government Set up under Article 267 of the constitution. In Public Account, transactions relating to debt deposit, advances, remittances and suspense shall be recorded.

(d) Advantages of preparation of Value Added (VA) statements:

Answer:

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

(i) 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.
(ii) 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.
(iii) 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.
(iv) 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.
(v) VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
(vi) 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.