COMPENDIUM
ON

ADVANCED FINANCIAL ACCOUNTING & REPORTING

ICWAI - FINAL

GROUP – IV

PAPER – 16

First Edition : May 2011

Published :

Directorate of Studies

The Institute of Cost and Works Accountants of India

12, Sudder Street, Kolkata-700 016

Printed at :

Repro India Limited

50/2 T.T.C. MIDC Industrial Area, Mahape, Navi Mumbai - 400710.

COMPENDIUM
ON
ADVANCED FINANCIAL ACCOUNTING & REPORTING

FINAL

GROUP – IV

PAPER – 16

INDEX

1
ACCOUNTING STANDARDS
(Answers to questions are based on Accounting Standards issued by ICAI prior to notification of "IND-AS" (Indian Accounting Standards notified by Ministry of Corporate Affairs Hence, "IND-AS" is not considered for this purpose)

Question 1

How would you deal with the following in the annual accounts of a company for the year ended 31st March, 2011?

(a) The company has to pay delayed jute clearing charges over and above the negotiated price for taking delayed delivery of jute from the Suppliers' Godown. Upto 2009-10, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2010-11. This would result into decrease in profit by ₹ 2.8 lakhs. .

(b) The company has obtained Institutional Term Loan of ₹ 700 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2011 amounted to ₹ 600 lakhs, ₹ 70 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 30 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 63.00 lakhs incurred during 2010-11 on the entire Institutional Term Loan of ₹ 700 lakhs.

Answer

(a) Para 29 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise. Therefore the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements. As per AS 2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards issued by the ICAl, delayed jute clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by ₹ 2.80 lakhs."

(b) As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

A qualifying asset is an asset that necessarily takes a substantial period of time* to get ready for its intended use or sale.

The treatment for total interest amount of ₹ 63.00 lakhs can be given as:

Purpose	Nature	Interest to be capitalised ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	$**63.00 \times \frac{600}{700} = 54.00$	
Advance to supplies for additional assets	Qualifying asset	$**63.00 \times \frac{70}{700} = 6.30$	
Working Capital	Not a qualifying asset		$63.00 \times \frac{30}{700} = 2.70$
		60.30	**2.70**

*Accounting Standards Interpretation (ASI) 1 deals with the meaning of expression 'substantial period of time'. A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

** It is assumed in the above solution that the modernization and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 63.00 lakhs will be recognized as expense in the profit and loss account for year ended 31st March, 2011.

Question 2

A firm of contractors obtained a contract for construction of bridges across a river. The following details are available in the records kept for the year ended 31st March, 2011.

	(₹ in lakhs)
Total Contract Price	2,000
Work Certified	1,000
Work not certified	210
Estimated further Cost to Completion	990
Progress Payment Received	800
To be Received	280

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by ICAI.

Answer

		(₹ in lakhs)
(a)	Amount of foreseeable loss	
	Total cost of construction (1,000 + 210 + 990)	2,200
	Less: Total contract price	2,000
	Total foreseeable loss to be recognized as expense	**200**

According to Para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

		(₹ in lakhs)
(b)	Contract work-in-progress i.e. cost incurred to date are ₹ 1,210 lakhs	
	Work certified	1,000
	Work not certified	210
		1,210

This is 55% (1,210/2,200 × 100) of total costs of construction.

(c) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised).

55% of ₹ 2,000 lakhs = ₹ 1,100 lakhs

(d) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= [1,210 + Nil – 200 – (800 + 280)] ₹ in lakhs = [1,210 – 200 –1,080] ₹ in lakhs

Amount due to customers = ₹ 70 lakhs. The amount of ₹ 70 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 (Revised) are given below:

	₹ in lakhs
Contract revenue	1,100
Contract expenses	1,210
Recognised profits less recognized losses	(200)
Progress billings (800 + 280)	1.080
Retentions (billed but not received from contractee)	280
Gross amount due to customers	70

Question 3

In preparing the financial statements of Z Ltd. for the year ended 31st March, 2011, you come across the following information. State with reasons, how you would deal with them in the financial statements:

(a) An unquoted long term investment is carried in the books at a cost of ₹ 12 lakhs. The published accounts of the unlisted company received in May, 2011 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 1,20,000.

(b) The company invested ₹50 lakhs in April, 2011 in the acquisition of another company doing similar business, the negotiations for which had started during the financial year.

Answer

As it is stated in the question that financial statements for the year ended 31st March, 2011 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

(a) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 1,20,000 in the financial statements for the year ended 31st March, 2011.

(b) Para 3.2 of AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2011. Applying para 15 which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 50 lakhs in April, 2011 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Question 4

(a) A Limited Company closed its accounting year on 30.6.2011 and the accounts for that period were considered and approved by the board of directors on 20th August, 2011. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2011 it had met a rocky surface for which it was estimated that there would be an extra cost of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.11.

(b) A Ltd. purchased fixed assets costing ₹ 5,100 lakhs on 1.1.10 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal installments. Exchange rates were 1 Dollar = ₹ 42.50 and ₹ 45.00 as on 1.1.10 and 31.12.10 respectively. First installment was paid on 31.12.10. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

Answer

(a) Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report.

(b) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', 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 recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{₹\ 5{,}100\ \text{lakhs}}{₹\ 42.50} = 120\ \text{lakhs US Dollars}$$

Exchange difference = ₹120 lakhs US Dollars × (45.00 – 42.50)

= ₹ 300 lakhs (including exchange loss on payment of first installment)

Therefore, entire loss due to exchange differences amounting ₹ 300 lakhs should be charged to profit and loss account for the year.

Question 5

(i) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2011.

A claim lodged with the Railways in March, 2008 for loss of goods of ₹ 2,60,000 had been passed for payment in March, 2011 for ₹ 1,75,000. No entry was passed in the books of the Company, when the claim was lodged.

(ii) The notes to accounts of X Ltd. for the year 2010-11 include the following:

"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Project amounting to ₹ 1,80,80,000 has been capitalized during the year, which includes approximately ₹ 1,76,00,000 capitalised in respect of the utilization of loan and debenture money for the said purpose." Is the treatment correct? Briefly comment.

Answer

(i) Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,75,000 were collected against a claim of ₹ 2,60,000. So this transaction cannot be taken as a Prior Period Item.

In the light of revised AS 5, it will not be treated as extraordinary item. However, Para 12 of AS 5 (Revised) states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately as per Para 12 of AS 5 (Revised).

(ii) The treatment done by the company is not in accordance with AS 16 'Borrowing Costs'. As per Para 10 of AS 16, 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. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. ₹ 1,76,00,000. Thus, there is an excess capitalisation of ₹ 4,80,000. This has resulted in overstatement of profits by ₹ 4,80,000 and amount of fixed assets has also gone up by this amount.

Question 6

State with reference to accounting standard, how will you value the inventories in the following cases:

(i) Raw material was purchased at ₹ 100 per kg. Price of raw material is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost. 5,000 kgs. of raw material is on stock at the year end. Replacement cost is ₹ 90 per kg.

(ii) In a production process, normal waste is 3% of input. 5,000 MT of input were put in process resulting in a wastage of 180 MT. Cost per MT of input is ₹ 800. The entire quantity of waste is on stock at the year end.

(iii) Per kg. of finished goods consisted of:

Material cost	₹ 150 per kg.
Direct labour cost	₹ 40 per kg.
Direct variable production overhead	₹ 20 per kg.

Fixed production charges for the year on normal capacity of 2,00,000 kgs. is ₹ 10 lakhs. 1,000 kgs. of finished goods are on stock at the year end.

Answer

(a) (i) As per Para 24 of AS 2 (Revised) on Valuation of Inventories, materials and other supplies held for use in the production of inventories are not written down below cost if the finished product in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Hence, in the given case, the stock of 5,000 kgs of raw material will be valued at ₹ 90 per kg. The finished goods, if on stock, should be valued at cost or net realisable value whichever is lower.

(ii) As per para 13 of AS 2 (Revised), abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 150 MT and abnormal waste is 30 MT.

The cost of 150 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to ₹ 24,000 (30 MT x ₹ 800) will be charged in the profit and loss statement.

(iii) In accordance with Paras 8 and 9 of AS 2 (Revised), the costs of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Thus, cost per kg. of finished goods can be computed as follows:

	₹
Material cost	150
Direct labour cost	40
Direct variable production overhead	20
Fixed production overhead $\left(\frac{₹\ 10,00,000}{2,00,000}\right)$	5
	215

Thus, the value of 1,000 kgs. of finished goods on stock at the year-end will be ₹ 2,15,000 (1,000 kgs. x ₹ 215).

Question 7

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2011 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2011

	₹ '000		**₹ '000**
Balance on 1.4.2010	400	Payment to Suppliers	2,600
Issue of Equity Shares	1,000	Purchase of Fixed Assets	1,200
Receipts from Customers	4,500	Overhead expense	200
Sale of Fixed Assets	200	Wages and Salaries	600
		Taxation	450
		Dividend	100
		Repayment of Bank Loan	800
		Balance on 31.3.2011	150
	6,100		6,100

Answer:

X Ltd.

Cash Flow Statement for the year ended 31st March, 2011 (Using the direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	4,500	
Cash payment to suppliers	(2,600)	
Cash paid to employees	(600)	
Cash payments for overheads	(200)	
Cash generated from operations	1,100	
Income tax paid	(450)	
Net cash from operating activities		650
Cash flows from investing activities		
Payment for purchase of fixed assets	(1,200)	
Proceeds from sale of fixed assets	200	
Net cash from investing activities		(1,000)
Cash flows from financing activities		
Proceeds from issuance of equity shares	1,000	
Bank loan repaid	(800)	
Dividend paid	(100)	
Net cash from financing activities		100
Net increase in cash and cash equivalents		(250)
Cash at beginning of the period		400
Cash at end of the period		150

Question 8

A Ltd. acquired 45% of shares in B Ltd. as on 31.3.2010 for ₹ 5 lakhs. The Balance Sheet of B Ltd. as on 31.3.2010 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Fixed Assets	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	10,00,000

During the year ended 31.3.2011 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.2010 at 40% from the Reserves.
(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2011.
(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.2011 on 30.4.2011.
A Ltd. is preparing Consolidated Financial Statements in accordance with AS – 21 for its various subsidiaries. Calculate:
(i) Goodwill if any on acquisition of B Ltd.'s shares.
(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?
(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Answer

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill

	₹ in lakhs
Cost of investment	5.00
Less: Share in the value of Equity of B.Ltd. as at the date of investment [45% of ₹10 lakhs (₹5 lakhs + ₹ 5 lakhs)]	4.50
Goodwill	**0.50**

(ii) **A Ltd.**

Consolidated Profit and Loss Account for the year ended 31st March, 2011 (extracts)

			₹ in lakhs
By	Share of profits in B Ltd.		3.15
By	Dividend received from B Ltd. (5,00,000 x 40% x 45%)	0.90	
	Transfer to investment A/c	0.90	Nil

(iii) **A Ltd.**

Consolidated Balance Sheet as on 31.3.2011 (extracts)

		₹ in lakhs
Investment in B Ltd.		
Share in B Ltd.' s Equity	4.50	
Less: Dividend received	0.90	
	3.60	
Add: Share of Profit for 2010– 2011	3.15	
	6.75	
Add: Goodwill	0.50	7.25

Working Notes:

1. Dividend received from B Ltd. amounting to ₹ 0.90 lakhs will be reduced from investment value in the books of A Ltd. However goodwill will not change.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 2011. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 3.15 lakhs. Investment in B Ltd. will be increased by ₹ 3.15 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 3.15 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 2011 will not be recognised in the consolidated financial statements of A Ltd.

Question 9

XYZ Ltd., has undertaken a project for expansion of capacity as per the following details:

	Plan	Actual
	₹	₹
April, 2011	2,00,000	2,00,000
May, 2011	2,00,000	3,00,000
June, 2011	10,00,000	–
July, 2011	1,00,000	–
August, 2011	2,00,000	1,00,000
September, 2011	5,00,000	8,00,000

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had ₹ 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over ₹ 10 lakhs from 1.9.2011. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure were incurred on 1st day of each month. Calculate:

(i) Interest to be capitalised.

(ii) Give reasons wherever necessary.

Assume:

(a) Overdraft will be less, if there is no capital expenditure.

(b) The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time.

Answer

(a) **XYZ Ltd.**

Month	Actual Expenditure ₹	Interest Capitalised ₹	Cumulative Amount ₹	
April, 2011	2,00,000	2,000	2,02,000	
May, 2011	3,00,000	5,020	5,07,020	
June, 2011	–	5,070	5,12,090	Note 2
July, 2011	–	5,120	5,17,210	
August, 2011	1,00,000	–	6,17,210	Note 3
September, 2011	8,00,000	10,000	14,27,210	Note 4
	14,00,000	**27,210**	**14,27,210**	

Note:

1. There would not have been overdraft, if there is no capital expenditure. Hence, it is a case of specific borrowing as per AS 16 on Borrowing Costs.

2. The company had a strike in June and hence could not continue the work during June. As per Para 14 (c) of AS 16, the activities that are necessary to prepare the asset for its intended use or sale are in progress. The strike is not during extended period. Thus during strike period, interest need to be capitalised.

3. During August, the company did not incur any interest as there was surplus cash in August. Therefore, no amount should be capitalised during August as per Para 14(b) of AS 16.

4. During September, it has been taken that actual overdraft is ₹ 10 lakhs only. Hence, only ₹10,000 interest has been capitalised even though actual expenditure exceeds ₹ 10 lakhs.

   Alternatively, interest may be charged on total amount of (₹ 6,17,210 + ₹ 8,00,000 = 14,17,210) for the month of September, 2011 as it is given in the question that overdraft was over ₹ 10 lakhs from 1.9.2011 and not exactly ₹ 10 lakhs. In that case, interest amount ₹ 14,172 will be capitalised for the month of September.

Question 10

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.2009. For the years ending 31.3.2010 and 31.3.2011, it made profits of ₹ 1,00,000 and ₹1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2009, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ended 2010 and 2011 for tax purposes. Prepare a statement of Profit and Loss for the years ended 2009, 2010 and 2011.

Answer: **Statement of Profit and Loss**

	31.3.2009 ₹	31.3.2010 ₹	31.3.2011 ₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/adjusted during the year		(40,000)	(40,000)
Profit (loss) after tax effect	**(1,20,000)**	**60,000**	**72,000**

Question 11

(a) J Ltd. purchased machinery from K Ltd. on 30.09.2010. The price was ₹ 370.44 lakhs after charging 8% Sales-tax and giving a trade discount of 2% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price. A loan of ₹ 300 lakhs was taken from the bank on which interest at 15% per annum was to be paid. Expenditure incurred on the trial run was Materials ₹ 65,000, Wages ₹ 48,000 and Overheads ₹ 45,000. Machinery was ready for use on 1.12.2010. However, it was actually put to use only on 1.5.2011. Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 1.12.2010 to 1.5.2011. The entire loan amount remained unpaid on 1.5.2011.

(b) State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 2011 with reference to Accounting Standards:

(i) The company finds that the stock sheets of 31.3.2010 did not include two pages containing details of inventory worth ₹ 14.5 lakhs.

(ii) The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 2010-2011, but proved to be a failure.

Answer

(a)	₹ (in Lakhs)	(₹ in Lakhs)	
Quoted price (refer to working note)	350.00		
Less: 2% Trade Discount	7.00		
	343.00		
Add: 8% Sales tax (8% × ₹ 343 lakhs)	27.44	370.44	
Transport charges (0.25% × ₹ 350 lakhs)		0.88	(approx.)
Installation charges (1% × ₹ 350 lakhs)		3.50	
Financing cost (15% on ₹ 300 Lakhs) for the period 30.9.2010 to 1.12.2010		7.50	
Trial Run Expenses			
Material	0.65		
Wages	0.48		
Overheads	0.45	1.58	
Total cost		**383.90**	

Interest on loan for the period 1.12.2010 to 1.05.2011 is ₹ 300 lakhs $\times \frac{15}{100} \times \frac{5}{12}$ = ₹18.75 lakhs

This expenditure may be charged to Profit and Loss Account or deferred for amortization between say three to five years. Assumed that no other expenses are incurred on the machine during this period.

Working Note:

Let the quoted price 'X'

Less: Trade Discount 0.02X.

Actual Price = 0.98X.

Sale Tax @8% = 1.08 × 0.98X

$$\text{or } X = \frac{₹\ 370.44 \text{ lakhs}}{1.08 \times 0.98} = ₹\ 350 \text{ lakhs}$$

(b) (i) Paragraph 4 of Accounting Standard 5 on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in stock valuation is a prior period item vide Para 4 of AS 5. ₹14.5 lakhs must be added to the opening stock of 1/4/2010. It is also necessary to show ₹ 14.5 lakhs as a prior period adjustment in the Profit and loss Account below the line. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.

(ii) In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to paras 41 to 43 of AS 26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

Question 12

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

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

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

(b) Z Ltd. presents the following information for the year ended 31.03.2010 and 31.03.2011 from which you are required to calculate the Deferred Tax Asset/Liability assuming tax rate of 30% and state how the same should be dealt with as per relevant accounting standard.

	31.03.2010 ₹ (lakhs)	31.03.2011 ₹ (lakhs)
Depreciation as per books	4,010.10	4,023.54
Unabsorbed carry forward business loss and depreciation allowance	2,016.60	4,110.00
Disallowance under Section 43B of Income tax Act, 1961	518.35	611.45
Deferred Revenue Expenses	4.88	–
Provision for Doubtful Debts	282.51	294.35

Z Ltd. had incurred a loss of ₹ 504 lakhs for the year ended 31.03.2011 before providing for Current Tax of ₹ 26.00 lakhs.

Answer

(a) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 30% of ₹ 1,20,000 + 10% of ₹ 2,00,000

= ₹ 36,000 + ₹ 20,000 = ₹ 56,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000

= ₹ 30,000 + ₹ 42,000 =₹ 72,000

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

(b)

	₹ in lakhs 31.3.2010	₹ in lakhs 31.3.2011
Carried Forward Business Loss and Depreciation Allowance	2,016.60	4,110.00
: Disallowance under Section 43 B of Income Tax Act,1961	518.35	611.45
Provision for Doubtful Debts	282.51	294.35
	2,817.46	5,015.80
Less: Depreciation	4,010.10	4,023.54
	(–) 1,192.64	992.26
Less: Deferred Revenue Expenditure	4.88	–
Timing Differences	(–) 1,197.52	992.26
Deferred Tax Liability	359.26	
Deferred Tax Asset		297.68

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that future taxable income will be available against which such deferred tax assets can be realized. The existence of unabsorbed depreciation or carry forward of losses is strong evidence that future taxable income may not be available. Deferred Tax Asset of ₹ 297.68 lakhs should not be recognized as an asset as per para 17 of AS 22 on 'Accounting for Taxes on Income'. Deferred Tax Liability of ₹ 359.26 lakhs should be disclosed under a separate heading in the balance sheet of Z Ltd., separately from current assets and current liabilities.

Question 13

(a) X Co. Ltd. supplied the following information. You are required to compute the basic earnings per share: Accounting year 1.1.2010 – 31.12.2010)

Net Profit	:	Year 2010 : ₹ 20,00,000
	:	Year 2011 : ₹ 30,00,000
No. of shares outstanding prior to Right Issue	:	10,00,000 shares
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares.
		Right Issue price – ₹ 20
		Last date of exercise rights – 31.3.2011.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.2011	:	₹ 25

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

	(₹ in Lakhs)
Fair value of the machinery	20.00

Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

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

(c) The following particulars are stated in the Balance Sheet of M/s Exe Ltd. as on 31.03.2010:

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

The following transactions were reported during the year 2010-11:

(i)	Tax Rate	50%
(ii)	Depreciation – As per Books	50.00
	Depreciation – for Tax purposes	30.00
	There were no addition to Fixed Assets during the year.	
(iii)	Items disallowed in 2009-10 and allowed for Tax purposes in 2010-11	10.00
(iv)	Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2011	20.00
(v)	Donations to Private Trusts made in 2010-11	10.00
(vi)	Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2010-11 (1/10th of ₹ 50.00 lakhs incurred in 2006-2007)	5.00
(vii)	Repairs to Plant and Machinery ₹ 100.00 lakhs was spread over the period 2010-11 and 2011-12 equally in the books. However, the entire expenditure was allowed for Income-tax purposes.	

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets and the balances of Deferred Tax Liability/Deferred Tax Asset as on 31.03.2011.

Answer

(a) Computation of Basic Earnings Per Share

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

	Year 2010	Year 2011
	₹	₹
EPS for the year 2010 as originally reported		
$= \dfrac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (₹ 20,00,000 / 10,00,000 shares)	2.00	

EPS for the year 2010 restated for rights issue

= [₹ 20,00,000 / (10,00,000 shares × 1.04)] 1.92

(Refer working note.2) (approx.)

EPS for the year 2011 including effects of rights issue

$$\frac{₹\ 30{,}00{,}000}{(10{,}00{,}000\ \text{shares} \times 1.04 \times 3/12) + (12{,}50{,}000\ \text{shares} \times 9/12)}$$

$$\frac{₹\ 30{,}00{,}000}{11{,}97{,}500\ \text{shares}}$$ 2.51 (approx.)

Working Notes:

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

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$= \frac{(₹\ 25 \times 10{,}00{,}000\ \text{shares}) + (₹\ 20 \times 2{,}50{,}000\ \text{shares})}{10{,}00{,}000\ \text{shares} + 2{,}50{,}000\ \text{shares}}$$

$$= \frac{₹\ 3{,}00{,}00{,}000}{12{,}50{,}000\ \text{shares}} = ₹\ 24$$

2. **Computation of adjustment factor**

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{₹\ 25}{₹\ 24\ (\text{Refer Working Note 1})} = 1.04\ (\text{approx.})$$

(b) Computation of Unearned Finance Income

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

where :

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

Gross Investment = Minimum lease payments + Unguaranteed residual value

= (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

= [(₹ 5,00,000 × 5 years) + ₹ 1,00,000] + ₹ 1,00,000 = ₹ 27,00,000

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

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value
	₹		₹
1	5,00,000	0.8696	4,34,800
2	5,00,000	0.7561	3,78,050
3	5,00,000	0.6575	3,28,750
4	5,00,000	0.5718	2,85,900
5	5,00,000	0.4972	2,48,600
	1,00,000 (Guaranteed residual value)	0.4972	49,720
			17,25,820
	1,00,000 (Unguaranteed residual value)	0.4972	49,720
			17,75,540

Unearned Finance Income = (i) – (ii)

= ₹ 27,00,000 – ₹ 17,75,540 = ₹ 9,24,460

Journal Entries in the books of B Ltd.

		₹	₹
At the inception of lease			
Machinery account	Dr.	17,25,820	
To A Ltd.'s account			17,25,820
(Being lease of machinery recorded at present value of MLP)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			
A Ltd.'s account	Dr.	5 ,00,000	
To Bank account			5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)			
Depreciation account	Dr.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	4,31,455	
To Depreciation account			1,72,582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

Working Note:

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

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

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

(c) Impact of various items in terms of deferred tax liability/deferred tax asset.

Transactions	Analysis	Nature of difference	Effect	Amount
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years	Responding timing difference	Reversal of DTL	₹ 20 lakhs × 50% = ₹ 10 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	₹ 10 lakhs × 50% = ₹ 5 lakhs
Interest to financial institutions	It is allowed as deduction under section 43B of the IT Act, if the payment is made before the due date of filing the return of income (i.e. 31st October, 2011).	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	₹ 5 lakhs × 50% = ₹ 2.5 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	₹ 50 lakhs × 50% = ₹ 25 lakhs

Deferred Tax Liability Account

Dr.			₹ in lakhs				Cr. ₹ in lakhs
31.3.2011	To	Profit and Loss account (Depreciation)	10.00	1.4.2010	By	Balance b/d	20.00
	To	Balance c/d	35.00		By	Profit and Loss Account (Repairs to plant)	25.00
			45.00				45.00
				1.4.2011	By	Balance b/d	35.00

Deferred Tax Asset Account

Dr.			₹ in lakhs				Cr. ₹ in lakhs
1.4.2010	To	Balance b/d	10.00	31.3.2011	By	Profit and Loss Account: Items disallowed in 2009-10 and allowed as per I.T. Act in 2010-11	5.00
						Share issue expenses	2.50
					By	Balance c/d	2.50
			10.00				10.00
1.4.2011	To	Balance b/d	2.50				

Question 14

(a) Venus Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2011 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

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

Answer

(a) (i) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

∴ Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(ii) **Journal Entries**

Particulars		Dr. Amount ₹ in lakhs	Cr. Amount ₹ in lakhs
a) Impairment loss A/c	Dr.	100	
To Asset A/c			100
(Being the entry for accounting impairment loss)			
b) Profit and loss A/c	Dr.	100	
To Impairment loss A/c			100
(Being the entry to transfer impairment loss to profit and loss account)			

(iii) **Balance Sheet of Venus Ltd. as on 31.3.2011 (extracts)**

	₹ in lakhs
Asset less depreciation	500
Less: Impairment loss	100
	400

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

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

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

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

Question 15

Global Ltd. has initiated a lease for three years in respect of an equipment costing ₹ 1,50,000 with expected useful life of 4 years. The asset would revert to Global Limited under the lease agreement.

The other information available in respect of lease agreement is:

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹20,000.
(ii) The implicit rate of interest is 10%.
(iii) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Global Ltd.
(i) The annual lease payment.
(ii) The unearned finance income.
(iii) The segregation of finance income, and also,
(iv) Show how necessary items will appear in its profit and loss account and balance sheet for the various years.

Answer

(i) Calculation of Annual Lease Payment

	₹
Cost of the equipment	1,50,000
Unguaranteed Residual Value	20,000
PV of residual value for 3 years @ 10% (₹ 20,000 x 0.751)	15,020
Fair value to be recovered from Lease Payment (₹1,50,000 – ₹15,020)	1,34,980
PV Factor for 3 years @ 10%	2.487
Annual Lease Payment (₹1,34,980/PV Factor for 3 years @ 10% i.e. 2.487)	54,275

(ii) Unearned Financial Income

Total lease payments [₹ 54,275 x 3]	1,62,825
Add: Residual value	20,000
Gross Investments	1,82,825
Less: Present value of Investments (₹ 1,34,980 + ₹ 15,020)	1,50,000
Unearned Financial Income	32,825

(iii) Segregation of Finance Income

Year	Lease Rentals	Finance Charges @ 10% on outstanding amount of the year	Repayment	Outstanding Amount
	₹	₹	₹	₹
0	-	-	-	1,50,000
I	54,275	15,000	39,275	1,10,725
II	54,275	11,073	43,202	67,523
III	74,275	6,752	67,523	--
	1,82,825	**32,825**	**1,50,000**	

(iv) Profit and Loss Account (Extracts) Credit side

		₹
I Year	By Finance Income	15,000
II year	By Finance Income	11,073
III year	By Finance Income	6,752

Balance Sheet (Extracts)

Assets side

	₹	₹
I year Lease Receivable	1,50,000	
Less: Amount Received	39,275	1,10,725
II year Lease Receivable	1,10,725	
Less: Received	43,202	67,523
III year :Lease Amount Receivable	67,523	
Less: Amount received	47,523	
Residual value	20,000	NIL

Notes to Balance Sheet

	₹
Year 1	
Minimum Lease Payments (54,275 + 54,275)	1,08,550
Residual Value	20,000
	1,28,550
Unearned Finance Income(11,073+ 6,752)	17,825
Lease Receivables	1,10,725
Classification:	
Not later than 1 year	43,202
Later than 1 year but not more than 5 years	67,523
Total	1,10,725
Year II:	
Minimum Lease Payments	54,275
Residual Value (Estimated)	20,000
	74,275
Unearned Finance Income	6,752
Lease Receivables (not later than 1year)	67,523
III Year:	
Lease Receivables (including residual value)	67,523
Amount Received	67,523
	NIL

2
Preparation of Company Accounts

Question 1

The following information has been extracted from the books of account of Hero Ltd. as at 31st March, 2011:

	Dr. (₹'000)	Cr. (₹'000)
Administration Expenses	480	
Cash at Bank and on Hand	228	
Cash Received on Sale of Fittings		10
Long Term Loan		70
Investments	200	
Depreciation on Fixtures, Fittings, Tools and Equipment (1st April, 2010)		260
Distribution Costs	102	
Factory Closure Costs	60	
Fixtures, Fittings, Tools and Equipment at Cost	680	
Profit & Loss Account (at 1st April, 2010)		80
Purchase of Equipment	120	
Purchases of Goods for Resale	1710	
Sales (net of Excise Duty)		3,000
Share Capital (1,00,000 shares of ₹. 10 each fully paid)		1,000
Stock (at 1st April, 2010)	140	
Trade Creditors		80
Trade Debtors	780	
	4,500	4,500

Additional Information:

(1) The stock at 31st March, 2011 (valued at the lower of cost or net realizable value) was estimated to be worth ₹ 2,00,000.

(2) Fixtures, fittings, tools and equipment all related to administration. Depreciation is charged at a rate of 20% per annum on cost. A full year's depreciation is charged in the year of acquisition, but no depreciation is charged in the year of disposal.

(3) During the year to 31st March, 2011, the Company purchased equipment of ₹ 1,20,000. It also sold some fittings (which had originally cost ₹ 60,000) for ₹ 10,000 and for which depreciation of ₹ 30,000 had been set aside.

(4) The average Income tax for the Company is 50%. Factory closure cost is to be presumed as an allowable expenditure for Income tax purpose.

(5) The company proposes to pay a dividend of 20% per Equity Share.

Prepare Hero Ltd.'s Profit and Loss Account for the year to 31st March, 2011 and balance Sheet as at that date in accordance with the Companies Act, 1956 in the Vertical Form along with the Notes on Accounts containing only the significant accounting policies.

Answer

Hero Ltd.
Balance Sheet as at 31st March, 2011

				(₹ in thousands)
I	**SOURCES OF FUNDS**			
	(1) Shareholders' funds:			
		(a) Capital	1,000	
		(b) Reserves and surplus	150	
				1,150
	(2) Loan funds:			
		(a) Secured loans	70	
		(b) Unsecured loans	–	
				70
		TOTAL		**1,220**
II	**APPLICATION OF FUNDS**			
	(1) Fixed assets:			
		(a) Gross block	740	
		(b) Less: Depreciation	378	
		(c) Net block	362	
		(d) Capital work in progress	–	
				362
	(2) Investments			200
	(3) Current assets, loans and advances:			
		(a) Inventories	200	
		(b) Sundry debtors	780	
		(c) Cash and bank balances	228	
		(d) Other current assets	–	
		(e) Loans and advances	–	
			1,208	
	Less: Current Liabilities and Provisions:			
		(a) Liabilities	80	
		(b) Provisions	470	
			550	
	Net current assets			658
	(4) Miscellaneous expenditure			–
	(to the extent not written off or adjusted)			–
	TOTAL			**1,220**
	Contingent Liabilities		Nil	

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

	(₹ in thousands)
Income	
Sales (Net of Excise Duty)	3,000
Increase /(Decrease) in Stocks	60
	3,060

Expenditure		
Purchase of Goods for Resale	1,710	
Administration Expenses	480	
Distribution costs	102	
Loss on sale of asset	20	
Depreciation	148	
		2,460
Profit before Extraordinary Items		600
Factory Closure Costs		60
Profit before taxation		540
Provision for tax		270
Net profit		270
Balance brought forward from previous year		80
Profit Available For Appropriation		350
Appropriations		
Proposed Equity Dividend	200	
Amount transferred to general reserve	30	230
Balance carried forward		120

NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 2011

Significant Accounting Policies:

(a) Basis for preparation of financial statements: The financial statements have been prepared under the historical cost convention, in accordance with the generally accepted accounting principles and the provisions of the companies Act, 1956 as adopted consistently by the company.

(b) Depreciation: Depreciation on fixed assets is provided using the straight-line method, based on the period of five years. Depreciation on additions is provided for the full year but no depreciation is provided on assets sold in the year of their disposal.

(c) Investments: Investments are valued at lower of cost or net realizable value.

(d) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.

Working Notes:

		(₹ in thousands)
(1) Fixtures, Fittings, Tools and Equipment		
Gross Block		
As on 1.4.2010	680	
Add: Additions during the year	120	
	800	
Less: Deductions during the year	60	
As on 31.3.2010		740
Depreciation		
As on 1.4.2010	260	
For the year (20% on 740)	148	
	408	
Less: Deduction during the year	30	

	As on 31.3.2011		378
	Net block as on 31.3.2011		362
(2)	Provision for taxation		
	Profit as per profit and loss account		540
	Add back: Loss on sale of asset (short term capital loss)	20	
	Depreciation	148	
			168
			708
	Less: Depreciation under Income-tax Act		168
			540
	Provision for tax @ 50%		270
	It has been assumed that depreciation calculated under Income-tax Act amounts to ₹ 1,68,000)		
(3)	Provisions		
	(a) Provision for taxation		270
	(b) Proposed dividend (20% on ₹. 10,00,000)		200
			470
(4)	In balance sheet, Reserves and Surplus represent general reserve ₹ 30,000 and profit and loss account ₹ 1,20,000.		

Notes:

(1) The rate of interest on long term loan is not given in the question. Reasonable assumption may be made regarding the rate of interest and accordingly it may be accounted for.

(2) As per Companies (Transfer of Profits to Reserve) Rules, the amount to be transferred to the reserves shall not be less than 7.5% of the current profits since proposed dividend exceeds 15% but does not exceed 20% of the paid up capital. In this answer, it has been assumed that ₹30,000 have been transferred to General Reserve. The students may transfer any amount based on a suitable percentage not less than 7.5%.

(3) In the absence of details regarding factory closure costs, there costs are treated as extraordinary items in the above solution assuming that the factory is permanently closed. However, the factory may close for a short span of time on account of strikes, lockouts etc. and such type of factory closure costs should be treated as loss from ordinary activities. In that case also, a separate disclosure regarding the factory closure costs will be required as per para 12 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.'

Question 2

The following balances are extracted from the books of Supreme Ltd., a real estate company, on 31st March, 2011:

	Dr.	Cr.
		(₹ '000)
Sales		13,800
Purchases of materials	6,090	
Share capital fully paid		500
Land purchased in the year as stock	365	
Leasehold premises	210	
Creditors		2,315
Debtors	3,675	
Directors' salaries	195	
Wages	555	
Work in progress on 01.04.2010	1,050	
Sub-contractors' cost	4,470	
Equipment, Fixtures and Fittings at cost on 01.04.2010	1,320	
Stock on 01.04.2010	295	
Profit and Loss Account, Credit Balance on 01.04.2010		640
Secured Loan		560
Bank Overdraft		525
Interest on Loan and Overdraft	110	
Depreciation on Equipment on 01.04.2010		820
Administration Expenses	735	
Office Salaries	90	
	19,160	19,160

You also obtain the following information:

(a) On 31st March, 2011, stock on hand including the land acquired during the year, is valued at ₹ 7,10,000. Work in progress at that date is valued at ₹ 7,00,000.

(b) On 1st October, 2010 the company moved to new premises. The premises are on a 12 years lease and the lease premium paid amounted to ₹ 2,10,000. The company used sub-contract labour of ₹ 2,00,000 and materials at cost of ₹ 1,90,000 in the refurbishment of the premises. These are to be considered as part of the cost of leasehold premises.

(c) A review of the debtors reveals specific doubtful debts of ₹ 1,75,000 and the directors wish to provide for these together with a general provision based on 2% of the balance.

(d) Depreciation on equipment, fixtures and fittings is provided at 15% on the written down value.

(e) Supreme Ltd. sued Shallow Ltd. for supplying defective materials which has been written off as valueless. The Directors are confident that Shallow Ltd. will agree for a settlement of ₹ 2,50,000.

(f) The directors propose a dividend of 25%.

(g) ₹ 1,00,000 is to be provided as audit fee.

(h) The company will provide 10% of the pre-tax profit as bonus to employees in the accounts before charging the bonus.

(i) Income tax to be provided at 50% of the profits.

You are required:

(i) to prepare the company's financial statements for the year ended 31st March, 2011 as near as possible to proper form of company final accounts; and

(ii) to prepare a set of Notes to accounts including significant accounting policies.

Notes: Workings should form part of your answer.
Previous year figures can be ignored.
Figures are to be rounded off to nearest thousands.

Answer

Supreme Ltd.

Balance Sheet as at 31st March, 2011

(₹. in thousands)

I	**SOURCES OF FUNDS**				
	(1)	Shareholders' funds:			
		(a)	Capital	500	
		(b)	Reserves and surplus	945	
					1,445
	(2)	Loan funds:			
		(a)	Secured loans	560	
		(b)	Unsecured loans	–	
					560
		TOTAL			2,005
II	**APPLICATION OF FUNDS**				
	(1)	Fixed assets:			
		(a)	Gross block	1,920	
		(b)	Less: Depreciation	920	
		(c)	Net block	1,000	
		(d)	Capital work in progress	–	1,000
	(2)	Investments			–
	(3)	Current assets, loans and advances:			
		(a)	Inventories	1,410	

	(b)	Sundry debtors	3,430	
	(c)	Cash and bank balances	–	
	(d)	Other current assets	–	
	(e)	Loans and advances	–	
			4,840	
	Less: Current Liabilities and Provisions:			
	(a)	Liabilities	2,940	
	(b)	Provisions	895	
			3,835	
	Net current assets			1,005
(4)	Miscellaneous expenditure (to the extent not written off or adjusted)			–
	TOTAL			2,005
	Contingent Liabilities		Nil	

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

		(₹ in thousands)
INCOME		
Sales		13,800
EXPENDITURE		
Manufacturing Expenses	11,025	
Other Expenses	1,485	
Interest	110	
Depreciation on Fixed Assets	100	
		12,720
Profit before Taxation		1,080
Provision for Tax		650
Net Profit		430
Balance brought forward from previous year		640
Profit Available for Appropriation		1,070
Appropriations		
Proposed Equity Dividend	125	
Amount transferred to General Reserve	45	170
Balance Carried Forward		900

NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 2011

1. **Accounting Policies:** The Accounts have been prepared primarily on the historical cost convention. The significant accounting policies followed by the Company are stated below:
   (a) Fixed Assets: Fixed assets are shown at cost less depreciation. Cost comprises the purchase price and other attributable expenses.
   (b) Depreciation on Fixed Assets: Depreciation on equipment, fixtures and fittings has been provided on written down value method at 15% per annum. Lease-hold premises/improvements are being amortised over the lease period.
   (c) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.

2. Other Matters:

(a) The cost of leasehold premises includes the cost of refurbishment to the extent of ₹ 3,90,000 (Materials ₹ 1,90,000 + Labour ₹ 2,00,000).

(b) Shallow Ltd. has been sued for supplying defective materials. Settlement of ₹ 2,50,000 is hopeful however it has not been recognized in the accounts as it represents contingent gain.

(₹ in thousands)

(1)	Manufacturing Expenses		
	Stocks at Commencement:		
	Opening Stock	295	
	Opening Work-in-progress	1,050	
			1,345
	Purchases of Materials (6,090 – 190)		5,900
	Purchase of Land		365
	Wages		555
	Sub-contractors' cost (4,470 – 200)		4,270
			12,435
	Less: Stocks at close:		
	Closing Stock	710	
	Closing Work-in-progress	700	
			1,410
			11,025
(2)	Administration Expenses		735
	Office Salaries		90
	Directors' Salaries		195
	Provision for Doubtful Debts [35 + 2% of (735 – 35)]		245
	Audit Fees		100
	Bonus (See Working Note 3)		120
			1,485

(3)	Bonus		
	Sales		13,800
	Less: Manufacturing Expenses	11,025	
	Other Expenses (excluding bonus)	1,365	
	Depreciation	100	
	Interest	110	
			12,600
	Pre-tax Profit		1,200
	Bonus (10%)		120
(4)	Fixed Assets		
	(a) Gross block		
	Equipment, Fixtures and Fittings		1,320
	Leasehold Premises (210 + 200 + 190)		600
			1,920
	(b) Depreciation		
	Equipment, Fixtures and Fittings(1.4.2010) 820		
	For the year [15% on (1,320– 820)]	75	895
	Cost of Leasehold Premises written off		25
	[(210 + 200 + 190) × 1/12 × 1/2]		
			920
(5)	Provision for Taxation		
	Profit as per Profit and Loss Account		1,080
	Add back: Provision for doubtful debts	245	
	Cost of Leasehold premises written off	25	
	Depreciation on equipment, fixtures and fittings	75	345
			1,425
	Less: Depreciation under Income-tax Act		125
			1,300
	Provision for Tax (@ 50%)		650
	(It has been assumed that depreciation calculated under Income-tax Act amounts to ₹ 1,25,000)		
(6)	(a) Sundry creditors		2,315
	(b) Bank overdraft		525
	(c) Audit fees		100
(7)	Provisions		
	(a) Provision for taxation		650
	(b) Proposed dividend		125
	(c) Provision for bonus		120
			895

Question 3

On 1st November, 2009 Squash Ltd. was incorporated with an authorized capital of ₹ 200 crores. It issued to its promoters equity capital of ₹ 10 crores which was paid for in full. On that day it purchased the running business of Jam Ltd. for ₹ 40 crores and allotted at par equity capital of ₹ 40 crores in discharge of the consideration. The net assets taken over from Jam Ltd. were valued as follows: Fixed Assets ₹ 30 crores, Inventory ₹ 2 crores, Customers' dues ₹ 14 crores and Creditors ₹ 6 crores. Squash Ltd. carried on business and the following information is furnished to you:

(a) Summary of cash/bank transactions (for year ended 31st October, 2010).

		(₹ in crores)
Equity capital raised:		
Promoters (as shown above)	10	
Others	50	60
Collections from customers		800
Sale proceeds of fixed assets (cost ₹ 18 crores)		4
		864
Payments to suppliers	400	
Payments to employees	140	
Payment for expenses	100	640
Investments in Upkar Ltd.		20
Payments to suppliers of fixed assets:		
Instalment due	120	
Interest	10	130
Tax payment		54
Dividend		10
Closing cash/bank balance		10
		864

(b) On 31st October, 2010 Squash Ltd.'s assets and liabilities were:

	(₹ in crores)
Inventory at cost	3
Customers' dues	80
Prepaid expenses	2
Advances to suppliers	8
Amounts due to suppliers of goods	52
Amounts due to suppliers of fixed assets	150
Outstanding expenses	6

(c) Depreciation for the year under:

(i) Companies Act, 1956 ₹ 36 crores

(ii) Income tax Act, 1961 ₹ 40 crores

(d) Provide for tax at 38.5% of "total income". There are no disallowed expenses for the purpose of income taxation. Provision for tax is to be rounded off.

For Squash Ltd. prepare:

(i) Revenue statement for the year ended 31st October, 2010 and

(ii) Balance Sheet as on 31st October, 2010 from the above information.

Answer

Squash Ltd. Balance Sheet as at 31st October, 2010

				Schedule		(₹ in crores)	
I	SOURCES OF FUNDS						
	(1)	Shareholders' funds:					
		(a)	Capital	A		100	
		(b)	Reserves and surplus			77.4	
							177.4
	(2)	Loan funds					150
		TOTAL					327.4
II	APPLICATION OF FUNDS						
	(1)	Fixed assets:					
		(a)	Gross block			296.4	
		(b)	Less: Depreciation			36	
		(c)	Net block				260.4
	(2)	Investments in Upkar Ltd.					20
	(3)	Current assets, loans and advances:					
		(a)	Inventories		3		
		(b)	Sundry debtors		80		
		(c)	Cash and bank balances		10		
		(d)	Loans and advances:				
			Advances to suppliers		8		
			Prepaid expenses		2		
			Tax payment		54	157	
		Less: Current liabilities and provisions:					
		(a)	Creditors for				
			Goods		52		
			Expenses		6		
					58		
		(b)	Provision for taxation		52		
						110	
		Net current assets					47
		TOTAL					327.4

Schedule to Balance Sheet

		(₹ in crores)
A.	Share Capital:	
	Authorised:	200
	Issued and paid-up:	
	10 crores equity shares of ₹ 10 each fully paid up (of which 4 crores equity shares have been issued for consideration other than cash, on take-over of business of Jam Ltd.)	100

Profit and Loss Account for the year ended 31st October, 2010

		(₹ in crores)
Sales		866
Expenditure:		
Stock taken over from Jam Ltd.	2	
Purchases	438	
	440	
Closing stock	3	
Inventory consumed/sold	443	
Employee cost	140	
Expenses	104	
		(681)
Profit before interest, depreciation and tax		185
Interest		(10)
Profit after interest but before depreciation		175
Depreciation		(36)
Profit after depreciation		139
Profit on sale of fixed assets		0.4
Profit before tax		139.4
Provision for tax		(52.00)
Net profit		87.4
Dividend		(10)
Balance carried forward		77.4

Working Notes:

(1) Net assets of Jam Ltd. taken over:

	(₹ in crores)
Fixed Assets	30
Inventory	2
Customers' dues	14
	46
Less: Creditors	6
	40

Purchase consideration: 4 crores equity shares of ₹ 10 each.

(2) **Customers' Account**

		₹			₹
To	Business Purchase A/c	14	By	Bank A/c	800
To	Sales A/c (Balancing figure)	866	By	Balance c/d	80
		880			880

Suppliers' (Goods) Account

		₹			₹
To	Bank A/c (400 – 8)	392	By	Business Purchase A/c	6
To	Balance c/d	52	By	Purchases A/c (Balancing figure)	438
		444			444

Suppliers' (Fixed Assets) Account

		₹			₹
To	Bank A/c	130	By	Fixed Assets A/c	270
To	Balance c/d (Loan funds)	150		(Balancing figure)	
			By	Interest A/c	10
		280			280

Fixed Assets Account

		₹			₹
To	Business Purchase A/c	30	By	Bank A/c	4
To	Profit and Loss A/c	0.4	By	Balance c/d	296.4
To	Suppliers' A/c	270			
		300.4			300.4

Expenses Account

		₹			₹
To	Bank A/c	100	By	Profit and Loss A/c	104
To	Balance c/d (Outstanding expenses)	6		(Balancing figure)	
			By	Balance c/d (Prepaid expenses)	2
		106			106

		₹
(3)	Calculation of tax provision:	
	Profit before depreciation	175
	Less: Depreciation under Income Tax Act	40
	Total income under Income Tax Act	135
	Tax due thereon @ 38.5% (rounded off)	52

Question 4

On 30th September, 2008 Zigzag Enterprises Ltd. was incorporated with an Authorised Capital of ₹ 50 lakhs. Its first accounts were closed on 31st March, 2009 by which time it had become a listed company with an issued subscribed and paid up Capital of ₹. 40 lakhs in 4,00,000 Equity Shares of ₹ 10each. The company started off with two lines of business namely 'First Division' and 'Second Division', with equal asset base with effect from 1st April, 2009. The 'Third Division' was added by the company on 1st April, 2010. The following data is gathered from the books of account of Zigzag Enterprises Ltd:

Trial Balance as on 31st March, 2011

(₹ in 000's)

	Dr.	Cr.
First Division sales	–	15,000
Cost of First Division sales	6,500	–
Second Division sales	–	20,000
Cost of sales of Second Division	10,750	–
Third Division Sales	–	3,750
Cost of sales of Third Division	2,250	–
Administration costs	5,000	–
Distribution costs	3,750	–
Dividend-Interim	3,000	–
Fixed Assets at cost	22,500	–
Accumulated Depreciation on Fixed Assets	–	3,750
Stock on 31st March, 2011	1,000	–
Trade Debtors	1,100	–
Cash at Bank	400	–
Trade Creditors	–	1,250
Equity Share Capital in shares of ₹ 10 each	–	10,000
Retained Profits	–	2,500
	56,250	56,250

Additional Information:

(a) Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.

(b) Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.

(c) Directors have proposed a Final Dividend of ₹ 20 lakhs.

(d) Some of the users of Third Division are unhappy with the product and have lodged claims against the company for damages of ₹ 18.75 lakhs. The claim is hotly contested by the company on legal advice.

(e) Fixed Assets worth ₹ 75 lakhs were added in the Third Division on 1.4.2010.

(f) Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.

(g) Income tax rate may be assumed at 35%.

(h) During the year First Division has sold to Hitachi Ltd. goods having a sales value of ₹ 62.5 lakhs. Mr. Rydu, the Managing Director of Zigzag Enterprises Ltd. owns 100% of the issued Equity Shares of Hitachi Ltd. The sales made to Hitachi Ltd. were at normal selling price of Zigzag Enterprises Ltd.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2011 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards.

Answer

Zigzag Enterprises Ltd.

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

		₹ '000
Sales		38,750
Cost of Sales		(19,500)
		19,250
Distribution costs		(3,750)
Administration costs		(5,000)
Profit before tax		10,500
Provision for tax	3,097.50	
Deferred tax (35% of ₹ 1,650)	577.50	(3,675)
Profit after tax		6,825
Dividends (₹ 3,000 + ₹ 2,000)		(5,000)
Profit for the year		1,825
Retained profit brought forward (₹ 2,500 – ₹ 525)		1,975
Retained Profit carried forward		3,800

Zigzag Enterprises Ltd.
Balance Sheet as at 31st March, 2011

Liabilities	Amount	Assets		Amount
	₹ '000		₹ '000	₹ '000
Share Capital		Fixed Assets		
Issued and subscribed		Gross block	22,500	
10,00,000 shares of ₹ 10 each, fully paid up	10,000	Less: Depreciation	3,750	18,750
Reserves and Surplus		Current Assets, Loans and Advances		
Retained profits	3,800	(a) Current assets		
Deferred Tax Liability	1,102.50	Stock	1,000	
		Debtors	1,100	

Current liabilities and Provisions				
(a) Current liabilities		Cash at bank	400	2,500
Creditors	1,250	(b) Loans and Advances		NIL
(b) Provisions				
Provision for tax	3,097.50			
Proposed dividend	2,000			
	21,250			21,250

Notes to Accounts:

1. Segmental Disclosures (Business Segments)

(Figures in ₹ 000's)

	First Division	Second Division	Third Division	Total
Sales	15,000	20,000	3,750	38,750
Cost of Sales	6,500	10,750	2,250	19,500
Administration Cost (5:3:2)	2,500	1,500	1,000	5,000
Distribution Cost (3:1:1)	2,250	750	750	3,750
Profit/Loss	3,750	7,000	(250)	10,500
	15,000	20,000	3,750	38,750
Original cost of Assets (Equal Capital Base)	7,500	7,500	7,500	22,500
Depreciation @ 10% p.a.				
For the year ended 31.3.2010	750	750	NIL	1,500
For the year ended 31.3.2011	750	750	750	2,250

Note: Third division is a reportable segment as per assets criteria.

2. Tax computation

	(₹ in 000's)
Profit before tax for the year ended 31.3.2010	10,500
Add: Depreciation provided in the books (750 + 750 + 750)	2,250
	12,750
Less: Depreciation as per Income Tax Act (1,200 + 1,200 + 1,500)	3,900
Taxable Income	8,850
Tax at 35%	3,097.50

3. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

	₹ '000
Opening Timing Difference on 1.4.2010	
WDV of fixed assets as per books	13,500
WDV of fixed assets as per Income Tax Act	12,000
Difference	1,500
Deferred Tax Liability @ 35% on 1,500	525

This has been adjusted against opening balance of retained profits.

Current year (ended 31st March, 2011)	₹ '000
Depreciation as per Books	2,250
Depreciation as per Income Tax Act (1,200 + 1,200 + 1,500)	3,900
Difference	1,650
Deferred Tax Liability @ 35% on 1,650 (to be carried forward)	577.50

4. **Contingent Liabilities not provided:** Company is contesting claim for damages for ₹ 18,75,000 and as such the same is not acknowledged as debts.

5. **Related Party Disclosure:** Para 3 of AS 18 lists out related party relationships. It includes individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises, and relatives of any such individual. In the instant case, Mr. Rydu as a managing director controls operating and financial actions of Zigzag Enterprise Ltd. He is also owning 100% share Capital of Hitachi Ltd. thereby exercising control over it. Hence, Hitachi Ltd. is a related party as per Para 3 of AS 18.

Disclosure to be made:

Name of the related party and nature of relationship	Hitachi Ltd. common director
Nature of the transaction	Sale of goods at normal commercial terms
Volume of the transaction	Sales to Hitachi Ltd. worth ₹. 62.50 lakhs.

Question 5

The following is the Balance Sheet of River Ltd. having an authorised capital of ₹ 1,000 Crores as on 31st March, 2006:

	(₹ in crores)	₹	₹
Sources of funds:			
Shareholders' funds:			
Share capital			
Equity shares of ₹ 10 each fully paid in cash	750		
Reserves and surplus (Revenue)	2,250	3,000	
Loan funds:			
Secured against: (a) Fixed Assets ₹ 900 Cr.			
(b) Working capital ₹ 300 Cr.	1,200		
Unsecured:	1,800	3,000	
		6,000	
Employment of funds:			
Fixed assets:			
Gross block	2,400		
Less: Depreciation	600	1,800	
Investments at cost (Market value ₹ 3,000 Cr.)		1,200	
Net current assets:			
Current assets	9,000		
Less: Current liabilities	6,000	3,000	
		6,000	

Capital commitments: ₹ 2,100 crores.

The company consists of 2 divisions:

(i) Established division whose gross block was ₹ 600 crores and net block was ₹ 90 crores; current assets were ₹ 4,500 crores and working capital was ₹ 3,600 crores; the entire amount being financed by shareholders' funds.

(ii) New project division to which the remaining fixed assets, current assets and current liabilities related.

The following scheme of reconstruction was agreed upon:

(a) Two new companies Sun Ltd. and Moon Ltd. are to be formed. The authorised capital of Sun Ltd. is to be ₹ 3,000 crores. The authorised capital of Moon Ltd. is to be ₹ 1,500 crores.

(b) Moon Ltd. is to take over investments at ₹ 2,400 crores and unsecured loans at balance sheet value. It is to allot equity shares of ₹ 10 each at par to the members of River Ltd. in satisfaction of the amount due under the arrangement.

(c) Sun Ltd. is to take over the fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which River Ltd. is to continue to stand guarantee at book values. It is to allot three crores equity shares of ₹ 10 each as consideration to River Ltd. Sun Ltd. made an issue of unsecured convertible debentures of ₹ 1,500 crores carrying interest at 15% per annum and having a right to convert into equity shares of ₹ 10 each at par on 31.3.2011. This issue was made to the members of Sun Ltd. as a right who grabbed the opportunity and subscribed in full.

(d) River Ltd. is to guarantee all liabilities transferred to the 2 companies.

(e) River Ltd. is to make a bonus issue of equity shares in the ratio of one equity share for every equity share held by making use of the revenue reserves.

Assume that the above scheme was duly approved by the Honourable High Court and that there are no other transactions. Ignore taxation.

You are asked to:

(i) Pass journal entries in the books of River Ltd., and

(ii) Prepare the balance sheets of the three companies giving all the information required by the Companies Act, 1956 in the manner so required to the extent of available information.

Answer

Journal of River Ltd. (₹ in crores)

		Dr.	Cr.
1. Moon Ltd. A/c	Dr.	2,400	
To Investments A/c			1,200
To Members A/c			1,200
(Being transfer of investments at agreed value of ₹ 2,400 crores under the scheme of reconstruction approved by the high court)			
2. Unsecured loans A/c	Dr.	1,800	
To Moon Ltd. A/c			1,800
(Being unsecured loans taken over by Moon Ltd. under the scheme of reconstruction approved by the honourable high court)			
3. Members A/c	Dr.	600	
To Moon Ltd.			600
(Being allotment by Moon Ltd. of 60 crore equity shares of ₹ 10 each to the members of the company in the ratio of 4 equity shares of Moon Ltd. for every 5 equity shares held in the company.			

4. Members A/c	Dr.	600	
To Capital Reserve A/c			600

(Being balance in Members A/c transferred to capital reserve)

5. Sun Ltd. A/c	Dr.	30	
Provision for Depreciation A/c	Dr.	90	
Secured loans against Fixed Assets A/c	Dr.	900	
Secured loans against working capital A/c	Dr.	300	
Current liabilities A/c	Dr.	5,100	
To Fixed Assets A/c			1,800
To Current Assets A/c			4,500
To Capital Reserve A/c			120

(Being assets and liabilities of new project division transferred to Sun Ltd. along with capital commitments of ₹ 2,100 crores, the difference between consideration and the book values at which transferred assets and liabilities appeared being credited to capital reserve)

6. Equity shares of Sun Ltd.	Dr.	30	
To Sun Ltd. A/c			30

(Being the receipt of three crores equity shares of ₹ 10 each from Sun Ltd. in full discharge of consideration on transfer of assets and liabilities of the new project division)

7. Investment in debentures A/c	Dr.	1,500	
To Bank A/c			1,500

(Being issue of unsecured convertible debentures by Sun Ltd., subscribed in full)

8. Revenue reserves A/c	Dr.	750	
To Equity share capital A/c			750

(Being allotment of 75 crores equity shares of ₹ 10 each as fully paid bonus shares to the members of the company by using revenue reserves in the ratio of one equity share for every equity share held)

River Ltd.

Balance Sheet after the scheme of arrangement

	Schedule No.		(₹ in crores)
I SOURCES OF FUNDS			
(1) Shareholders' funds:			
(a) Capital	A	1,500	
(b) Reserves and surplus	B	2,220	
			3,720
(2) Loan funds:			
(a) Secured against:			
Fixed assets		–	
Working capital		–	
(b) Unsecured		–	–
TOTAL			3,720
II APPLICATION OF FUNDS			
(1) Fixed assets:	C		
(a) Gross block		600	
(b) Less: Depreciation		510	
(c) Net block			90
(2) Investments	D		30
(3) Current assets		4,500	
Less: Current liabilities		510	
Net current assets			3,600
TOTAL			3,720
1. Capital commitments			Nil
2. Contingent Liability			
Guarantee given in respect of:			
Capital commitments by Sun Ltd.			2,100
Liabilities transferred to Sun Ltd.			6,300
Liabilities transferred to Moon Ltd.			1,800

Schedules to Accounts

			(₹ in crores)
A.	**Share Capital:**		
	Authorised:		
	300 crores Equity Shares of ₹ 10 each		3,000
	Issued, Subscribed and Paid-up:		
	150 crores Equity Shares of ₹ 10 each fully paid-up		1,500
	Of the above shares, 75 crores fully paid		
	Equity Shares of ₹ 10 each have been issued as bonus shares by capitalization of revenue reserves.		
B.	**Reserves and Surplus:**		
	Capital Reserve on transfer of:		
	Investments to Moon Ltd.		600
	Business of New project division to Sun Ltd.		120
			720
	Revenue Reserves:		
	As per last balance sheet	2,250	
	Less: Used for issue of fully paid bonus shares	750	1,500
			2,220
C.	Fixed assets:		
	Gross block:		
	As per last balance sheet	2,400	
	Less: Transfer to Sun Ltd.	1,800	600
	Provision for depreciation:		
	As per last balance sheet	600	
	Less: In respect of assets transferred to Sun Ltd.	90	510
			90
D.	Investments (at cost):		
	In wholly owned subsidiary Sun Ltd.		
	(a) 3 crore equity shares of ₹ 10 each		30
	(b) 15% unsecured convertible debentures		1,500
			1,530

Balance Sheet of Sun Ltd. after the scheme of arrangement

	Schedule No.			(₹ in crores)
I. SOURCES OF FUNDS				
(1) Shareholders' funds:				
(a) Capital	A		30	
(b) Reserves and surplus			–	30
(2) Loan funds:				
(a) Secured loans	B		1,200	
(b) Unsecured loans	C		1,500	
				2,700
TOTAL				2,730
II. APPLICATION OF FUNDS				
(1) Fixed assets:				
(a) Goodwill			120	
(b) Other fixed assets			1,710	
				1,830
(2) Investments				–
(3) Current Assets :				
(a) Bank balance		1,500		
(b) Others		4,500		
			6,000	
Less: Current liabilities			5,100	
				900
TOTAL				2,730
1. Capital commitments				
2. Guarantee given by River Ltd.				
in respect of:				
Capital commitments			2,100	
Liabilities			6,300	
				8,400

Schedules to Accounts (₹ in crores)

A	Share Capital	
	Authorised	
	300 crores Equity Shares of ₹ 10 each	3,000
	Issued, Subscribed and Paid-up	

	3 crore Equity Shares of ₹ 10	
	each fully paid-up	30
	(All the above shares have been issued for consideration other than cash, on takeover of new project division from River Ltd. All the above shares are held by the holding company River Ltd.)	
B	Secured Loans	
	(a) Against fixed assets	900
	(b) Against working capital	300
		1,200
C	Unsecured Loans	
	15% Unsecured convertible Debentures	1,500
	(Convertible into equity shares of ₹ 10 each at par on 31.3.2011)	

Balance Sheet of Moon Ltd. after the scheme of arrangement

	Schedule No.		(₹ in crores)
SOURCES OF FUNDS			
(1) Shareholders' funds:			
(a) Capital	A	600	
(b) Reserves and surplus		–	
			600
(2) Loan funds:			
(a) Secured loans		–	
(b) Unsecured loans		1,800	
			1,800
TOTAL			2,400
APPLICATION OF FUNDS			
Investments			2,400
TOTAL			2,400
Guarantee given by River Ltd. in respect of unsecured loans			1,800

Schedule to Accounts

		(₹ in crores)
A	Share Capital	
	Authorised	
	150 crores Equity Shares of ₹ 10 each	1,500
	Issued, Subscribed and Paid-up	
	60 crores Equity Shares of ₹ 10 each fully paid-up	600

(All the above shares have been issued to members of River Ltd. for consideration other than cash, on acquisition of investments and taking over of liability for unsecured loans from River Ltd.)

Working Notes:

(₹ in crores)

1.	Established Division	New Project Division	Total
Fixed assets:			
Gross block	600	1,800	2,400
Less: Depreciation	510	90	600
	90	1,710	1,800
Current assets	4,500	4,500	9,000
Less: Current liabilities	900	5,100	6,000
Employment of funds	3,000	(600)	3,000

2. Guarantee by River Ltd. against:		
(a) (i) Capital commitments		2,100
(ii) Liabilities transferred to Sun Ltd.		
Secured loans against fixed assets	900	
Secured loans against working capital	300	
Current liabilities	5,100	
		6,300
(b) Liabilities transferred to Moon Ltd.		1,800

Question 6

Globetrotters Ltd. has two divisions – 'Inland' and 'International'. The Balance Sheet as at 31st December, 2010 was as under:

		International	Total
	(₹ crores)	(₹ crores)	(₹ crores)
Fixed Assets:			
Cost	300	300	600
Depreciation	250	100	350
W.D.V. (written down value)	50	200	250
Net Current Assets:			
Current assets	200	150	350
Less: Current liabilities	100	100	200
	100	50	150
	150	250	400
Financed by:			
Loan funds:			
	–	50	50
(Secured by a charge on fixed assets)			
Own Funds:			
Equity capital (fully paid up ₹ 10 shares)			25
Reserves and surplus			325
	?	?	350
	150	250	400

It is decided to form a new company 'Beautiful World Ltd.' for international tourism to take over the assets and liabilities of international division.

Accordingly 'Beautiful World Ltd.' was formed to takeover at Balance Sheet figures the assets and liabilities of international division. 'Beautiful World Ltd.' is to allot 2.5 crore equity shares of ₹ 10 each in the company to the members of 'Globetrotters Ltd.' in full settlement of the consideration. The members of 'Globetrotters Ltd.' are therefore to become members of 'Beautiful World' as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of 'Globetrotters Ltd.' and also in 'Beautiful World Ltd'. Also show the Balance Sheets of both the companies as on 1st January, 2011 showing corresponding figures, before the reconstruction also.

(b) The directors of both the companies ask you to find out the net asset value of equity shares pre and post-demerger.

(c) Comment on the impact of demerger on "shareholders wealth".

Answer

(a) **Journal of Globetrotters Ltd.** (₹ in crores)

Particulars		Dr.	Cr.
		₹	₹
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	50	

Provision for depreciation A/c	Dr.	100	
Loss on reconstruction A/c (Balancing figure)	Dr.	200	
To Fixed assets A/c			300
To Current assets A/c			150
(Being the assets and liabilities of International division taken out of the books on transfer of the division to Beautiful World Ltd.; the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)			

Journal of Beautiful World Ltd. (₹ in crores)

		Dr. ₹	Cr. ₹
Fixed assets A/c (300 – 100)	Dr.	200	
Current assets A/c	Dr.	150	
To Current liabilities A/c			100
To Loan funds (secured) A/c			50
To Equity share capital A/c			25
To Capital reserve A/c			175
(Being the assets and liabilities of International division of Globetrotters Ltd. taken over by Beautiful World Ltd. and allotment of 2.5 crores equity shares of ₹ 10 each at par as fully paid up to the members of Globetrotters Ltd.)			

Globetrotters Ltd.
Balance Sheet as on 1st January, 2011

(₹ in crores)

			After reconstruction		Before reconstruction	
I.	SOURCES OF FUNDS					
	(1) Shareholders' Funds					
		(a) Capital	25		25	
		(b) Reserves and Surplus (Schedule A)	125		325	
				150		350
	(2) Loans Funds					
		Secured Loans		–		50
		Total		150		400

II. APPLICATION OF FUNDS					
(1) Fixed Assets					
(a) Gross Block	300		600	
(b) Less: Depreciation	250		350	
(c) Net block		50		250
(2) Investments		–		–
(3) Current Assets	200		350	
Less: Current liabilities	100		200	
Net current assets		100		150
Total		150		400

Schedule to Balance Sheet

(₹ in crores)

	After reconstruction	Before reconstruction
A. Reserves and surplus	325	325
Less: Loss on reconstruction	200	–
	125	325

Note to Accounts: Consequent to reconstruction of the company and transfer of international division of Globetrotters Ltd. to newly incorporated Company Beautiful World Ltd., the members of the company have been allotted 2.5 crore equity shares of ₹ 10 each at par of 'Beautiful World Ltd.'

Beautiful World Ltd.
Balance Sheet as on January 1, 2011

(₹ in crores)

I. SOURCES OF FUNDS		
(1) Shareholder's Funds		
(a) Capital (Schedule A)	25	
(b) Reserves and Surplus	175	200
(2) Loans Funds		
Secured Loans		50
Total		250
II. APPLICATION OF FUNDS		
(1) Fixed Assets		200
(2) Investments		–
(3) Current Assets	150	
Less: Current Liabilities	100	
Net Current Assets		50
Total		250

Schedule to Balance Sheet

		(₹ in crores)
A.	Share Capital:	
	Issued and paid up capital:	
	2.5 crore equity shares of ₹. 10 each fully paid up	25
	(All the above equity shares have been issued for consideration other than cash to the members of Travels and Tours Ltd. on takeover of International division.)	

(b) Net Asset Value of an equity share

	Pre-Demerger	Post-Demerger
Globetrotters Ltd.	$\frac{₹\ 350\ \text{crores}}{2.5\ \text{crore shares}}$	$\frac{₹\ 150\ \text{crores}}{2.5\ \text{crore shares}}$
	= ₹ 140	= ₹ 60
Beautiful World Ltd.		$\frac{₹\ 200\ \text{crores}}{2.5\ \text{crore shares}}$
		= ₹ 80

(c) Demerger into two companies has no impact on 'net asset value' of shareholding. Pre-demerger, it was ₹ 140 per share. After demerger, it is ₹ 60 + ₹ 80 = ₹ 140 per original share.

It is only the yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of de-merger.

Question 7

A Ltd. and B Ltd. were amalgamated on and from 1st April, 2011. A new company C Ltd. was formed to take over the business of the existing companies. The Balance Sheets of A Ltd. and B Ltd. as on 31st March, 2011 are given below:

(₹ in lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital			Fixed Assets		
Equity Shares of ₹ 100 each	1,200	1,125	Land and Building	825	600
12% Preference shares of ₹ 100 each	450	300	Plant and Machinery	525	375
Reserves and Surplus			Investments	235	75
Revaluation Reserve	225	150	Current Assets, Loans and Advances		
General Reserve	255	225			
Investment Allowance Reserve	75	75	Stock	525	375
Profit and Loss Account	75	45	Sundry Debtors	375	450
Secured Loans			Bills Receivable	75	75

10% Debentures (₹ 100 each)	90	45	Cash and Bank	450	300
Current Liabilities and provisions					
Sundry Creditors	405	180			
Bills Payable	225	105			
	3,000	2,250		3,000	2,250

Additional Information:

(1) 10% debenture-holders of A Ltd. and B Ltd. are discharged by C Ltd. issuing such number of its 15% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd. at a price of ₹ 150 per share (face value of ₹ 100).

(3) C Ltd. will issue 5 equity shares for each equity share of A Ltd. and 4 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹ 30 each, having a face value of ₹ 10 per share.

(4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd. as on 1st April, 2011 after the amalgamation has been carried out on the basis of Amalgamation in the nature of purchase.

Answer **Balance Sheet of C Ltd. as at 1st April, 2011**

(₹ In lakhs)

Liabilities	Amount	Assets	Amount
SHARE CAPITAL		FIXED ASSETS	
1,05,00,000 Equity shares of ₹10 each	1,050	Goodwill	30
7,50,000 Preference shares of ₹ 100 each (all the above shares are allotted as fully paid-up pursuant to contracts without payment being received in cash)	750	Land and Building	1,425
		Plant and Machinery	900
		INVESTMENTS	300
		CURRENT ASSETS, LOANS AND ADVANCES	
RESERVES AND SURPLUS		A. Current Assets	
Securities Premium Account	2,475	Stock	900
Investment Allowance Reserve	150	Sundry debtors	825
SECURED LOANS		Cash and Bank	750
15% Debentures	90	B. Loans and Advances	
UNSECURED LOANS	–	Bills Receivable	150
CURRENT LIABILITIES AND PROVISIONS		MISCELLANEOUS EXPENDITURE (to the extent not written off or adjusted)	
A Current Liabilities		Amalgamation Adjustment Account	150
Acceptances	330		
Sundry Creditors	585		
B Provisions	–		
	5,430		5,430

Working Notes:

			(₹ in lakhs)		
			A Ltd.		B Ltd.
(1)	Computation of Purchase consideration				
	(a) Preference shareholders:				
	$\left(\frac{4,50,00,000}{100} \text{ i.e. } 4,50,000 \text{ shares}\right) \times$ ₹ 150 each		675		
	$\left(\frac{3,00,00,000}{100} \text{ i.e. } 3,00,000 \text{ shares}\right) \times$ ₹ 150 each				450
	(b) Equity shareholders:				
	$\left(\frac{12,00,00,000 \times 5}{100} \text{ i.e. } 60,00,000 \text{ shares}\right) \times$ ₹ 30 each		1,800		
	$\left(\frac{11,25,00,000 \times 4}{100} \text{ i.e. } 45,00,000 \text{ shares}\right) \times$ ₹ 30 each				1,350
	Amount of Purchase Consideration		2,475		1,750
(2)	Net Assets Taken Over				
	Assets taken over:				
	Land and Building		825		600
	Plant and Machinery		525		375
	Investments		225		75
	Stock		525		375
	Sundry Debtors		375		450
	Bills receivable		75		75
	Cash and bank		450		300
			3,000		2,250
	Less: Liabilities taken over:				
	Debentures	60		30	
	Sundry Creditors	405		180	
	Bills payable	225		105	
			690		315
	Net assets taken over		2,310		1,935
	Purchase consideration		2,475		1,800
	Goodwill		**165**		
	Capital reserve				**135**

Note: Since Investment Allowance Reserve is to be maintained for 4 more years, it is carried forward by a corresponding debit to Amalgamation Adjustment Account in accordance with AS-14.

Question 8

The Balance Sheets of Big Ltd. and Small Ltd. as on 31.03.2010 were as follows:

	Big Ltd. (₹)	Small Ltd. (₹)		Big Ltd. (₹)	Small Ltd. (₹)
Equity Share Capital (₹ 10)	8,00,000	3,00,000	Building	2,00,000	1,00,000
10% Preference Share Capital (₹ 100)	–	2,00,000	Machinery	5,00,000	3,00,000
			Furniture	1,00,000	60,000
General reserve	3,00,000	1,00,000	Investment:		
Profit and Loss Account	2,00,000	1,00,000	6,000 shares of Small Ltd.	60,000	–
Creditors	2,00,000	3,00,000	Stock	1,50,000	1,90,000
			Debtors	3,50,000	2,50,000
			Cash and Bank	90,000	70,000
			Preliminary Expenses	50,000	30,000
	15,00,000	**10,00,000**		**15,00,000**	**10,00,000**

Big Ltd. has taken over the entire undertaking of Small Ltd. on 30.09.2010, on which date the position of current assets except Cash and Bank balances and Current Liabilities were as under:

	Big Ltd. (₹)	Small Ltd. (₹)
Stock	1,20,000	1,50,000
Debtors	3,80,000	2,50,000
Creditors	1,80,000	2,10,000

Profits earned for the half year ended on 30.09.2010 after charging depreciation at 5% on building, 15% on machinery and 10% on furniture, are:

Big Ltd.	₹ 1,02,500
Small Ltd.	₹ 54,000

On 30.08.2010 both Companies have declared 15% dividend for 2009-2010.

Goodwill of Small Ltd. has been valued at ₹ 50,000 and other fixed assets at 10% above their book values on 31.03.2010. Preference shareholders of Small Ltd. are to be allotted 10% Preference Shares of Big Ltd. and equity shareholders of Small Ltd. are to receive requisite number of equity shares of Big Ltd. valued at ₹ 15 per share in satisfaction of their claims.

Show the Balance Sheet of Big Ltd. as of 30.09.2010 assuming absorption is through by that date.

Answer

Balance Sheet of Big Ltd. as at 30th September, 2010

Liabilities	Amount (₹)	Assets		Amount (₹)
SHARE CAPITAL		FIXED ASSETS		
1,09,600 Equity shares of		Building	2,00,000	
₹ 10 each	10,96,000	Less: Depreciation	5,000	
10% Preference shares	2,00,000		1,95,000	
(Of the above shares, 29,600		Add: Taken over	1,07,500	3,02,500
equity shares and all		Machinery	5,00,000	
preference shares are allotted		Less: Depreciation	37,500	
as fully paid-up for			4,62,500	
consideration other than cash)				
RESERVES AND SURPLUS		Add: Taken over	3,07,500	
Capital Reserve	1,000			7,70,000
Securities Premium Account	1,48,000	Furniture	1,00,000	
General Reserve	3,00,000	Less: Depreciation	5,000	
Profit and Loss Account	1,91,500		95,000	
SECURED LOANS	–	Add: Taken over	63,000	
UNSECURED LOANS	–			1,58,000
CURRENT LIABILITIES AND PROVISIONS		INVESTMENTS		
		CURRENT ASSETS,		
Sundry Creditors	3,90,000	LOANS AND ADVANCES		
		Current Assets		
		Stock		2,70,000
		Sundry Debtors		6,30,000
		Cash and Bank		1,46,000
		MISCELLANEOUS EXPENDITURE		
		(to the extent not written off or adjusted)		
		Preliminary Expenses		50,000
	23,26,500			**23,26,500**

Working Notes:

1. Ascertainment of Cash and Bank Balances as on 30th September, 2010

Balance Sheets as at 30th September, 2010

Liabilities	Big Ltd. (₹)	Small Ltd. (₹)	Assets	Big Ltd. (₹)	Small Ltd. (₹)
Equity Share	8,00,000	3,00,000	Building**	1,95,000	97,500

Capital					
10% Preference Share Capital	–	2,00,000	Machinery**	4,62,500	2,77,500
General reserve	3,00,000	1,00,000	Furniture**	95,000	57,000
Profit and Loss Account*	1,91,500	89,000	Investment	60,000	–
Creditors	1,80,000	2,10,000	Stock	1,20,000	1,50,000
			Debtors	3,80,000	2,50,000
			Cash and Bank (Balancing figure)	1,09,000	37,000
			Preliminary Expenses	50,000	30,000
	14,71,500	**8,99,000**		**14,71,500**	**8,99,000**

*Balance of Profit and Loss Account on 30th September, 2010.

	Big Ltd. (₹)	Small Ltd. (₹)
Net profit (for the first half)	1,02,500	54,000
Balance brought forward	2,00,000	1,00,000
	3,02,500	1,54,000
Less: Dividend on Equity Share Capital Paid	1,20,000	45,000
	1,82,500	1,09,000
Less: Dividend on Preference Share Capital Paid	–	20,000
	1,82,500	89,000
Add: Dividend received $\left[\frac{1}{5}\times 45{,}000\right]$	9,000	–
	1,91,500	89,000

**Fixed Assets on 30th September, 2010 (Before absorption)

	Big Ltd. (₹)	Small Ltd. (₹)
(1) Building		
As on 1.4.2010	2,00,000	1,00,000
Less: Depreciation (5% p.a.)	5,000	2,500
	1,95,000	97,500
(2) Machinery		
As on 1.4.2010	5,00,000	3,00,000
Less: Depreciation (15% p.a.)	37,500	22,500
	4,62,500	2,77,500
(3) Furniture		
As on 1.4.2010	1,00,000	60,000
Less: Depreciation (10% p.a.)	5,000	3,000
	95,000	57,000

2. Calculation of Shares Allotted

Assets taken over:		₹
Goodwill		50,000
Building	1,00,000	
Add: 10%	10,000	
	1,10,000	
Less: Depreciation	2,500	
		1,07,500
Machinery	3,00,000	
Add: 10%	30,000	
	3,30,000	
Less: Depreciation	22,500	
		3,07,500
Furniture	60,000	
Add: 10%	6,000	
	66,000	
Less: Depreciation	3,000	
		63,000
Stock		1,50,000
Debtors		2,50,000
Cash and Bank		37,000
		9,65,000
Less: Liabilities taken over:		
Creditors		2,10,000
Net assets taken over		7,55,000
Less: Allotment of 10% Preference Shares to preference shareholders of Small Ltd.		2,00,000
		5,55,000
Less: Belonging to Big Ltd.*** $\left[\frac{1}{5}\times 5{,}55{,}000\right]$		1,11,000
Payable to other Equity Shareholders		4,44,000
Number of equity shares of ₹ 10 each to be Issued (valued at ₹ 15 each)	$\frac{4{,}44{,}000}{15}$ = 29,600	

[*** 6,000 shares out of 30,000 shares of Small Ltd. are already with Big Ltd.]

3. Ascertainment of Goodwill / Capital Reserve

			₹
(A)	Net Assets taken over		7,55,000
(B)	Preference shares allotted	2,00,000	
	Payable to other equity shareholders	4,44,000	
	Cost of investments	60,000	
			7,04,000
(C)	Capital Reserve [(A) – (B)]		51,000
(D)	Goodwill taken over		50,000
(E)	Balance in Capital Reserve [(C) – (D)]		1,000

Question 9

Given below is the Balance Sheet of H Ltd. as on 31.3.2010:

(in ₹ lakhs)

Equity share capital	7.00	Block assets less depreciation to date	10.50
(in equity shares of ₹ 10 each)		Stock and debtors	9.275
10% preference share capital	5.25	Cash and bank	1.05
General reserve	1.75		
Profit and loss account	1.75		
Creditors	5.25		
	21.00		21.00

M Ltd. another existing company holds 25% of equity share capital of H Ltd. purchased at ₹ 10 per share. It was agreed that M Ltd. should take over the entire undertaking of H Ltd. on 30.09.2010 on which date the position of current assets (except cash and bank balances) and creditors was as follows:

Stock and debtors	7 lakhs
Creditors	3.5 lakhs

Profits earned for half year ended 30.09.2010 by H Ltd. was ₹ 1,23,375 after charging depreciation of ₹ 56,875 on block assets. H Ltd. declared 10% dividend for 2009-10 on 30.08.2010 and the same was paid within a week.

Goodwill of H Ltd. was valued at ₹ 1,40,000 and block assets were valued at 10% over their book value as on 31.3.2010 for purposes of take over. Preference shareholders of H Ltd. will be allotted 10% preference shares of ₹ 10 each by M Ltd. Equity shareholders of H Ltd. will receive requisite number of equity shares of ₹ 10 each from M Ltd. valued at ₹ 10 per share.

(a) Compute the purchase consideration.

(b) Explain, how the capital reserve or goodwill, if any, will appear in the Balance Sheet of M Ltd. after absorption.

Answer

(a) Calculation of Purchase Consideration (for net assets of H Ltd. taken over)

	₹
Assets taken over:	
Goodwill as agreed	1,40,000
Block of Assets at 10% over their book value as on 31.3.2010	11,55,000
(agreed value for purposes of take-over)	
Stock and Debtors	7,00,000
Cash and Bank (See Working Note)	2,32,750
	22,27,750

Less: Liabilities taken over:	
Creditors	3,50,000
	18,77,750

	₹
Calculation of Shares Allotted:	
Net Assets taken over	18,77,750
Less: Allotment of 10% preference shares to preference shareholders of H Ltd.	5,25,000
	13,52,750
Less: Belonging to M Ltd. (1/4 × 13,52,750)	3,38,188
Payable to other equity shareholders	10,14,562

Number of equity shares of ₹ 10 each to be issued (valued at ₹ 10 each) = 1,01,456

		₹
Calculation of Capital Reserve:		
Net Assets taken over		18,77,750
Less: Preference shares to be allotted	5,25,000	
Equity shares to be allotted	10,14,560	
Cost of investments	1,75,000	
Cash	2	17,14,562
Capital Reserve		**1,63,188**
Alternatively, Capital Reserve may be computed as follows:		
Value of investments in H Ltd.		3,38,188
Less: Cost of investments		1,75,000
		1,63,188

(b) **Balance Sheet of M Ltd. as at 30th September, 2010**

(extracts)

		₹
Capital Reserve	1,63,188	
Less: Goodwill	1,40,000	23,188

Working Note:

Ascertainment of Cash and Bank Balances as on 30th September, 2010:

Balance Sheet as at 30th September, 2010

			₹			₹
Equity Share Capital			7,00,000	Block Assets	10,50,000	
10% Preference Share Capital			5,25,000	Less: Depreciation	56,875	9,93,125
General Reserve			1,75,000	Stock and Debtors		7,00,000
Profit and Loss Account:				Cash and Bank		2,32,750
Balance brought forward		1,75,000		(Balancing figure)		
Add: Profit for the first half		1,23,375				
		2,98,375				
Less: Dividend on preference						
share capital paid	52,500					
Dividend on equity share capital paid	70,000	1,22,500	1,75,875			
Creditors			3,50,000			
			19,25,875			19,25,875

Question 10

D Ltd. and Y Ltd. decide to amalgamate and to form a new company DY Ltd. The following are their balance sheets as at 31.3.2010:

Liabilities	D Ltd.	Y Ltd.	Assets	D Ltd.	Y Ltd.
Share Capital			Fixed Assets	3,75,000	1,00,000
(₹ 100) each	5,00,000	3,00,000	Investments:		
General Reserve	50,000	25,000	750 Shares in Y Ltd	1,75,000	–
Investment Allowance			2,000 Shares in D		2,50,000
Reserve 20,000		15,000	Ltd	–	
12% Debentures			Current Assets	4,00,000	1,00,000
(₹ 100 each)	1,50,000	50,000			
Sundry Creditors	30,000	10,000			
	75,00,000	4,00,000		7,50,000	4,00,000

Calculate the amount of purchase consideration for D Ltd. and Y Ltd. and draw up the balance sheet of DY Ltd. after considering the following:

(a) Fixed assets of D Ltd. are to be reduced by ₹ 25,000 and that of Y Ltd. are to be taken at ₹ 1,50,000.

(b) 12% debentureholders of D Ltd. and Y Ltd. are discharged by DY Ltd. by issuing such number of its 15% debentures of ₹ 100 each so as to maintain the same amount of interest.

(c) Shares of DY Ltd. are of ₹ 100 each.

Answer

Calculation of Purchase consideration

(i) Value of Net Assets of D Ltd. and Y Ltd. as on 31st March, 2011

		D Ltd.		Y Ltd.
		₹		₹
Assets taken over:				
Fixed Assets	3,50,000		1,50,000	
Current Assets	2,00,000	5,50,000	50,000	2,00,000
Less: Liabilities taken over:				
Debentures	1,20,000*		40,000**	
Sundry Creditors	30,000	1,50,000	10,000	50,000
		4,00,000		1,50,000

* $1{,}50{,}000 \times \frac{12}{100} \times \frac{100}{15} = ₹\ 1{,}20{,}000$

** $50{,}000 \times \frac{12}{100} \times \frac{100}{15} = ₹\ 40{,}000$

(ii) Value of Shares of D Ltd. and Y Ltd.

The value of shares of D Ltd. is ₹ 4,00,000 plus 1/4 of the value of the shares of Y Ltd.

Similarly, the value of shares of Y Ltd. is ₹ 1,50,000 plus 2/5 of the value of shares of D Ltd.

Let a denote the value of shares of D Ltd. and m denote the value of shares of Y Ltd. then

a = 4,00,000 + 1/4 m ; and

m = 1,50,000 + 2/5 a.

Substituting the value of m,

a = 4,00,000 + 1/4 (1,50,000 + 2/5 a)

a = 4,00,000 + 37,500 + 1/10 a

9/10 a = 4,37,500

a = 4,86,112

m = 1,50,000 + 2/5 (4,86,112)

m = 3,44,444

(iii) Amount of Purchase Consideration

	D Ltd.	Y Ltd.
	₹	₹
Total value of shares (as determined above)	4,86,112	3,44,444
Less: Internal investments:		
2/5 for shares held by Y Ltd.	1,94,445	
1/4 for shares held by D Ltd.		86,111
Amount due to outsiders	2,91,667	2,58,333

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

	D Ltd.	Y Ltd.
	₹	₹
In shares (of ₹ 100 each)	2,91,600	2,58,300
In cash	67	33

(iv) Net Amount of Goodwill/Capital Reserve

	₹	₹
Total Purchase Consideration		
D Ltd.	2,91,667	
Y Ltd.	2,58,333	5,50,000
Less: Net Assets taken over		
D Ltd.	4,00,000	
Y Ltd.	1,50,000	5,50,000
		Nil

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

Balance Sheet of DY Ltd. as at 31st March, 2011

Liabilities	Amount	Assets	Amount
	₹		₹
Share Capital 5,499 shares of ₹ 100 each	5,49,900	Goodwill	–
(All the above shares are allotted as fully paid-up for consideration other than cash)		Fixed Assets	5,00,000
		Investments	–
Investment Allowance Reserve	35,000	Current Assets	2,49,900
15% Debentures	1,60,000	(2,50,000 – 67 – 33)	
Sundry Creditors	40,000	Miscellaneous	

		Expenditure (to the extent not written off or adjusted): Amalgamation Adjustment Account	35,000
	7,84,900		7,84,900

Question 11

The Balance Sheets of Z Ltd. and P Ltd. as on 31st March, 2011 are as under:

(₹ in lakhs)

Liabilities	Z	P	Assets	Z	P
	₹	₹		₹	₹
Equity Shares of ₹ 10 each	75.00	150.00	Fixed Assets	330.00	150.00
Reserves	393.00	87.75	Investments	48.75	75.00
12% Debentures	33.00	16.50	Current Assets	120.75	9.75
Creditors	24.00	8.25	Miscellaneous Expenditure	25.50	27.75
	525.00	262.50		525.00	262.50

Investments of Z Ltd. represent 3,75,000 shares of P Ltd. Investments of P Ltd. are considered worth ₹ 90 lakhs. P Ltd. is taken over by Z Ltd. on the basis of the intrinsic value of shares in their respective books of account. Prepare a statement showing the number of shares to be allotted by Z Ltd. to P Ltd. and the Balance Sheet of Z Ltd. after absorption of P Ltd.

Answer

Balance sheet of Z Ltd. (after absorption)

(₹ in lakhs)

Liabilities	Amount	Assets		(Amount)
SHARE CAPITAL		FIXED ASSETS		
10,31,250 Equity Shares of ₹10 each	103.125	Fixed Assets	330.00	
(Of the above shares, 2,81,250 equity shares are allotted as fully paid-up for consideration other than cash)		Add: Taken over	150.00	480.00
		INVESTMENTS		90.00
RESERVES AND SURPLUS		CURRENT		

			ASSETS,		
As per last Balance Sheet	393.00		LOANS AND ADVANCES		
Capital Reserve	7.50				
Securities Premium	140.625	541.125	Current Assets	120.75	
SECURED LOANS			Add: Taken over	9.75	130.50
12% Debentures	33.00		MISCELLANEOUS EXPENDITURE		25.50
Add: Taken over	16.50	49.50			
CURRENT LIABILITIES AND PROVISIONS					
Creditors	24.00				
Add: Taken over	8.25	32.25			
		726.00			726.00

Working Notes:

(a) (i) Calculation of Net Assets

(₹ in lakhs)

	Z Ltd.	P Ltd.
Fixed Assets	330.00	150.00
Investments	56.25#	90.00
Current Assets	120.75	9.75
	507.00	249.75
12% Debentures	33.00	16.50
Creditors	24.00	8.25
	57.00	24.75
Net Assets	450.00	225.00

	Z Ltd.	P Ltd.
(ii) Number of equity shares	7.50 lakhs	15.00 lakhs
Intrinsic Value	₹ 60.00	₹ 15.00

3.75 lakhs shares × ₹ 15

(b) Calculation of Shares Allotted

	(₹ in lakhs)
Net assets taken over	225.00
Less: Belonging to Z Ltd. $\left(\frac{3,75,000}{15,00,000} \times 225\,\text{lakhs}\right)$	56.25
Payable to other equity shareholders	168.75

Number of equity shares of ₹ 10 each to be issued = $\frac{\text{Rs. }1,68,75,000}{\text{Rs. }60} =$

= 2,81,250 shares (valued at ₹ 60 each)

Credit to share capital	₹ 28,12,500
Credit to securities premium	₹ 1,40,62,500

Question 12

The following are the Balance Sheets of M Ltd. and B Ltd. as on 31st December, 2010:

Liabilities	M Ltd.	B Ltd.	Assets	M Ltd.	B Ltd.
	₹	₹		₹	₹
Share Capital			Fixed Assets	14,00,000	5,00,000
Equity Shares of			Investment:		
₹ 10 each	12,00,000	6,00,000			
10% Pref. Shares of			12,000 Shares of B Ltd.	1,60,000	–
₹ 100 each	4,00,000	2,00,000	10,000 Shares of M Ltd.	–	1,60,000
Reserves and Surplus	6,00,000	4,00,000			
Secured Loans:			Current Assets:		
12% Debentures	4,00,000	3,00,000	Stock	4,80,000	6,40,000
Current Liabilities:			Debtors	7,20,000	3,80,000
Sundry Creditors	4,40,000	2,50,000	Bills Receivable	1,20,000	40,000
Bills Payable	60,000	50,000	Cash at Bank	2,20,000	80,000
	31,00,000	18,00,000		31,00,000	18,00,000

Fixed Assets of both the companies are to be revalued at 15% above book value. Stock in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, M Ltd. will absorb B Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by M Ltd. at par against 6 shares of B Ltd.

(ii) 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in M Ltd.

(iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 12% Debentures in M Ltd. issued at a discount of 10%.

(iv) ₹ 60,000 is to be paid by M Ltd. to B Ltd. for Liquidation expenses. Sundry Creditors of B Ltd. include ₹ 20,000 due to M Ltd.

Prepare:

(a) Absorption entries in the books of M Ltd.

(b) Statement of consideration payable by M Ltd.

Answer

(a) **Absorption Entries in the Books of M Ltd.**

		Dr.	Cr.
		₹	₹
Fixed Assets	Dr.	2,10,000	
To Revaluation Reserve			2,10,000
(Revaluation of fixed assets at 15% above book value)			
Bank Account	Dr.	1,20,000	
To Reserves and Surplus			1,20,000
(Dividend received from B Ltd. on 12,000 shares)			
Reserve and Surplus	Dr.	1,20,000	
To Equity Dividend			1,20,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	1,20,000	
To Bank Account			1,20,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	7,20,000	
To Liquidator of B Ltd.			7,20,000
(Consideration payable for the business taken over from B Ltd.)			
Fixed Assets (115% ₹ 5,00,000)	Dr.	5,75,000	
Stock (90% ₹ 6,40,000)	Dr.	6,08,000	
Debtors	Dr.	3,80,000	
Bills Receivable	Dr.	40,000	
Cash at Bank	Dr.	30,000	
(₹ 80,000 – ₹ 60,000 dividend paid + ₹ 10,000 dividend received)			
To Provision for Bad Debts			19,000
(5% of ₹ 3,80,000)			
To Sundry Creditors			2,50,000
To 12% Debentures in B Ltd.			3,24,000
To Bills Payable			50,000
To Business Purchase Account			7,80,000
To Investments in B Ltd.			1,60,000
To Capital Reserve (Balancing figure)			50,000
(Incorporation of various assets and liabilities taken			

over from B Ltd. at agreed values and cancellation of investment in B Ltd. account, profit being credited to capital reserve)			
Liquidator of B Ltd.	Dr.	7,20,000	
To Equity Share Capital			5,40,000
To 10% Preference Share Capital			1,80,000
Discharge of consideration for B Ltd.'s business)			
Capital Reserve	Dr.	60,000	
To Bank Account			60,000
(Payment of liquidation expenses)			
12% Debentures in B Ltd. (₹ 3,00,000 × 108%)	Dr.	3,24,000	
Discount on Issue of Debentures	Dr.	36,000	
To 12% Debentures			3,60,000
(Allotment of 12% Debentures to debenture holders at a discount of 10% to discharge the liability on B Ltd. debentures)			
Sundry Creditors	Dr.	20,000	
To Sundry Debtors			20,000
(Cancellation of mutual owing)			

(b) Statement of Consideration payable by M Ltd.

For equity shares held by outsiders

Shares held by them 60,000 – 12,000 = 48,000

Shares to be allotted $\frac{48,000}{6} \times 8 =$ 64,000

as 10,000 shares are already will B Ltd; i.e. M Ltd. will now issue only 54,000 shares of ₹ 10 each i.e. ₹ 5,40,000 (i)

For 10% preference shares, to be paid at 10% discount

$\frac{2,00,000 \times 90}{100}$ ₹ 1,80,000 (ii)

Consideration amount [(i) + (ii)] 7,20,000

Note: It has been assumed that dividend on equity shares have been paid by both the companies.

Question 13

The following are the Balance Sheets of RS Ltd. and XY Ltd. as on 31.3.2011: (₹ in '000s)

Liabilities	RS Ltd. ₹	XY Ltd. ₹	Assets	RS Ltd. ₹	XY Ltd. ₹
Share Capital:			Fixed Assets net of		
Equity Shares of ₹ 100	6,000	3,000	depreciation	8,100	2,550
each fully paid up			Investments	2,100	–
Reserves and Surplus	2,400	–	Sundry Debtors	1,200	450
10% Debentures	1,500	–	Cash and Bank	750	–
Loan from Financial			Profit and Loss	–	2,400
Institutions	750	1,200	Account		
Bank Overdraft	–	300			
Sundry Creditors	900	900			
Proposed Dividend	600	–			
	12,150	5,400		12,150	5,400

It was decided that XY Ltd. will acquire the business of RS Ltd. for enjoying the benefit of carry forward of business loss. After acquisition, XY Ltd. will be renamed as XYZ Ltd. The following scheme has been approved for the merger:

(i) XY Ltd. will reduce its shares to ₹ 10 and then consolidate 10 such shares into one share of ₹100 each (New Share).

(ii) Financial institutions agreed to waive 15% of the loan of XY Ltd.

(iii) Shareholders of RS Ltd. will be given one new share of XY Ltd. in exchange of every share held in RS Ltd.

(iv) RS Ltd. will cancel 20% holding of XY Ltd. Investments were held at ₹ 750 thousands.

(v) After merger the proposed dividend of RS Ltd. will be paid to the shareholders of RS Ltd.

(vi) Authorised Capital of XY Ltd. will be raised accordingly to carry out the scheme.

(vii) Sundry creditors of XY Ltd. includes payable to RS Ltd. ₹ 3,00,000.

Pass the necessary entries to implement the scheme in the books of RS Ltd. and XY Ltd. and prepare a Balance Sheet of XYZ Ltd.

Answer

Journal Entries in the books of RS Ltd.

(₹ '000)

		Dr. ₹	Cr. ₹
10% Debentures A/c	Dr.	1,500	
Loan from Financial Institutions A/c	Dr.	750	
Sundry Creditors A/c	Dr.	900	
Proposed Dividend A/c	Dr.	600	
Realisation A/c	Dr.	8,400	
To Fixed Assets A/c			8,100

To Investments A/c			2,100
To Sundry Debtors A/c			1,200
To Cash and Bank A/c			750
(Transfer of assets and liabilities to realisation account)			
Share Capital A/c	Dr.	6,000	
Reserve and Surplus A/c	Dr.	2,400	
To Equity Shareholders A/c			8,400
(Transfer of share capital, reserve and surplus to shareholders account)			
Equity Shareholders A/c	Dr.	750	
To Realisation A/c			750
(Cancellation of 20% holding of XY Ltd. held as investments)			
Shares in XYZ Ltd.	Dr.	6,000	
To Realisation A/c			6,000
(Issue of shares by XYZ Ltd. in the ratio of 1 : 1)			
Equity Shareholders A/c	Dr.	1,650	
To Realisation A/c			1,650
(Transfer of loss on realisation)			
Equity Shareholders A/c	Dr.	6,000	
To Shares in XYZ Ltd.			6,000
(Distribution of Shares of XYZ Ltd. among the shareholders)			

Journal Entries in the books of XY Ltd. (₹ '000)

		Dr. ₹	Cr. ₹
Equity Share Capital (Face value ₹ 100) A/c	Dr.	3,000	
To Equity Share Capital (Face value ₹ 10) A/c			300
To Reconstruction A/c			2,700
(Face value of equity shares of ₹ 100 each reduced to ₹ 10 each)			
Equity Share Capital (Face value ₹ 10 each) A/c	Dr.	300	
To Equity Share Capital A/c (Face value – ₹ 100 each)			300
(Consolidation of 30,000 equity shares of ₹ 10 each to 3,000 equity shares of ₹ 100 each)			
Loan from Financial Institutions A/c	Dr.	180	
To Reconstruction A/c			180
(Waiver of 15%of loan by financial institutions)			

Reconstruction A/c (2,700 + 180)	Dr.	2,880	
To Profit and Loss A/c			2,400
To Capital Reserve			480
(Balance of Reconstruction account availed to write off the Profit and Loss Account)			
Proposed Dividend A/c	Dr.	600	
To Bank A/c			600
(Payment of Proposed dividend to shareholders of RS Ltd.)			
Fixed Assets A/c	Dr.	8,100	
Other Investments A/c	Dr.	1,350	
Sundry Debtors A/c	Dr.	1,200	
Cash and Bank A/c	Dr.	750	
To Reserves A/c			1,710
To 10% Debentures A/c			1,500
To Loan from Financial Institutions A/c			750
To Sundry Creditors A/c			900
To Proposed Dividend A/c			600
To Business Purchase A/c			5,940
(Incorporation of various assets and liabilities acquired from RS Ltd. after cancellation of investment held by RS Ltd. in XY Ltd., profit on acquisition credited to Reserves Account)			
Business Purchase A/c	Dr.	5,940	
To Liquidator of RS Ltd.			5,940
(Consideration Payable on business acquired from RS Ltd.)			
Liquidator of RS Ltd.	Dr.	5,940	
To Equity Share Capital of XYZ Ltd.			5,940
(Discharge of purchase consideration in the form of equity shares of XYZ Ltd.)			
Sundry Creditors A/c	Dr.	300	
To Sundry Debtors A/c			300
(Cancellation of intercompany owings)			

Balance Sheet of XYZ Ltd. as on 31st March, 2011 (immediately after acquisition)

(₹ in 000's)

Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets net of depreciation	10,650
62,400 Equity Shares @ ₹ 100		Investments	1,350
each (5,940 + 60 + 240)	6,240	Sundry Debtors	1,350
Capital Reserve	1,680		

General Reserve	1,710	
10% Debentures	1,500	
Loan from financial institutions	1,770	
Bank Overdraft (300 – 750 + 600)	150	
Sundry Creditors	1,500	
	13,350	13,350

Working Notes:

				₹
1.	Original Share Capital of XY Ltd.			
	30,000 Equity Shares of ₹ 100 each			30,00,000
	Share Capital of XY Ltd. after Reduction			
	30,000 Equity Shares of ₹ 10 each			3,00,000
2.	Share Capital of XY Ltd. after Reconsolidation			
	3,000 Equity Shares of ₹ 100 each			3,00,000
3.	Reduced value of holdings of RS Ltd. in XY Ltd.			
	RS Ltd. was holding 20% of XY Ltd., that is,			
	6,000 Equity Shares of ₹ 100 each			6,00,000
	which has now reduced to 600 Equity Shares of ₹ 100 each			60,000
4.	Calculation of Purchase Consideration			
	Equity Share Capital of RS Ltd. 60,000 Equity Shares of ₹ 100 each			60,00,000
	Exchange Ratio = 1 : 1			
	No. of Equity Shares to be given	60,000		
	Less: No. of Equity Shares already held by RS Ltd.	600		
		59,400		
	Purchase consideration			
	59,400 Equity Shares of ₹ 100 each			59,40,000
5.	Aggregate Reserves in the new company on acquisition			
	Reserves of RS Ltd. acquired			24,00,000
	Less: Loss on investments held by RS Ltd.			
	Value of investments cancelled		7,50,000	
	Less: Reduced value of shares of XY Ltd.		60,000	6,90,000
	Amount of Reserves to be carried to Balance Sheet			17,10,000
6.	Share Capital in Combined Balance Sheet of XYZ Ltd.			
	Holding of RS Ltd. (600 Equity Shares @ ₹ 100 each)			60,000
	Other Existing Shares (2400 Equity Shares of ₹ 100 each)			2,40,000
	Given as Purchase Consideration (59,400 equity shares @ ₹100 each)			59,40,000
				62,40,000

7. It has been assumed that the bank overdraft and cash balance can be adjusted.

Question 14

The Balance Sheet of MM Ltd. on 31st March, 2011 is as under:

Liabilities	₹	Assets	₹
Authorised, issued equity share capital		Goodwill	5,00,000
50,000 shares of ₹ 100 each	50,00,000	Plant and machinery	45,00,000
25,000 preference shares (7%) of		Stock	7,50,000
₹ 100 each	25,00,000	Debtors	18,75,000
Sundry creditors	18,75,000	Preliminary expenses	2,50,000
Bank overdraft	7,50,000	Cash	3,75,000
		Profit and loss account	17,50,000
	1,00,00,000		1,00,00,000

Two years' preference dividends are in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend provided the capital base is reduced.

An internal reconstruction scheme as follows was agreed to by all concerned:

(i) Creditors agreed to forego 50% of the claim.

(ii) Preference shareholders withdrew arrear dividend claim. They also agreed to lower their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reorganization in case equity shareholders' loss exceed 50% on the application of the scheme.

(iii) Bank agreed to convert overdraft into term loan to the extent required for making current ratio equal to 2 : 1.

(iv) Revalued figure for plant and machinery was accepted as ₹ 37,50,000.

(v) Debtors to the extent of ₹ 10,00,000 were considered good.

(vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reorganisation.

Show:

(a) Total loss to be borne by the equity and preference shareholders for the reorganization;

(b) Share of loss to the individual classes of shareholders;

(c) New structure of share capital after reorganization;

(d) Working capital of the reorganized Company; and

(e) A proforma balance sheet after reorganization.

Answer

(a) Loss to be borne by Equity and Preference Shareholders

	₹
Profit and loss account (debit balance)	18,75,000
Preliminary expenses	2,50,000
Goodwill	5,00,000
Plant and machinery (₹ 45,00,000 – ₹ 37,50,000)	7,50,000
Debtors (₹ 18,75,000 – ₹ 10,00,000)	8,75,000
Amount to be written off	41,25,000
Less: 50% of sundry creditors	8,75,000
Total loss to be borne by the equity and preference shareholders	32,50,000

(b) Share of loss to preference shareholders and equity shareholders

Total loss of ₹ 32,50,000 being more than 50% of equity share capital i.e. ₹ 25,00,000.

Preference shareholders' share of loss = 20% of ₹ 25,00,000	= ₹ 5,00,000
Equity shareholders' share of loss (₹ 32,50,000 – ₹ 5,00,000)	= ₹ 27,50,000
Total loss	₹ 32,50,000

(c) New structure of share capital after reorganisation

	₹
Equity shares:	
50,000 equity shares of ₹ 45 each, fully paid up (₹ 50,00,000 – ₹ 27,50,000)	22,50,000
Preference shares:	
25,000, 9% preference shares of ₹ 80 each, fully paid up (₹ 25,00,000 – ₹ 5,00,000)	20,00,000
	42,50,000

(d) Working capital of the reorganized company

	₹	₹
Current Assets:		
Stock		7,50,000
Debtors		10,00,000
Cash		3,75,000
		21,25,000
Less: Current liabilities:		
Creditors	8,75,000	
Bank overdraft	1,87,500	10,62,500
Working capital		10,62,500

Note:
Current ratio shall be 2 : 1, i.e. total current liabilities shall be 50% of ₹ 21,25,000 (i.e. ₹ 6,00,000 + 8,00,000 + 3,00,000) = ₹ 8,50,000. Therefore, Bank overdraft = ₹ 1,50,000 (₹ 8,50,000 less creditors ₹ 7,00,000).

(e) **Balance Sheet of MM Ltd. (and reduced) as on 31st March, 2011**

Liabilities	₹	Assets	₹
Share Capital Authorised (issued and paid up)		Fixed Assets	
50,000 equity shares of ₹ 45 each	22,50,000	Plant and Machinery	37,50,000
25,000, 9% preference shares of ₹ 80 each	20,00,000	Current Assets	
Unsecured loan		Stock	7,50,000
Term loan with Bank	4,50,000	Debtors	10,00,000
Current liabilities		Cash	3,75,000
Bank overdraft	1,50,000		
Creditors	8,75,000		
	58,75,000		58,75,000

Question 15

The following are the Balance sheets (as at 31.3.2011) of M Ltd. and B Ltd.:

Liabilities	M Ltd. ₹	B. Ltd. ₹	Assets	M Ltd. ₹	B. Ltd. ₹
Share Capital:			**Fixed Assets**	25,00,000	15,00,000
Equity Shares of ₹.10 each	18,00,000	9,00,000	Investments	2,50,000	2,50,000
			Current Assets		
10% Preference shares of ₹ 100 each	6,00,000	-	Stock	9,00,000	6,00,000
			Debtors	7,50,000	6,00,000
			Bills receivable	25,000	5,000
12% Preference shares of ₹ 100 each	-	3,00,000	Cash at Bank	75,000	45,000
Reserve and Surplus:					
Statutory Reserve	50,000	50,000			
General Reserve	12,50,000	8,50,000			
Secured Loan					
15% Debentures	2,50,000	-			
12% Debentures	-	2,50,000			
Current Liabilities					
Sundry creditors	5,40,000	6,40,000			
Bills payable	10,000	10,000			
	45,00,000	30,00,000		45,00,000	30,00,000

Contingent liabilities for bills receivable discounted ₹ 10,000.

(A) The following additional information is provided to you:

	M Ltd.	B Ltd.
	₹	₹
Profit before Interest and Tax	7,37,500	3,90,000
Rate of Income-tax	40%	40%
Preference dividend	60,000	36,000
Equity dividend	1,80,000	1,35,000

Balance profit transferred to Reserve account.

(B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.

(C) A Ltd proposes to absorb business of B Ltd. as on 31.3.2011. The agreed terms for absorption are:

(i) 12% Preference shareholders of B Ltd. will receive 10% Preference shares of M Ltd. sufficient to increase their present income by 20%.

(ii) The Equity shareholders of B Ltd. will receive equity shares of M Ltd. on the following terms:

(a) The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of M Ltd. based on the results of 2010-11 of both the Companies.

(b) The market price of Equity shares of M Ltd. is ₹ 40 per share.

(c) The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.

(d) In addition to Equity shares, 10% Preference shares of M Ltd. will be issued to the equity shareholders of B Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2010-11.

(iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 15% debentures in M Ltd. issued at a discount of 10%.

(iv) ₹ 8,000 is to be paid by M Ltd. to B Ltd. for liquidation expenses. Sundry Creditors of B Ltd. include ₹ 10,000 due to M Ltd. Bills receivable discounted by M Ltd. were all accepted by B Ltd.

(v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.

(vi) Statutory reserve has to be maintained for two more years

(vii) For the next two years no increase in the rate of equity dividend is anticipated.

(viii) Liquidation expense is to be considered as part of purchase consideration.

You are required to:

(i) Find out the purchase consideration.

(ii) Give journal entries in the books of M Ltd.

(iii) Give the Balance Sheet as at 31.3.2011 after absorption.

Answer

(i) Computation of Purchase Consideration

	₹
For Preference Shareholders	
Present Income of Preference Shareholders of B Ltd.	36,000
Add : 20% increase	7,200
	43,200

10% Preference Shares to be issued of ₹ 4,32,000 (43,200/10x 100)

For Equity Shareholders

Valuation of Equity Shares of B Ltd. =

Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of M Ltd. x 60/100)

$= 90{,}000 \times (₹\ 2 \times 20 \times \frac{60}{100}) \ = 90{,}000 \times 24 = ₹\ 21{,}60{,}000$

Issue of Equity Shares

No. of Equity Shares to be issued at 80% of Market Price i.e.

80% of ₹ 40 = ₹ 32

$\frac{21{,}60{,}000}{32} =$ 67,500 shares

Equity Share Capital = 67,500 × ₹ 10=	₹ 6,75,000
Securities premium = 67,500 x ₹ 22 =	14,85,000
=	**₹ 21,60,000**

Issue of Preference Shares

Present Equity Dividend	
Less: Expected Equity Dividend from M Ltd.	₹ 1,35,000
$(6{,}75{,}000 \times \frac{10}{100})$	67,500
	2,12,500
Loss in income	67,500
10% Preference Shares to be issued of ₹ 67,000 (67,500/10 × 100)	1,35,000
10% Preference Shares to be issued of ₹ 13,50,000 (1,35,000/10x 100)	

Purchase Consideration

Preference Shares Capital [₹ 4,32,000 + ₹ 6,75,000]	**11,07,000**
Equity Share Capital (67,500 shares of ₹ 10 each at ₹ 32 per share)	**21,60,000**
Liquidation Expenses (in cash)	**8,000**
	32,75,000

(ii) Journal Entries in the Books of M Ltd.

	Particulars		Dr. (₹) .	Cr. (₹)
1.	Fixed Assets A/c	Dr.	5,00,000	
	To Revaluation Reserve			5,00,000
	(Being fixed assets revalued at 120% of book value)			
2.	Business Purchase A/c	Dr.	32,75,000	
	To Liquidator of B Ltd.			32,75,000
	(Being purchase consideration payable for the business taken over from B Ltd.			
3.	Fixed Assets A/c	Dr.	18,00,000	
	Investment A/c	Dr.	2,50,000	
	Stock A/c	Dr.	5,40,000	
	Debtors A/c	Dr.	6,00,000	

	Bills Receivable A/c	Dr.	5,000	
	Cash at Bank A/c	Dr.	45,000	
	Goodwill A/c (Balancing figure)	Dr.	9,55,000	
	To 12% Debentures in B Ltd.			2,70,000
	To Creditors			6,40,000
	To Bills Payable			10,000
	To Business Purchase A/c			32,75,000
	(Being incorporation of different assets and liabilities of B Ltd. taken over at agreed values and balance debited to goodwill account)			
4.	Liquidator of B Ltd.	Dr.	32,75,000	
	To Equity Share Capital A/c			6,75,000
	To Securities Premium A/c			14,85,000
	To Preference Share Capital A/c			11,07,000
	To Bank A/c			8,000
	(Being discharge of consideration for B Ltd's business)			
5.	12% Debentures in B Ltd.	Dr.	2,70,000	
	Discount on issue of Debentures	Dr.	30,000	
	To 15% Debentures			3,00,000
	(Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of B Ltd. debentures)			
6.	Sundry Creditors A/c	Dr.	10,000	
	To Sundry Debtors A/c			10,000
	(Being cancellation of Mutual owing)			
7.	Amalgamation Adjustment A/c	Dr.	50,000	
	To Statutory Reserve A/c			50,000
	(Being statutory reserve account is maintained under statutory requirements)			
8.	Securities Premium A/c	Dr.	30,000	
	To Discount on issue of Debentures A/c			30,000
	(Being discount on issue of Debentures written off out of securities premium)			

(iii) Balance Sheet of A Ltd (after absorption of B Ltd.) as on 31.3.2011

Liabilities	Amount ₹	Assets	Amount ₹
Share Capital:		Fixed Assets:	
24,75,000 Equity Shares of ₹ 10 each fully paid (67,500 shares have been allotted as fully paid up for consideration other than cash)	24,75,000	Goodwill	9,55,000
		Other Fixed Assets (30,00,000+18,00,000)	48,00,000
		Investment (2,50,000+2,50,000)	5,00,000
10% Preference Shares of ₹100 each fully paid	17,07,000	Current Assets: Stock (9,00,000+5,40,000)	14,40,000
Reserve & Surplus:		Debtors	
Statutory Reserve	1,00,000	(7,50,000+6,00,000-10,000)	13,40,000
Revaluation Reserve	5,00,000	Bills Receivable	
General Reserve	12,50,000		30,000
Securities Premium	14,55,000	(25,000+5,000)	
Secured Loan:		Cash at Bank	1,12,000
15% Debentures (2,50,000 + 3,00,000)	5,50,000	(75,000+45,000-8,000)	
Current Liabilities and Provisions: Creditors (5,40,00+6,40,000-10,000)	11,70,000	Amalgamation Adjustment A/c	50,000
Bills Payable (10,000 + 10,000)	20,000		
	92,27,000		92,27,000

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

Working Notes:

1. Calculation of EPS & P/E ratio

	M Ltd. ₹	B Ltd. ₹
Profit before Interest and Tax	7,37,500	3,90,000
Less: Interest on debentures	37,500	30,000
Profit before tax	7,00,000	3,60,000
Less: Tax @ 40%	2,80,000	1,44,000
	4,20,000	2,16,000
Less: Preference Dividend	60,000	36,000
Earnings available for equity shareholders	3,60,000	1,80,000
Number of shares	1,80,000 shares	90,000 shares
EPS (Earnings/ No. of shares)	2	2
Market Price	₹ 40	Not given
P/E ratio	40/2 = 20	N.A.

2. Computation of Goodwill/Capital Reserve on absorption:

				₹
Purchase Consideration				32,75,000
Fixed Assets taken over		15,00,000		
Add:	Increase by 20%	3,00,000	18,00,000	
Investments			2,50,000	
Current Assets:				
Stock		6,00,000		
Less:	Reduction in value by 10%	60,000		
		5,40,000		
Debtors		6,00,000		
B/R		5,000		
Cash at Bank		45,000	11,90,000	
			32,40,000	
Less:	Outside Liabilities:			
	12% Debentures at premium	2,70,000		
	Sundry Creditors	6,40,000		
	Bills Payable	10,000	9,20,000	23,20,000
Goodwill				**9,55,000**

3

Group Financial Statements

Question 1

The Balance Sheets of Spring Ltd. and its subsidiary Winter Ltd. as on 31st March, 2011 are as under:

Liabilities	Spring Ltd.	Winter Ltd.	Assets	Spring Ltd.	Winter Ltd.
	₹	₹		₹	₹
Equity shares of ₹ 10 each	4,80,000	2,00,000	Goodwill	45,000	30,000
10% Preference shares of ₹ 10 each	70,000	38,000	Plant and machinery	1,20,000	50,000
General reserve	55,000	42,000	Motor vehicles	95,000	75,000
Profit and loss account	1,00,000	60,000	Furniture and fittings	65,000	40,000
Bank overdraft	12,000	7,000	Investments	2,60,000	45,000
Sundry creditors	43,000	48,000	Stock	45,000	72,000
Bills payable	–	16,000	Cash at bank	22,500	21,000
			Debtors	93,000	78,000
			Bills receivable	14,500	–
	7,60,000	4,11,000		7,60,000	4,11,000

Details of acquisition of shares by Spring Ltd. are as under:

Nature of shares	No. of shares acquired	Date of acquisition	Cost of acquisition ₹
Preference shares	1,425	1.4.2008	31,000
Equity shares	8,000	1.4.2009	95,000
Equity shares	7,000	1.4.2010	80,000

Other information:

(i) On 1.4.2010 profit and loss account and general reserve of Winter Ltd. had credit balances of ₹ 30,000 and ₹ 20,000 respectively.

(ii) Dividend @ 10% was paid by Winter Ltd. for the year 2009-2010 out of its profit and loss account balance as on 1.4.2010. Spring Ltd. credited its share of dividend to its profit and loss account.

(iii) Winter Ltd. allotted bonus shares out of general reserve at the rate of 1 share for every 10 shares held. Accounting thereof has not yet been made.

(iv) Bills receivable of Spring Ltd. were drawn upon Winter Ltd.

(v) During the year 2010-2011 Spring Ltd. purchased goods from Winter Ltd. for ₹ 10,000 at a sale price of ₹ 12,000. 40% of these goods remained unsold at close of the year.

(vi) On 1.4.2010 motor vehicles of Winter Ltd. were overvalued by ₹ 10,000. Applicable depreciation rate is 20%.

(vii) Dividends recommended for the year 2010-2011 in the holding and the subsidiary companies are 15% and 10% respectively.

Prepare consolidated Balance Sheet as on 31st March, 2011.

Answer

Consolidated Balance Sheet of Spring Ltd. and its subsidiary Winter Ltd. as on 31st March, 2011

Liabilities	₹	Amount ₹	Assets	₹	Amount ₹
Share Capital			Fixed Assets		
Authorised, Issued and paid up capital		–	Goodwill		
48,000 equity shares of ₹ 10			Spring Ltd.	45,000	
each		4,80,000	Winter Ltd.	30,000	
7,000 10% preference shares of				75,000	
₹10 each		70,000	Add: Goodwill on		
Minority Interest (W.N . 3)		98,675	consolidation (W.N. 2)	19,750	94,750
Reserves and Surplus			Plant and Machinery		
General reserve (W.N. 5)		71,500	Spring Ltd.	1,20,000	
Profit and loss account (W.N. 4)		50,775	Winter Ltd.	50,000	1,70,000
Current Liabilities and Provisions			Motor Vehicles		
Bank Overdraft			Spring Ltd.	95,000	
Spring Ltd.	12,000		Winter Ltd.		
Winter Ltd.	7,000	19,000	(75,000 – 10,000 + 2,000)	67,000	1,62,000
Sundry Creditors			Furniture & Fittings		
Spring Ltd.	43,000		Spring Ltd.	65,000	
Winter Ltd.	48,000	91,000	Winter Ltd.	40,000	1,05,000
Bills payable			Investments		
Winter Ltd.	16,000		Spring Ltd.		
Less: Mutual debt	14,500	1,500	(2,60,000 – 2,06,000)	54,000	
Proposed Dividend			Winter Ltd.	45,000	99,000
Equity	72,000		Current assets, loans		
Preference	7,000	79,000	and advances		
			Current assets		
			Stock		
			Spring Ltd.	45,000	
			Winter Ltd.	72,000	
				1,17,000	
			Less: Unrealised profit	800	1,16,200

		Debtors		
		Spring Ltd.	93,000	
		Winter Ltd.	78,000	1,71,000
		Cash at Bank		
		Spring Ltd.	22,500	
		Winter Ltd.	21,000	43,500
		Loans and advances		
		Bills receivable		
		Spring Ltd.	14,500	
		Less: Mutual Debt	14,500	
				Nil
	9,61,450			9,61,450

Working Notes:

(1) **Analysis of Profits of Winter Ltd.**

			Capital Profits	Revenue Reserve	Revenue Profit
		₹	₹	₹	₹
(a)	General Reserve as on 1.4.2010	20,000			
	Less: Bonus issue (1/10 of ₹ 2,00,000)	20,000	–	–	
(b)	Addition to General Reserve during 2010-2011 (₹ 42,000 – ₹ 20,000)			22,000	
(c)	Profit and Loss Account balance as on 1.4.2010	30,000			
	Less: Dividend paid for the year 2009-2010	20,000	10,000		
(d)	Profit for the year 2010-2011 (₹ 60,000 – ₹ 10,000)				50,000
(e)	Adjustment for over valuation of motor vehicles		(10,000)		
(f)	Adjustment of revenue profit due to overcharged depreciation (20% on ₹ 10,000)				2,000
(g)	Preference dividend for the year 2010-2011 @ 10%				(3,800)
			–	22,000	48,200
	Spring Ltd.'s share (3/4)			16,500	36,150
	Minority Interest (1/4)			5,500	12,050
				22,000	48,200

			₹	₹
(2)	**Cost of Control**			
	Cost of investments in Winter Ltd.			2,06,000
	Less: Paid up value of equity shares (including bonus shares) [8,000 + 7,000 + (10% of 15,000)] × ₹ 10		1,65,000	
	Paid-up value of preference shares		14,250	
	Pre-acquisition dividend*		7,000	1,86,250
	Cost of control/Goodwill			19,750
(3)	**Minority Interest**			
	Equity share capital [₹ 50,000 + ₹ 5,000 (Bonus)]			55,000
	Preference share capital (₹ 38,000 – ₹ 14,250)			23,750
	Share of revenue reserve			5,500
	Share of revenue profit			12,050
	Proposed preference dividend			2,375
				98,675
(4)	**Profit and Loss Account – Spring Ltd.**			
	Balance			1,00,000
	Share in profit of Winter Ltd.			36,150
	Share in proposed preference dividend of Winter Ltd.			1,425
				1,37,575
	Less: Pre-acquisition dividend credited to profit and loss account		7,000	
	Unrealised profit on stock (40% of ₹ 2,000)		800	
	Proposed equity dividend		72,000	
	Proposed preference dividend		7,000	86,800
				50,775
(5)	**General reserve – Spring Ltd.**			
	Balance			55,000
	Add: Share in Winter Ltd.			16,500
				71,500

Note: No information has been given in the question regarding date of bonus issue by Winter. It is also not mentioned whether the bonus shares are issued from pre-acquisition general reserve or post-acquisition general reserve. The above solution is given on the basis that Winter Ltd. allotted bonus shares out of pre-acquisition general reserve.

* The dividend on 7,000 shares only (acquired on 1.4.2010) is a pre-acquisition dividend.

Question 2

The Balance Sheet of Parrot and Sparrow Limited as on 31.3.2011 are given below:

Liabilities	Parrot Ltd. (₹)	Sparrow Ltd.(₹)	Assets	Parrot Ltd. (₹)	Sparrow Ltd. (₹)
Equity share capital	18,00,000	18,00,000	Fixed assets	6,60,000	12,60,000
General reserve	3,00,000	2,40,000	Investment	13,50,000	75,000
Profit and Loss account	1,80,000	2,92,500	Sundry debtors	90,000	2,25,000
Bills payable	30,000	75,000	Bills receivable	60,000	2,40,000
Sundry creditors	60,000	1,12,500	Stock in trade	1,50,000	6,00,000
			Cash at bank	60,000	1,20,000
	23,70,000	25,20,000		23,70,000	25,20,000

Note: Contingent liability of Parrot Ltd.: Bills discounted not yet matured at ₹ 37,500.

Additional information:

(i) On 1.10.2008, Parrot Ltd. acquired 1,20,000 shares of ₹10 each at the rate of ₹11 per share.

(ii) Balances to General reserve and Profit and Loss account of Sparrow Ltd. stood on 1.4.2008 at ₹ 4,50,000 and ₹ 2,40,000 respectively.

(iii) Dividends have been paid @ 10% for each of the years 2008-09 and 2009-10. Dividend for the year 2008-09 was paid out of the pre-acquisition profits. No dividend has been proposed for the year 2010-11 as yet and no provision need to be made in consolidated Balance Sheet. Parrot Ltd. has credited all dividends received to profit and Loss account.

(iv) On 1.3.2011, bonus shares were issued by Sparrow 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 1.4.2008.

(v) On 1.10.2008, Fixed assets was revalued at ₹ 16,20,000, but no adjustment had been made in the books.

(vi) Depreciation had been charged @ 10% p.a. on the book value as on 1.4.2008 (on straight line method), there being no addition or sale since then.

(vii) Out of Current profits ₹ 30,000 have been transferred to General reserve every year.

(viii) Bills receivable of Parrot Ltd. include ₹ 30,000 bills accepted by Sparrow Ltd. Bills discounted by Parrot Ltd., but not yet matured include ₹ 22,500 accepted by Sparrow Ltd.

(ix) Sundry creditors of Parrot Ltd. include ₹ 30,000 due to Sparrow Ltd. Sundry debtors of Sparrow Ltd. include ₹ 60,000 due from Parrot Ltd.

(x) It is found that Parrot Ltd. has remitted a cheque of ₹ 30,000, which has not yet been received by Sparrow Ltd.

Prepare consolidated Balance Sheet as at 31.3.2011 of Parrot Ltd. and its Subsidiary.

Answer

Parrot Ltd and its Subsidiary Sparrow Ltd.
Consolidated Balance Sheet as on 31st March, 2011

Liabilities		Amount ₹	Assets		Amount ₹
Share capital		18,00,000	Fixed Assets	6,60,000	
(1,80,000 shares of ₹10 each)			(12,60,000-90,000+22,500)	11,92,500	18,52,500
Minority Interests		4,53,000			
Capital Reserve		3,99,000	Investment (30,000*+75,000)		1,05,000
General Reserve		3,60,000			
Consolidated P&L Account		2,13,000	Debtors (2,25,000-30,000)	2,85,000	
Bills Payable	1,05,000		Less: Mutual Debts	30,000	2,55,000
Less: Mutual indebtedness	30,000	75,000	Bills Receivable	3,00,000	
			Less: Mutual Debts	30,000	2,70,000
Sundry creditors	1,72,500		Stock (1,50,000+6,00,000)		7,50,000
Less: Mutual			Remittance in Transit		30,000
indebtedness	30,000	1,42,500	Cash at Bank (60,000+1,20,000)		1,80,000
		34,42,500			34,42,500

Note: Contingent Liability of Bills discounted not yet matured for payment ₹ 2,000.

* ₹ 13,50,000 – (1,20,000 shares x ₹ 11)

Working Notes:-

(i) Interest of Parrot Ltd in Sparrow Ltd.

	₹
Share capital of Sparrow Ltd. on 31.3.2011	18,00,000
Less: Issue of Bonus Shares $\left(\frac{1}{6} \text{ of } ₹\ 18,00,000\right)$	3,00,000
Share capital before Bonus issue	15,00,000
No. of Equity Shares before Bonus issue $\frac{15,00,000}{10}$	1,50,000
No. of shares held by Parrot Ltd.	1,20,000
Interest of Parrot Ltd. in Sparrow Ltd $\frac{1,20,000}{1,50,000} \times 100$	80%
Minority shareholders' Interest	20%

(ii) Analysis of Profit of Sparrow Ltd.

		Capital Profit	Revenue Reserve	Revenue Profit
	₹	₹	₹	₹
General Reserve on 31.3.2011 (After Bonus issue)	2,40,000			
Add: Bonus issue	3,00,000			
Balance (before bonus issue)	5,40,000			
General Reserve on 1.4.2008	4,50,000			
Less: Bonus issue	3,00,000	1,50,000		
Increase in General Reserve (Transfer of ₹30,000 p.a. for 3 years)				
(5,40,000 – 4,50,000)	90,000	15,000	75,000	
Profit and Loss Account				
Increase in Profit after Dividend				

(2,92,500 – 90,000) =	2,02,500*	33,750	1,68,750
Additional depreciation written back due to revaluation of fixed assets $\left(90{,}000 \times \frac{10}{100} \times 2.5\right)$			22,500
	1,98,750	75,000	1,91,250
Share of Parrot Ltd. (80%)	1,59,000	60,000	1,53,000
Share of Minority Shareholders (20%)	39,750	15,000	38,250
	1,98,750	75,000	1,91,250

(iii) Loss on Revaluation has been calculated as follows:

	₹
Value of Assets on 1.4.2008 (12,60,000 × $\frac{100}{70}$)	18,00,000
Less : Depreciation for 6 months (18,00,000× $\frac{10}{100} \times \frac{1}{2}$)	90,000
Valuation of Assets on 1.10.2008	17,10,000
Less: Re-valued value of Assets	16,20,000
Loss on Revaluation	90,000

(iv) Cost of Control

		₹
Cost of Investment in Sparrow Ltd.		13,20,000
Less: Dividend out of capital profit	1,20,000	
Less: Paid up value of investment (including Bonus Shares) (12,00,000 + 12,00,000 × $\frac{1}{5}$)	14,40,000	
Less: Capital Profit	1,59,000	17,19,000
Capital Reserve		3,99,000

* It has been assumed that Profit of ₹ 2,02,500 after payment of dividend for the year 2009-2010, has been earned evenly in 3 years, (year 2008-09, 2009-10 and 2010-11) hence profit per year would be $\frac{2{,}02{,}500}{3}$ = ₹ 67,500. Half of the profit of ₹ 67,500 for the year 2008-09 would be pre-acquisition (Capital Profit) and Remaining half i.e. ₹ 33,750 would be post-acquisition profit (Revenue profit).

(v) Minority Interest

Paid-up share capital (Including Bonus Shares)		
$\left(3,00,000+3,00,000\times\frac{20}{100}\right)$		3,60,000
Add: Share in Capital Profit	39,750	
Share in Revenue Reserve	15,000	
Share in Revenue Profit	38,250	93,000
		4,53,000

(vi) General Reserve

Balance in Parrot Ltd.	3,00,000
Add: Share in Sparrow Ltd.	60,000
	3,60,000

(vii) Consolidated Profit and Loss Account

Balance in Parrot Ltd.	1,80,000
Less:Dividend credited out of Pre-acquisition Profit (Capital Profit)	1,20,000
	60,000
Add: Share in Profit of Sparrow Ltd.	1,53,000
	2,13,000

Question 3

X Ltd. purchases its raw materials from Y Ltd. and sells goods to Z Ltd. In order to ensure regular supply of raw materials and patronage for finished goods, X Ltd. through its wholly owned subsidiary, X Investments Ltd. acquires on 31st December, 2010, 51% of equity capital of Y Ltd. for ₹ 150 crores and 76% of equity capital of Z Ltd. for ₹ 300 crores. X Investments Ltd. was floated by X Ltd. in 2004 from which date it was wholly owned by X Ltd.

The following are the Balance Sheets of the four companies as on 31st December, 2010:

(₹ in crores)	X Ltd. ₹		X Investments Ltd. ₹		Y Ltd. ₹		Z Ltd. ₹	
Share Capital:								
Equity (Fully paid) ₹ 10 each	250		50		100		150	
Reserves and Surplus	750	1,000	200	250	150	250	200	350
Loan Funds:								
Secured	150		–		50		200	
Unsecured	100	250	500	500	100	150	150	350
Total Sources		1250		750		400		700
Fixed Assets:								

Cost	600		–		150		300	
Less: Depreciation	350	250	–	–	70	80	170	130
Investments at cost in Equity Shares, fully paid								
X Investments Ltd.		50		–		–		–
Y Ltd.		–		150		–		–
Z Ltd.		–		300		–		–
Other Companies (Market Value ₹ 1160 Cr.)		–		290		–		–
Net Current Assets:								
Current Assets	1050		10		960		2000	
Current Liabilities	100	950	–	10	640	320	1430	570
		1250		750		400		700

There are no intercompany transactions outstanding between the companies.

You are asked to prepare consolidated balance sheet as at 31st December, 2010 in vertical form.

Answer

Consolidated Balance Sheet of X Ltd. and its subsidiaries
X Investments Ltd., Y Ltd. and Z Ltd. as at 31st December, 2010

(₹ in crores)

I	SOURCES OF FUNDS					
	(1)	Shareholders' funds:				
		(a)	Capital		250.00	
		(b)	Reserves and surplus		950.00	
						1200.00
	(2)	Minority interest in:				
		(a)	Y Ltd.		122.50	
		(b)	Z Ltd.		84.00	
						206.50
	(3)	Loan funds:				
		(a)	Secured loans		400.00	
		(b)	Unsecured loans		850.00	
						1,250.00
	TOTAL					2,656.50
II	APPLICATION OF FUNDS					
	(1)	Fixed assets:				
		(a)	Goodwill on consolidation of:			
			Y Ltd.	22.50		
			Z Ltd.	34.00		
					56.50	

	(b) Others:			
	Gross block	1,050.00		
	Less: Depreciation	590.00		
			460.00	
				516.50
(2)	Investments at cost			290.00
	(in equity shares of other companies – Market value ₹ 116 crores)			
(3)	Current assets		4,020.00	
	Less: Current liabilities		2,170.00	
	Net current assets			1,850.00
	TOTAL			2,656.50

Working Notes:

(A) X Investments Ltd.

(₹ in crores)

			Capital Profit	Revenue Profit	Share Capital
(1)	Analysis of Profits and Share Capital:				
	(i) Y Ltd.		150.00	–	100.00
	Minority Interest (49%)		73.50	–	49.00
	Share of X Investments Ltd.		76.50	–	51.00
	(ii) Z Ltd.		200.00	–	150.00
	Minority Interest (24%)		48.00	–	36.00
	Share of X Investments Ltd.		152.00	–	114.00
(2)	Cost of Control:		Y Ltd.		Z Ltd.
	Cost of investments		150.00		300.00
	Less: Paid up value of shares	51.00		114.00	
	Capital profits	76.50		152.00	
			127.50		266.60
	Goodwill on consolidation		22.50		34.00
(3)	Minority interest		Y Ltd.		Z Ltd.
	Share Capital		49.00		36.00
	Capital Profits		73.50		48.00
	Revenue Profits		–		–
			122.50		84.00

(4) **Group Balance Sheet of X Investments Ltd. and its subsidiaries**

Y Ltd. and Z Ltd. as at 31st December, 2010

					(₹ in crores)
I	SOURCES OF FUNDS				
	(1)	Shareholders' funds:			
		(a) Capital		50.00	
		(b) Reserves and surplus		200.00	
					250.00
	(2)	Minority interest in:			
		(a) Y Ltd.		122.50	
		(b) Z Ltd.		84.00	
					206.50
	(3)	Loan funds:			
		(a) Secured loans		250.00	
		(b) Unsecured loans		750.00	
					1,000.00
	TOTAL				1,456.50
II	APPLICATION OF FUNDS				
	(1)	Fixed assets:			
		(a) Goodwill on consolidation of:			
		Y Ltd.	22.50		
		Z Ltd.	34.00		
				56.50	
		(b) Others:			
		Gross block	450.00		
		Less: Depreciation	240.00		
				210.00	
					266.50
	(2)	Investments at cost			290.00
		(Market value ₹ 116 crores)			
	(3)	Current assets		2,970.00	
		Less: Current liabilities		2,070.0	
		Net current assets			900.00
		TOTAL			1,456.50

(B) X Ltd.

(i) Analysis of Profits of X Investments Ltd.:

	Capital Profit	Revenue Profit
Reserves and Surplus	–	200
Minority Interest	–	–
(X Investments Ltd. being wholly owned subsidiary of X Ltd.)		
(ii) Minority Interest in X Investments Ltd.	–	–
(iii) Cost of Control:		
Cost of investments in X Investments Ltd.		50
Less: Paid-up value of shares held in X Investments Ltd. by X Ltd.	50	
Capital Profit	–	50
Cost of Control		–

Question 4

From the following Balance Sheets of a group of companies and the other information provided, draw up the consolidated Balance Sheet as on 31.3.2011. Figures given are in ₹ Lakhs:

Balance Sheets as on 31.3.2011

	X	Y	Z		X	Y	Z
Shares capital (in shares of ₹ 10 each)	1,650	1,100	550	Fixed Assets less depreciation	715	825	550
Reserves	275	220	165	Cost of investment in Y Ltd.	990	–	–
Profit and loss balance	330	275	220	Cost of investment in Z Ltd.	220	–	–
Bills payables	55	–	27.5	Cost of investment in Z Ltd.	–	440	–
Creditors	165	55	50	Stock	275	110	110
Y Ltd. balance	–	–	82.5	Debtors	385	55	110
Z Ltd. balance	275	–	–	Bills receivables	–	55	110
				Z Ltd. balance	–	55	–
				X Ltd. balance	–	–	165
				Cash and bank balance	165	110	55
	2,750	1,650	1,100		2,750	1,650	1,100

a) X Ltd. holds 8,80,000 shares and 1,65,000 shares respectively in Y Ltd. and Z Ltd.; Y Ltd. holds 3,30,000 shares in Z Ltd. These investments were made on 1.7.2010 on which date the provision was as follows:

	Y Ltd.	Z Ltd.
Reserves	110	55
Profit and loss account	165	88

b) In December, 2010 Y Ltd. invoiced goods to X Ltd. for ₹ 220 lakhs at cost plus 25%. The closing stock of X Ltd. includes such goods valued at ₹ 27.5 lakhs.

c) Z Ltd. sold to Y Ltd. an equipment costing ₹ 132 lakhs at a profit of 25% on selling price on 1.1.2011. Depreciation at 10% per annum was provided by Y Ltd. on this equipment.

d) Bills payables of Z Ltd. represent acceptances given to Y Ltd. out of which Y Ltd. had discounted bills worth ₹ 16.5 lakhs.

e) Debtors of X Ltd. Include ₹ 16.5 lakhs being the amount due from Y Ltd.

f) X Ltd. proposes dividend at 10%.

Answer

Consolidated Balance Sheet of X Ltd.

and its subsidiaries Y Ltd. and Z Ltd. as at 31st March, 2011

(₹ in lakhs)

Liabilities		Amount	Assets		Amount	
Share capital		1,650.00	Fixed Assets			
Minority Interest				X Ltd.	715.00	
Y Ltd.	346.94			Y Ltd.	825.00	
Z Ltd.	89.21	436.15		Z Ltd.	550.00	
Capital Reserve		73.70			2,090.00	
			Less: Unrealised profit		42.90	2,047.10
Other Reserves		448.80	Stock			
Profit and Loss Account		312.95		X Ltd.	275.00	
Bills Payables				Y Ltd.	110.00	
X Ltd.	55.00			Z Ltd.	110.00	
Y Ltd.	27.50				495.00	
	82.50		Less: Unrealised profit		5.5	489.50
Less: Mutual indebtedness	11.00	71.50	Debtors			

			X Ltd.	385.00	
Creditors			Y Ltd.	55.00	
X Ltd.	165.00		Z Ltd.	110.00	
Y Ltd.	55.00			550.00	
Z Ltd.	55.00		Less: Mutual indebtedness	27.50	522.50
	275.00		Cash and Bank Balances		330.00
Less: Mutual indebtedness			Bills Receivables		
	27.50	247.50	Y Ltd.	55.00	
Current Account Balances			Z Ltd.	110.00	
				165.00	
X Ltd.	275.00		Less: Mutual indebtedness	11.00	154.00
Z Ltd.	82.50				
	357.50				
Less: Mutual indebtedness (55+165)	220.00	137.50			
Proposed Dividend		165.00			
		3,543.10			3,543.10

Working Notes:

(₹ in lakhs)

		Capital Profit	Revenue Reserve	Revenue profit
(1)	Analysis of Profits of Z Ltd.			
	Reserves on 1.7.2010	55.00		
	Profit and Loss A/c on 1.7.2010	88.00		
	Increase in Reserves		110.00	
	Increase in Profit			132.00
		143.00	110.00	132.00
	Less: Minority Interest (10%)	14.30	11.00	13.20

		128.70	99.00	118.80
	Share of X Ltd.	42.90	33.00	39.60
	Share of Y Ltd.	85.80	66.00	79.20
(2)	Analysis of Profits of Y Ltd.			
	Reserves on 1.7.2010	110.00		
	Profit and Loss A/c on 1.7.2010	165.00		
	Increase in Reserves		110.00	
	Increase in Profit			110.00
		275.00	110.00	110.00
	Share in Z Ltd.		66.00	79.20
		275.00	176.00	189.20
	Less: Minority Interest (20%)	55.00	35.20	37.84
	Share of X Ltd.	220.00	140.80	151.36
(3)	Cost of Control			
	Investments in Y Ltd.			990.00
	Investments in Z Ltd.			660.00
				1,650.00
	Less: Paid up value of investments			
	in Y Ltd.	880.00		
	in Z Ltd.	495.00	1,375.00	
	Capital Profit			
	in Y Ltd.	220.00		
	in Z Ltd.	128.70	348.70	1,723.70
	Capital Reserve			73.70
(4)	Minority Interest	Y Ltd.	Z Ltd.	
	Share Capital	220.00	55.00	
	Capital Profit	55.00	14.30	
	Revenue Reserves	35.20	11.00	
	Revenue Profits	37.84	13.20	
		348.04	93.50	
	Less: Unrealised profit on stock (20% of 5.5)	1.1		
	Unrealised profit on equipment (10% of 42.90)		4.29	
		346.94	89.21	
(5)	Unrealised Profit on equipment sale			
	Cost	132.00		
	Profit	44.00		
	Selling Price	176.00		

Unrealised profit = $44 - 44 \times \frac{10}{100} \times \frac{3}{12}$ = 44.00 – 1.1 = 42.90

(6) Profit and Loss Account – X Ltd.

Balance	330.00
Less: Proposed Dividend	165.00
	165.00
Share in Y Ltd.	151.36
Share in Z Ltd.	39.60
	355.96
Less: Unrealised profit on equipment (90% of 42.90)	38.61
	317.35
Less: Unrealised profit on stock $\left(27.50 \times \frac{25}{125} \times 80\%\right)$	4.4
	312.95

(7) Reserves – X Ltd.

X Ltd.	275.00
Share in Y Ltd.	140.80
Share in Z Ltd.	33.00
	448.80

Question 5

Following are the Balance Sheets of Mumbai Limited, Delhi Limited, Amritsar Limited and Kanpur Limited as at 31st December, 2010:

Liabilities	Mumbai Ltd.	Delhi Ltd.	Amritsar Ltd.	Kanpur Ltd.
Share Capital (₹ 100 face value)	1,00,00,000	80,00,000	40,00,000	1,20,00,000
General Reserve	40,00,000	8,00,000	5,00,000	20,00,000
Profit & Loss Account	20,00,000	8,00,000	5,00,000	6,40,000
Sundry Creditors	6,00,000	2,00,000	1,00,000	1,60,000
	1,76,00,000	98,00,000	51,00,000	1,48,00,000
Assets				
Investments :				
60,000 shares in Delhi Ltd.	70,00,000	—	—	—
20,000 shares in Amritsar Ltd	22,00,000	—	—	—
10,000 shares in Amritsar Ltd.	—	10,00,000	—	—
Shares in Kanpur Ltd. @ ₹ 120	72,00,000	36,00,000	12,00,000	—
Fixed Assets	—	40,00,000	30,00,000	1,40,00,000
Current Assets	2,00,000	12,00,000	9,00,000	8,00,000
	1,76,00,000	98,00,000	51,00,000	1,48,00,000

Balance in General Reserve Account and Profit & Loss Account, when shares were purchased in different companies were:

	Mumbai Ltd.	Delhi Ltd.	Amritsar Ltd.	Kanpur Ltd.
General Reserve Account	20,00,000	4,00,000	2,00,000	12,00,000
Profit & Loss Account	12,00,000	4,00,000	1,00,000	1,20,000

Required :

Prepare the consolidated Balance Sheet of the group as at 31st December, 2010 (Calculations may be rounded off to the nearest rupee).

Answer

Consolidated Balance Sheet of Mumbai Ltd. and
its subsidiaries Delhi Ltd., Amritsar Ltd. and Kanpur Ltd. as at 31st December, 2010

Liabilities	₹	Assets	₹
Share Capital	1,00,00,0000	Goodwill	12,75,000
(Fully paid shares of ₹ 100 each)		Fixed Assets	2,10,00,000
Minority Interest	62,50,625	Current Assets	31,00,000
General Reserve	51,02,083		
Profit and Loss Account	29,62,292		
Sundry Creditors	11,60,000		
	2,53,75,000		2,53,75,000

Working Notes:

(i) Analysis of profits of Kanpur Ltd.

	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
General Reserve on the date of purchase of shares	12,00,000		
Profit and Loss A/c on the date of purchase of shares	1,20,000		
Increase in General Reserve		8,00,000	
Increase in profit			5,20,000
	13,20,000	8,00,000	5,20,000
Less : Minority Interest (1/6)	1,10,000	1,33,333	86,667
	11,00,000	6,66,667	4,33,333
Share of Mumbai Ltd. (1/2)	6,60,000	4,00,000	2,60,000
Share of Delhi Ltd. (1/4)	3,30,000	2,00,000	1,30,000
Share of Amritsar Ltd. (1/12)	1,10,000	66,667	43,333

(ii) Analysis of profits of Amritsar Ltd.

	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
General Reserve on the date of purchase of shares	2,00,000		
Profit and Loss A/c on the date of purchase of shares	1,00,000		
Increase in General Reserve		3,00,000	
Increase in Profit and Loss A/c			4,00,000
Share in Kanpur Ltd.		66,667	43,333
	3,00,000	3,66,667	4,43,333
Less : Minority Interest (1/4)	75,000	91,667	1,10,833
	2,25,000	2,75,000	3,32,500
Share of Mumbai Ltd. (1/2)	1,50,000	1,83,333	2,21,667
Share of Delhi Ltd. (1/4)	75,000	91,667	1,10,833

(iii) Analysis of profits of Delhi Ltd.

	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
General Reserve on the date of purchase of shares	4,00,000		
Profit and Loss A/c on the date of purchase of shares	4,00,000		
Increase in General Reserve		4,00,000	
Increase in Profit and Loss A/c			4,00,000
Share in Kanpur Ltd.		2,00,000	1,30,000
Share in Amritsar Ltd.		91,667	1,10,833
	8,00,000	6,91,667	6,40,833
Less : Minority Interest (1/4)	2,00,000	1,72,917	1,60,208
Share of Mumbai Ltd. (3/4)	6,00,000	5,18,750	4,80,625

(iv) Cost of control

		₹
Investments in		
Delhi Ltd.	70,00,000	
Amritsar Ltd.	32,00,000	
Kanpur Ltd.	1,20,00,000	
	2,22,00,000	

Paid up value of investments in			
Delhi Ltd.		60,00,000	
Amritsar Ltd.		30,00,000	
Kanpur Ltd.		1,00,00,000	
Capital profits in			(1,90,00,000)
Delhi Ltd.		6,00,000	
Amritsar Ltd.		2,25,000	
Kanpur Ltd.		11,00,000	(19,25,000)
Goodwill			12,75,000
(v) Minority interest			
Share Capital:			
Delhi Ltd. (1/4)	20,00,000		
Amritsar Ltd. (1/4)	10,00,000		
Kanpur Ltd (1/6)	20,00,000		50,00,000
Share in profits & reserves			
(Pre and Post-Acquisitions)			
Delhi Ltd.	5,33,125		
Amritsar Ltd.	2,77,500		
Kanpur Ltd.	4,40,000		12,50,625
			62,50,625
(vi) General Reserve — Mumbai Ltd.			
Balance as on 31.12.2010 (given)			40,00,000
Share in			
Delhi Ltd.			5,18,750
Amritsar Ltd.			1,83,335
Kanpur Ltd.			4,00,000
			51,02,083
(vii) Profit and Loss Account — Mumbai Ltd.			
Balance as on 31.12.2010 (given)			20,00,000
Share in			
Delhi Ltd.			4,80,625
Amritsar Ltd.			2,21,667
Kanpur Ltd.			2,60,000
			29,62,292

Question 6

A Limited is a holding company and B Limited and C Limited are subsidiaries of A Limited. Their Balance Sheets as on 31.12.2010 are given below:

	A Ltd.	B Ltd.	C Ltd.		A Ltd.	B Ltd.	C Ltd.
	₹	₹	₹		₹	₹	₹
Share Capital	3,00,000	3,00,000	1,80,000	Fixed Assets	60,000	1,80,000	1,29,000
Reserves	1,44,000	30,000	27,000	Investments			
Profit & Loss Account	48,000	36,000	27,000	Shares in B Ltd.	2,95,000		
C Ltd. Balance	9,000			Shares in C Ltd.	39,000	1,59,000	
Sundry Creditors	21,000	15,000		Stock in Trade	36,000		
A Ltd. Balance		21,000		B Ltd. Balance	24,000		
				Sundry Debtors	78,000	63,000	96,000
				A Ltd. Balance			9,000
	5,22,000	4,02,000	2,34,000		5,22,000	4,02,000	2,34,000

The following particulars are given:

(i) The Share Capital of all companies is divided into shares of ₹ 10 each.

(ii) A Ltd. held 24,000 shares of B Ltd. and 3,000 shares of C Ltd.

(iii) B Ltd. held 12,000 shares of C Ltd.

(iv) All these investments were made on 30.6.2010.

(v) On 31.12.2009, the position was as shown below:

	B Ltd.	C Ltd.
	₹	₹
Reserve	24,000	22,500
Profit & Loss Account	12,000	9,000
Sundry Creditors	15,000	3,000
Fixed Assets	1,80,000	1,29,000
Stock in Trade	12,000	1,06,500
Sundry Debtors	1,44,000	99,000

(vi) 10% dividend is proposed by each company.

(vii) The whole of stock in trade of B Ltd. as on 30.6.2010 (₹ 12,000) was later sold to A Ltd. for ₹13,200 and remained unsold by A Ltd. as on 31.12.2010.

(viii) Cash-in-transit from B Ltd. to A Ltd. was ₹ 3,000 as at the close of business.

You are required to prepare the Consolidated Balance Sheet of the group as on 31.12.2010.

Answer

Consolidated Balance Sheet of A Ltd.
and its subsidiaries B Ltd. and C Ltd.as on 31st December, 2010

Liabilities	Amount ₹	Assets		Amount ₹
Share Capital	3,00,000	Goodwill		16,575
Minority Interest	1,13,460	Fixed Assets		3,69,000
Reserves	1,47,975	Stock in Trade	36,000	
Profit & Loss Account	32,940	Less: Provision for		
Sundry Creditors	36,000	unrealised	1,200	34,800
Proposed Dividend	30,000	profit		2,37,000
		Sundry Debtors		
		Cash in Transit		
		(24,000 – 21,000)		3,000
	6,60,375			6,60,375

Working Notes:

(1) Position on 30.06.2010

	Reserves	Profit and Loss Account
B Ltd.	₹	₹
Balance on 31.12.2010	30,000	36,000
Less: Balance on 31.12.2009	24,000	12,000
Increase during the year	6,000	24,000
Estimated increase for half year	3,000	12,000
Balance on 30.06.2010	27,000 (24,000+3,000)	24,000 (12,000 + 12,000)
C Ltd.		
Balance on 31.12.2010	27,000	27,000
Balance on 31.12.2009	22,500	9,000
Increase during the year	4,500	18,000
Estimated increase for half year	2,250	9,000
Balance on 30.06.2010	24,750 (22,500+2,250)	18,000 (9,000 + 9,000)

(2) Analysis of Profits of C Ltd.

	Capital Profit	Revenue Reserve	Revenue profit
	₹	₹	₹
Reserves on 30.6.2010	24,750		
Profit and Loss A/c on 30.6.2010	18,000		
Increase in reserves		2,250	
Increase in profit			6,000
	42,750	2,250	6,000

Less: Minority interest (1/6)	7,125	375	1,500
	35,625	1,875	7,500
Share of A Ltd. (1/6)	7,125	375	1,500
Share of B Ltd. (4/6)	28,500	1,500	6,000

(3) Analysis of Profits of B Ltd.

	Capital Profit	Revenue Reserve	Revenue profit
	₹	₹	₹
Reserves on 30.6.2010	27,000		
Profit and Loss A/c on 30.6.2010	24,000		
Increase in reserves		3,000	
Increase in profit			12,000
Share in C Ltd.		1,500	6,000
	51,000	4,500	18,000
Less: Minority interest (2/10)	10,200	900	3,600
Share of A Ltd. (8/10)	40,800	3,600	14,400

(4) Cost of control

	₹	₹
Investments in		
B Ltd.	2,85,000	
C Ltd.	1,98,000	
		4,83,000
Paid up value of investments in		
B Ltd.	2,40,000	
C Ltd.	1,50,000	
		(3,90,000)
Capital profits in		
B Ltd.	40,800	
C Ltd.	(35,625)	
		(76,425)
Goodwill		16,575

(5) Minority Interest

	₹	₹
Share Capital:		
B Ltd.	60,000	
C Ltd.	30,000	90,000
Share in profits and reserves		

(Pre and Post-Acquisitions)		
B Ltd.	14,700	
C Ltd.	9,000	23,700
		1,13,700
Less: Provision for unrealized profit		
(20% of ₹ 1,200)		240
		1,13,460

(6) Reserves – A Ltd.

	₹
Balance as on 31.12.2010 (given)	1,44,000
Share in	
B Ltd.	3,600
C Ltd.	375
	1,47,975

(7) Profit and Loss Account – A Ltd.

	₹
Balance as on 31.12.2010 (given)	48,000
Share in	
B Ltd.	14,400
C Ltd.	1,500
	63,900
Less: Proposed dividend (10% of ₹ 3,00,000)	30,000
Provision for unrealised profit on stock	960
80% of (₹ 13,200 – ₹ 12,000)	
	32,940

Note: The above solution has been done by direct method. Alternatively, students may follow indirect method. In indirect method, the share in pre-acquisition profits of B Ltd. in C Ltd. amounting ₹ 28,500 will be included as capital profit while analysing the profits of B Ltd. and will not be considered for the purpose of cost of control. Thus, in this case, the amounts of goodwill and minority interest will increase by ₹ 5,700 (2/10 of ₹ 28,500). Goodwill and minority interest will be shown at ₹ 22,275 and ₹ 1,19,160 respectively in the consolidated balance sheet. Therefore, the total of the assets and liabilities side of the consolidated balance sheet will be ₹ 6,66,075.

Question 7

On 31st March, 2010 Bee Ltd. became the holding company of Cee Ltd. and Dee Ltd. by acquiring 900 lakhs fully paid shares in Cee Ltd. for ₹ 13,500 lakhs and 480 lakhs fully paid shares in Dee Ltd. for ₹ 4,320 lakhs. On that date, Cee Ltd. showed a balance of ₹ 5,100 lakhs in General Reserve and a credit balance of ₹ 1,800 lakhs in Profit and Loss Account. On the same date, Dee Ltd. showed a debit balance of ₹ 720 lakhs in Profit and Loss Account. While its Preliminary Expenses Account showed a balance of ₹ 60 lakhs.

After one year, on 31st March, 2011 the Balance Sheets of three companies stood as follows:

(All amounts in lakhs of Rupees)

Liabilities	Bee Ltd.	Cee Ltd.	Dee Ltd.
Fully paid equity shares of ₹ 10 each	54,000	15,000	6,000
General Reserve	66,000	6,300	–
Profit and Loss Account	18,000	2,400	1,500
15 lakh fully paid 9.5%			
Debentures of ₹ 100 each	–	–	3,000
Loan from Cee Ltd.	–	–	150
Bills Payable	–	–	300
Sundry Creditors	28,200	5,400	1,860
	1,66,200	29,100	12,810

(All amounts in lakhs of Rupees)

Assets	Bee Ltd.	Cee Ltd.	Dee Ltd.
Machinery	78,000	15,000	4,200
Furniture and Fixtures	12,000	3,000	1,200
Investments:			
900 lakhs shares in Cee Ltd.	13,500	–	–
480 lakhs shares in Dee Ltd.	4,320	–	–
6 lakhs debentures in Dee Ltd.	588	–	–
Stocks	33,000	6,000	3,000
Sundry Debtors	18,000	2,700	2,580
Cash and Bank balances	6,402	2,100	1,800
Loan to Dee Ltd.	–	180	–
Bills Receivable	390	120	–
Preliminary Expenses	–	–	30
	1,66,200	29,100	12,810

The following points relating to the above mentioned Balance Sheets are to be noted:

(i) All the bills payable appearing in Dee Ltd.'s Balance Sheet were accepted in favour of Cee Ltd. out of which bills amounting to ₹ 150 lakhs were endorsed by Cee Ltd. in favour of Bee Ltd. and bills amounting to ₹ 90 lakhs had been discounted by Cee Ltd. with its bank.

(ii) On 29th March, 2011 Dee Ltd. remitted ₹ 30 lakhs by means of a cheque to Cee Ltd. to return part of the loan; Cee Ltd. received the cheque only after 31st March, 2011.

(iii) Stocks with Cee Ltd. includes goods purchased from Bee Ltd. for ₹ 400 lakhs. Bee Ltd. invoiced the goods at cost plus 25%.

(iv) In August, 2010 Cee Ltd. declared and distributed dividend @ 10% for the year ended 31st March, 2010. Bee Ltd. credited the dividend received to its Profit and Loss Account.

You are required to prepare a Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2011.

Answer

Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2011

Liabilities		₹ in lakhs	Assets		₹ in lakhs
Share Capital			Fixed Assets		
Authorised		?	Goodwill (W.N. 3)		492
Issued and subscribed			Machinery		97,200
Fully paid equity shares of ₹ 10 each		54,000	Furniture and Fixtures		16,200
Minority interest (W.N. 2)		10,974	Current Assets, Loans and Advances:		
Reserves and Surplus			(A) Current Assets		
General Reserve (W.N. 4)		66,720	Stock	42,000	
Profit and Loss A/c (W.N.4)		20,080	Less: Unrealised profit	80	41,920
Secured Loans			Sundry debtors		23,280
Debentures		2,400	Cash and bank balances		10,302
Current Liabilities			Cash in transit		30
Acceptances	300		(B) Loan and Advances		
Less: Mutual owing	210	90	Bills receivable	510	
Sundry creditors		35,460	Less: Mutual owing (W.N.5)	210	300
		1,89,724			1,89,724

Working Notes:

(1) Calculation of pre and post acquisition profits of subsidiaries:

(₹ in lakhs)

			Post-acquisition	
		Pre-acquisition capital profit	General Reserve	Profit/Loss A/c
Cee Ltd.				
General Reserve (Cr.)		5,100	1,200	
Profit and Loss A/c (Cr.)	1,800			

(–) Dividend	1,500	300		2,100
		5,400	1,200	2,100
Holding (60%)		3,240	720	1,260
Subsidiary (40%)		2,160	480	840

(₹ in lakhs)

		Post-acquisition	
	Pre-acquisition capital profit	Preliminary expenses	Profit / Loss A/c
Dee Ltd.			
Profit and Loss A/c (Cr.)	(720)		2,220
Preliminary expenses (Dr.)	(60)	30	
(–) Dividend	(780)	30	2,220
Holding (80%)	(624)	24	1,776
Subsidiary (20%)	(156)	6	444

(2) Minority Interest

(₹ in lakhs)

Cee Ltd.				
Share capital			6,000	
Capital profit		2,160		
Revenue General Reserve		480		
Profit/Loss		840	3,480	9,480
Dee Ltd.				
Share capital			1,200	
Capital profit		(156)		
Revenue profit (Cr.)	444			
Add: Preliminary expenses written off	6	450	294	1,494
				10,974

(3) Cost of Control (₹ in lakhs)

Cee Ltd.		
Investment	13,500	
Less: Dividend received and wrongly credited to Profit and Loss	900	12,600

Less: Paid-up share capital (60%)	9,000		
Capital profit	3,240	12,240	360
Dee Ltd.			
Investment in Shares	4,320		
in debentures	588	4,908	
Less: Paid-up share capital (80%)	4,800		
Nominal value of debentures	600		
Capital profit	(624)	4,776	132
Goodwill			492

(4) Consolidated General Reserve and Profit and Loss Account

	General Reserve	Profit and Loss A/c
Bee Ltd.	66,000	18,000
Less: Wrong dividend credited	–	900
	66,000	17,100
Cee Ltd.	720	1,260
Dee Ltd. (1,776 + 24)	–	1,800
	66,720	20,160
Less: Unrealised profit on stock	–	80
	66,720	20,080

(5) Mutual owing regarding bills = ₹ (300 – 90) lakhs = ₹ 210 lakhs.

(6) Unrealised profit = $\left(400 \times \frac{25}{125}\right)$ lakhs = ₹ 80 lakhs

(7) Amount of dividend wrongly credited to Profit and Loss A/c = 60% of ₹ 1,500 lakhs = ₹ 900 lakhs.

Question 8

The following are the Balance Sheets of Arun Ltd., Brown Ltd. and Crown Ltd. as at 31.12.2010:

Liabilities:	Arun Ltd.	Brown Ltd.	Crown Ltd.
	₹	₹	₹
Share Capital (Shares of ₹100 each)	10,80,000	7,20,000	4,32,000
Reserves	1,44,000	72,000	54,000
Profit and Loss Account	3,60,000	2,16,000	1,80,000

Sundry Creditors	1,44,000	1,80,000	1,08,000
Arun Ltd.	–	72,000	57,600
Total	17,28,000	12,60,000	8,31,600
Assets:			
Goodwill	1,44,000	1,08,000	72,000
Fixed Assets	5,04,000	3,60,000	4,32,000
Shares in:			
Brown Ltd. (5,400 Shares)	6,48,000	–	–
Crown Ltd. (720 Shares)	1,08,000	–	–
Crown Ltd. (2,520 Shares)	–	3,74,000	–
Due from: Brown Ltd.	86,400	–	–
Crown Ltd.	57,600	–	–
Current Assets	1,80,000	4,17,600	3,27,000
Total	17,28,000	12,60,000	8,31,000

(i) All shares were acquired on 1.7.2010.

(ii) On 1.1.2010 the balances to the various accounts were as under:

Particulars	Arun Ltd.	Brown Ltd.	Crown Ltd.
	₹	₹	₹
Reserves	72,000	72,000	36,000
Profit and Loss account	36,000	(Dr.) 36,000	21,600

(iii) During 2010, Profits accrued evenly.

(iv) In August, 2010, each company paid interim dividend of 10%. Arun Ltd. and Brown Ltd. have credited their profit and loss account with the dividends received.

(v) During 2010, Crown Ltd. sold an equipment costing ₹ 72,000 to Brown Ltd. for ₹ 86,400 and Brown Ltd. in turn sold the same to Arun Ltd. for ₹ 93,600.

Prepare the consolidated Balance Sheet as at 31.12.2010 of Arun Ltd. and its subsidiaries.

Answer

Consolidated Balance Sheet of Arun Ltd. and its subsidiaries as on 31.12.2010

Liabilities	₹	Assets	₹
Share Capital (Shares of ₹ 100 each)	10,80,000	Goodwill (W. N. 5)	3,25,800
Minority Interest (W. N. 4)	4,20,712	Fixed Assets	12,74,400
Reserves (W. N. 8)	1,49,438	Current Assets	9,25,200

Profit & Loss A/c (W. N. 8)	4,57,650	Cash in Transit (W. N. 7)	14,400
Sundry Creditors	4,32,000		
	25,39,800		25,39,800

Working Notes

1. Shareholding Pattern

	Number of Shares	%age of Holding
In Brown Ltd.:		
Arun Ltd.	5,400	75%
Minority Interest	1,800	25%
In Crown Ltd.:		
Arun Ltd.	720	16.667%
Brown Ltd.	2,520	58.333%
Minority Interest	1,080	25%

2. Analysis of apportionment of profit in Crown Ltd.

(a) Calculation of Unrealized Profit in Equipment

Crown Ltd sold equipment to Brown Ltd. at a profit of ₹ 14,400 and this would be apportioned to

	₹
Arun Ltd.	2,399
Brown Ltd.	8,401
Minority Interest	3,600
	14,400

Brown Ltd sold the equipment to Arun Ltd. at a profit of ₹ 7,200. This would be apportioned to:

	₹
Arun Ltd.	5,400
Minority Interest	1,800
	7,200

The above amounts are to be deducted from the respective share of profits.

(b) Reserves

	₹	
Closing balance	54,000	
Opening balance	36,000	Capital Profit
Current year Appropriation	18,000	
Apportionment of Profit from 1.1.2010 to 30.6.2010	9,000	Capital Profit
Apportionment of Profit from 1.7.2010 to 31.12.2010	9,000	Revenue Reserve

(c) Profit and Loss Account

Closing balance	1,80,000	
Opening balance	21,600	Capital Profit
Current year profits before interim dividend	2,01,600	
Apportionment of Profit from 1.1.2010 to 30.6.2010	1,00,800	
Less: Interim Dividend	43,200	
	57,600	Capital Profit
From 1.7.2010 to 31.12.2010	1,00,800	Revenue Profit

(d) Apportionment of profits of Crown Ltd.

	Pre-Acquisition	**Post Acquisition**	
	Capital Profit	Revenue Reserve	Revenue Profit
	₹	₹	₹
Reserves	45,000	9,000	—
Profit & Loss Account	79,200	--	1,00,800
	1,24,200	9,000	1,00,800
Arun Ltd [16.667%]	20,700	1,499	16,799
Brown Ltd. [58.333%]	72,450	5,251	58,801
Minority Interest [25%]	31,050	2,250	25,200

3. Analysis of Profit of Brown Ltd

(a) Reserves

	₹	
Closing balance	72,000	
Opening balance	72,000	(Capital Profit)
Current year Appropriation	Nil	

(b) Profit and Loss Account

	₹
Closing balance	2,16,000
Opening balance (Dr.)	36,000
Current year Appropriation after interim dividend	2,52,000
Interim Dividend	72,000

Profit before Interim Dividend	3,24,000
Less: Dividend from Crown Ltd.	25,200
	2,98,800
Apportionment of Profit from 1.1.2010 to 30.6.2010	1,49,400
Less: Interim Dividend	72,000
Capital profit	77,400
Apportionment of Profit from 1.7.2010 to 31.12.2010 (Revenue profit)	1,49,400

(c) Apportionment of Profit of Brown Ltd.

	Pre-Acquisition	**Post-Acquisition**	
	Capital Profit	Revenue Reserve	Revenue Profit
	₹	₹	₹
Reserves	72,000	—	—
Profit & Loss Account			
(Opening balance (-) 36,000 + 77,400)	41,400		1,49,400
Less: Unrealised Profit of Equipment from Crown Ltd.			(8,401)
Share of Post-Acquisition Profit of Crown Ltd.	--	5,251	58,801
	1,13,400	5,251	1,99,800
Arun Ltd. 75%	85,050	3,938	1,49,850
Minority Interest 25%	28,350	1,312	49,950

4. Minority Interest

	Brown Ltd.	Crown Ltd.
	₹	₹
Share Capital	1,80,000	1,08,000
Capital Profit	28,350	31,050
Revenue: Reserves	1,312	2,250
Profit & Loss Account	49,950	25,200
Unrealised Profit on Equipment	(1,800)	(3,600)
	2,57,812	1,62,900

Total Minority Interest: ₹ 2,57,812+ ₹ 1,62,900 = ₹ 4,20,712

5. Cost of Control

	Arun Ltd. in Brown Ltd.	Arun Ltd. in Crown Ltd.	Brown Ltd in Crown Ltd.
	₹	₹	₹
Amount Invested	6,48,000	1,08,000	3,74,400
Less: Pre-acquisition dividend*	54,000	7,200	25,200
Adjusted Cost of Investment (A)	5,94,000	1,00,800	3,49,200
Share capital	5,40,000	72,000	2,52,000
Capital Profit	85,050	20,700	72,450
	6,25,050	92,700	3,24,450
(B)			
Capital Reserve/Goodwill (A)-(B)	(31,050)	8,100	24,750
Net Goodwill	₹ 1,800		

Goodwill on Consolidation ₹ (1,44,000+ 1,08,000+72,000+1,800) = ₹ 3,25,800

6. Dividend declared

	Brown Ltd.	Crown Ltd.
	₹	₹
Dividend declared	72,000	43,200
Share of: Arun Ltd.	54,000	7,200
Brown Ltd.		25,200
Minority	18,000	10,800

7. Inter-Company Transactions

(a) Owings

	Dr.	Cr.	Cr.
	Arun Ltd.	Brown Ltd.	Crown Ltd.
	₹	₹	₹
Balance in books	1,44,000	72,000	57,600
Less: Inter- co. owings	1,29,600	72,000	57,600
Cash-in-transit	14,400	NIL	NIL

* The entire amount of interim dividend of 10 % has been treated as pre-acquisition dividend.

(b) Fixed Assets

	₹
Total Fixed Assets	12,96,000
Less: Unrealised Profit on sale of equipment	21,600
Amount to be taken to consolidated Balance Sheet	12,74,400

8. Reserves and Profit and Loss Account balances in the Consolidated Balance Sheet

	Reserves	Profit and Loss A/c
	₹	₹
Balance in Books	1,44,000	3,60,000
Add: Shares of Post Acquisition Profits:		
From Brown Ltd.	3,938	1,49,850
From Crown Ltd	1,499	16,799
Less: Pre-Acquisition dividend:		
From Brown Ltd.		(54,000)
From Crown Ltd		(7,200)
Less: Unrealised Profit on Equipment:		
From Brown Ltd.		(5,400)
From Crown Ltd.		(2,399)
	1,49,437	4,57,650

Question 9

The draft Balance Sheets of 3 Companies as at 31st March, 2011 are as below:

(In ₹ 000's)

Liabilities	Morning Ltd.	Evening Ltd.	Night Ltd.
Share Capital – shares of ₹ 100 each	1,00,000	50,000	25,000
Reserves	4,500	2,500	2,250
P/L A/c (1.4.10)	3,750	5,000	2,000
Profit for 2010-11	17,500	9,500	4,500
Loan from Morning Ltd.	–	12,500	–-
Creditors	6,250	2,500	3,500
	1,32,000	82,000	37,250

Assets

Investments:

4,00,000 shares in Evening	45,000	–	–
1,87,000 shares in Night	20,000	–	–
Loan to Evening Ltd.	12,500	–	–
Sundry assets	54,500	82,000	37,250
	1,32,000	82,000	37,250

Following additional information is also available:

(a) Dividend is proposed by each company at 10%.

(b) Stock transferred by Night Ltd. to Evening Ltd. fully paid for was ₹ 20 lacs on which the former made a Profit of ₹ 7.5 lacs. On 31st March, 2011, this was in the inventory of the latter.

(c) Loan referred to is against 8% interest. Neither Morning Ltd. nor Evening Ltd. has considered the interest.

(d) Reserves as on 1.4.2010 of Evening Ltd. and Night Ltd. were ₹ 20,00,000 and ₹ 18,75,000 respectively.

(e) Cash-in-transit from Evening Ltd. to Morning Ltd. was ₹ 2,50,000 as on 31.3.2011.

(f) The shares of the subsidiaries were all acquired by Morning Ltd. on 1st April, 2010.

Prepare consolidated Balance Sheet as on 31st March, 2011. Workings should be part of the answer.

Answer

Consolidated Balance Sheet of Morning Ltd. with its subsidiaries Evening Ltd. and Night Ltd.

As on 31st March, 2011

(₹ in thousand)

Liabilities	₹	₹	₹	**Assets**	₹	₹	₹
Share Capital			1,00,000	Sundry Assets*			
Minority Interest				Morning Ltd.		54,500	
Evening Ltd.		12,200		Evening Ltd.	82,000		
Night Ltd.		7,812.50	20,012.50	Less:			
				Unrealized profit	750	81,250	

* The total of Sundry Assets of the Group mutually sets off the effect of Cash-in-transit of Rs.2.5 lakhs from Evening Ltd. to Morning Ltd. Hence, cash in transit has not been separately shown.

Capital Reserve [Refer Note 5]			2,256.25	Night Ltd.	37,250	1,73,000
General Reserve						
Morning Ltd.		4,500				
Evening Ltd.		400				
Night Ltd.		281.25	5,181.25			
Profit & Loss A/c						
Balance on 1.04.10	3,750					
Profit during 10-11	17,500					
Add: Interest on Loan	1,000					
	22,250					
Less: Proposed dividend	10,000	12,250				
Add: P& L Account of Evening Ltd.		6,800				
Add: P& L Account of Night Ltd		2,625	21,675			
Creditors						
Morning Ltd.		6,250				
Evening Ltd.		2,500				
Night Ltd		3,500	12,250			
Proposed Dividend						
Morning Ltd.		10,000				
Evening Ltd. (Minority)		1,000				
Night Ltd. (Minority)		625	11,625			
			1,73,000			
						1,73,000

Workings Notes:

A. Morning Ltd.'s holding in Evening Ltd. is 4,00,000 shares out of 5,00,000 shares, i.e., 4/5th or 80%; Minority holding 1/5th or 20%.

B. Morning Ltd.'s holding in Night Ltd. is 1,87,500 shares out of 2,00,000 shares, i.e., 3/4th or 75%; Minority holding 1/4th or 25%.

Analysis of Reserves and Profits of Subsidiary Companies

		Evening Ltd. (₹'000)	Night Ltd ₹('000)	Minority interest in Evening Ltd. (1/5) ₹('000)	Minority interest in Night Ltd. (1/4) ₹('000)
1.	**Capital Reserve (pre-acquisition reserves and profits)**				
	Reserves on 1.04.2010	2,000	1,875		
	Profit on 1.04.2010	5,000	2,000		
		7,000	3,875		
	Less: Minority interest	1,400	968.75	1,400	968.75
		5,600	2,906.25		
2.	**General Reserve**				
	Reserves as per Balance Sheet	2,500	2,500		
	Less: Capital Reserve [See Note A]	2,000	1,875		
		500	375		
	Less: Minority interest	100	93.75	100	37.5
		160	281.25		
3.	**Profit and Loss Account**				
	Profit for the year as per Balance Sheet	9,500	4,500		
	Less: Interest on Loan (12,500 × 8%)	1,000			
		8,500			
	Less: Minority Interest	1,700	1,125	1,750	1,125
		6,800	3,375		
	Less: Unrealised profit on stock transfer		750*		
		6,800	2,625		

* As per para 17 of AS 21, 'Unrealised profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full.

4. **Share Capital**

As per Balance sheet	50,000	25,000		
Less: Minority interest	10,000	6,250	10,000	6,250
Transferred for computation of Goodwill/Capital Reserve	40,000	18,750	13,200	8,437.50
Less: Proposed dividend shown separately			1,000	625
Transferred to Consolidated Balance Sheet			12,200	7,812.50

5. **Computation of Cost of Control i.e. Goodwill / Capital Reserve on consolidation**

(₹ in thousand)

	Evening Ltd.	Night Ltd.
Cost of Investments	45,000	20,000
Less: Paid up value of shares [Refer Note 4]	40,000	18,750
	5,000	1,250
Less: Capital Reserve [Refer Note 1]	5,600	2,906.25
	(500)	(1,656.25)
Total Capital Reserve (₹ 600 + ₹ 1,656.25)	2,256.25	

Question 10

Astha Ltd. acquired 80% of both classes of shares in Birat Ltd. on 1.4.2010. The draft Balance Sheets of two companies on 31st March, 2011 were as follows:

(₹ in 000's)

Liabilities	Astha Ltd.	Birat Ltd.	Assets	Astha Ltd.	Birat Ltd.
Share Capital:					
Equity shares of ₹10 each, full paid up	4,500	900	Plant & machinery	3,090	900
14% Preference shares of ₹100 each, fully paid up	-	600	Furniture & fixtures	900	810
General reserve	2,850	60	Investments		
			in equity shares of Birat Ltd.	2,880	-
Profit and loss account	2,400	1,080	in preference shares of Birat Ltd.	480	-

Creditors	450	480	Stock	1,020	606
			Debtors	840	474
			Cash at bank	990	330
	10,200	3,120		10,200	3,120

Note:

Contingent liability – Astha Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – ₹ 2,32,500.

Additional Information:

(i) General reserve balance of Birat Ltd. was the same as on 1.4.2010.

(ii) The balance in Profit and Loss A/c of Birat Ltd. on 1.4.2010 was ₹ 4,80,000, out of which dividend of 16% p.a. on the Equity capital of ₹ 9,00,000 was paid for the year 2009-10.

(iii) The dividend in respect of preference shares of Birat Ltd. for the year 2010-11 was still payable as on 31.3.2011.

(iv) Astha Ltd. credited its Profit and Loss A/c for the dividend received by it from Birat Ltd. for the year 2009-10.

(v) Sundry creditors of Astha Ltd. included an amount of ₹ 1,80,000 for purchases from Birat Ltd., on which the later company made a loss of ₹ 15,000.

(vi) Half of the above goods were still with the closing stock of Astha Ltd. as at 31.3.2011.

(vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%. There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.

(viii) The directors of Astha Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31st March, 2011, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer.

Answer

Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd.

as at 31st March 2011

(₹ in '000s)

Liabilities	Amount	Assets		Amount
Share capital:		Goodwill (W.N.5)		1,632
4,50,000 Equity shares of		Plant and machinery		
₹ 10 each fully paid up	4,500.00	Astha Ltd.	3,090	
Minority interest (W.N.4)	540.60	Birat Ltd. (W.N.7)	1,125	4,215

General reserves		2,850.00	Furniture and fixtures		
Profit and loss A/c (W.N.6)		2,841.90	Astha Ltd.	900	
Creditors			Birat Ltd. (W.N. 8)	648	1,548
Astha Ltd.	450.0		Stock		
Birat Ltd.	480.0		Astha Ltd.	1,020	
	930.0		Birat Ltd.	606	
Less: Mutual owings	180.0	750.0		1,626.	
			Add: Unrealised loss	7.5	1,633.50
			Debtors		
			Astha Ltd.	840	
			Birat Ltd.	474	
				1,314	
			Less: Mutual owings	180	1,134.00
			Cash at Bank		
			Astha Ltd.	990	
			Birat Ltd.	330	1,320.00
		11,482.50			11,482.50

Contingent liability: Claim against damages lodged by a contractor against Astha Ltd. is pending in a law suit ₹ 232.5 thousands (W.N. 9).

Working Notes:

1. Calculation of capital profits (pre-acquisition) (₹ in '000s)

General reserve balance as on 1-4-2010		60.00
Profit and loss account balance as on 1-4-2010	480	
Less: Dividend at 16% p.a. on ₹ 6,00,000 for the year 2009-10	144	336.00
		396.00
Add: Profit on revaluation of plant and machinery (W.N.7)		300.00
		696.00
Less: Loss on revaluation of furniture and fixtures (W.N.8)		180.00
		516.00
Share of Astha Ltd. (80%)		412.80
Share of Minority Interest (20%)		103.20

2. Calculation of revenue profits (post-acquisition) (₹ in '000s)

Profits during the year 2010-11 (1,080 – 336)	744.00

Less: Preference dividend for the year 2010-11 @ 14% on ₹ 6,00,000	84.00
	660.00
Less: Under charging of depreciation on plant and machinery due to upward revaluation (₹ 3,00,000 × 25%)	75.00
	585.00
Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (₹ 1,80,000 × 10%)	18.00
	603.00
Share of Astha Ltd. (80%)	482.40
Share of Minority Interest (20%)	120.60

3. Calculation of dividend on preference shares of Birat Ltd. (₹ in '000s)

Dividend on preference shares (₹ 4,00,000 × 14%)		84.00
Share of Astha Ltd.	(80%)	67.20
Share of Minority Interest	(20%)	16.80
		84.00

4. Calculation of Minority Interest (₹ in '000s)

Equity share capital (20%)	180.00
Preference share capital (20%)	120.00
Share of capital profits (W.N. 1)	103.20
Share of Revenue profit (W.N.2)	120.60
Share of preference dividend (W.N.3)	16.80
	540.60

5. Calculation of Cost of Control - Goodwill (₹ in '000s)

Investment by Astha Ltd. in		
Equity shares of Birat Ltd.	2,880.00	
Less: Dividend received for 2009-10 (900 × 80% 16%)	115.20	2,764.80
Preference shares		480.00
		3,244.80
Less: Paid up value of		
Equity shares (80%)	720.00	
Preference shares (80%)	480.00	
Share in Capital Profit (W.N. 1)	412.80	1,612.80
Goodwill		1,632.00

6. Calculation of Consolidated Profit and Loss A/c

		(₹ in '000s)
Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2010		2,400.00
Add:	Revenue profit from Birat Ltd (W.N. 2)	482.40
	Preference dividend of Birat Ltd. (W.N. 3)	67.20
	Share of unrealised loss on stock (₹ 15,000 × 50%)	7.50
		2,957.10
Less:	Dividend wrongly credited	115.20
		2,841.90

7. Value of Plant and Machinery of Birat Ltd.

		(₹ in '000s)
Value as on 1.04.10 (900 × 100/75)		1,200.00
Add: Appreciation on revaluation (25%)		300.00
Revalued figure		1,500.00
Less: Depreciation		
Already charged (1200-900)	300.00	
Due to upward revaluation (300 × 25%)	75.00	(375.00)
		1,125.00

8. Value of Furniture and Fixtures of Birat Ltd.

		(₹ in '000s)
Value as on 1.4.2010 (810 × 100/90)		900.00
Less: Diminution on revaluation (20%)		(180.00)
Revalued Figure		720.00
Less: Depreciation already charged (900 - 810)	90.00	
Less: Depreciation written back due to downward revaluation (180 × 10%)	(18.00)	
		(180.00)
		648.00

9. Contingent liability:

As per para 68 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability." Therefore, it would not be correct to ignore the contingent liability.

4

Valuation of Shares, Goodwill and Business

Question 1

The Balance Sheets of R Ltd. for the years ended on 31.3.2009, 31.3.2010 and 31.3.2011 are as follows:

	31.3.2009	31.3.2010	31.3.2011
Liabilities	₹	₹	₹
3,20,000 Equity Shares of ₹ 10 each fully paid	32,00,000	32,00,000	32,00,000
General Reserve	24,00,000	28,00,000	32,00,000
Profit and Loss Account	2,80,000	3,20,000	4,80,000
Creditors	12,00,000	16,00,000	20,00,000
	70,80,000	79,20,000	88,80,000
Assets	₹	₹	₹
Goodwill	20,00,000	16,00,000	12,00,000
Building and Machinery (Less: Depreciation)	28,00,000	32,00,000	32,00,000
Stock	20,00,000	24,00,000	28,00,000
Debtors	40,000	3,20,000	8,80,000
Bank Balance	2,40,000	4,00,000	8,00,000
	70,80,000	79,20,000	88,80,000

Actual valuation were as under:	**31.3.2009**	**31.3.2010**	**31.3.2011**
	₹	₹	₹
Building and Machinery	36,00,000	40,00,000	44,00,000
Stock	24,00,000	28,00,000	32,00,000
Net Profit (including opening balance) after writing off depreciation and goodwill, tax provision and transfer to General Reserve	8,40,000	12,40,000	16,40,000

Capital employed in the business at market values at the beginning of 2008–2009 was ₹ 73,20,000, which included the cost of goodwill. The normal annual return on Average Capital employed in the line of business engaged by R Ltd. is 15%.

The balance in the General Reserve account on 1st April, 2008 was ₹ 20 lakhs.

The goodwill shown on 31.3.2009 was purchased on 1.4.2008 for ₹ 20,00,000 on which date the balance in the Profit and Loss Account was ₹ 2,40,000. Find out the average capital employed each year.

Goodwill is to be valued at 5 years purchase of super profits (Simple average method). Also find out the total value of the business as on 31.3.2011.

Answer

Note:

1. Since goodwill has been paid for, it is taken as part of capital employed. Capital employed at the end of each year is shown below.
2. Assumed that the building and machinery figure as revalued is after considering depreciation.

	31.3.2009	31.3.2010	31.3.2011
	₹	₹	₹
Goodwill	20,00,000	16,00,000	12,00,000
Building and Machinery (revalued)	36,00,000	40,00,000	44,00,000
Stock (revalued)	24,00,000	28,00,000	32,00,000
Debtors	40,000	3,20,000	8,80,000
Bank Balance	2,40,000	4,00,000	8,00,000
Total Assets	82,80,000	91,20,000	1,04,80,000
Less: Creditors	12,00,000	16,00,000	20,00,000
Closing Capital	70,80,000	75,20,000	84,80,000
Opening Capital	73,20,000	70,80,000	75,20,000
	1,44,00,000	1,46,00,000	1,60,00,000
Average Capital	72,00,000	73,00,000	80,00,000

Maintainable profit has to be found out after making adjustments as given below:

	31.3.2009	31.3.2010	31.3.2011
	₹	₹	₹
Net Profit as given	8,40,000	12,40,000	16,40,000
Less: Opening Balance	2,40,000	2,80,000	3,20,000
	6,00,000	9,60,000	13,20,000
Add: Under valuation of closing stock	4,00,000	4,00,000	4,00,000
	10,00,000	13,60,000	17,20,000
Less: Adjustment for valuation in opening stock	—	4,00,000	4,00,000
	10,00,000	9,60,000	13,20,000
Add: Goodwill written-off	—	4,00,000	4,00,000
	10,00,000	13,60,000	17,20,000
Add: Transfer to Reserves	4,00,000	4,00,000	4,00,000
	14,00,000	17,60,000	21,20,000
Less: 15% Normal Return	10,80,000	10,95,000	12,00,000
Super Profit	3,20,000	6,65,000	9,20,000

Average super profits = (₹3,20,000 + ₹6,65,000 + ₹9,20,000) / 3

= 19,05,000/ 3 = ₹ 6,35,000

Goodwill = 5 years purchase = ₹ 6,35,000 × 5 = ₹ 31,75,000.

	₹
Total Net Assets (31/3/2002)	84,80,000
Less: Goodwill	12,00,000
	72,80,000
Add: Goodwill	31,75,000
Value of Business	1,04,55,000

Question 2

Find out the average capital employed of ND Ltd. from its Balance sheet as at 31st March, 2011:

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
Share Capital:		Fixed Assets:	
Equity shares of ₹10 each	50.00	Land and buildings	25.00
9% Pref. shares fully paid up	10.00	Plant and machinery	80.25
Reserve and Surplus:		Furniture and fixture	5.50
General reserve	12.00	Vehicles	5.00
Profit and Loss	20.00	Investments	10.00
Secured loans:		Current Assets:	
16% debentures	5.00	Stock	6.75
16% Term loan	18.00	Sundry Debtors	4.90
Cash credit	13.30	Cash and bank	10.40
Current Liabilities and Provisions:		Preliminary expenses	0.50
Sundry creditors	2.70		
Provision for taxation	6.40		
Proposed dividend on:			
Equity shares	10.00		
Preference shares	0.90		
	148.30		148.30

Non-trade investments were 30% of the total investments.

Balances as on 1.4.2010 to the following accounts were:

Profit and Loss account ₹ 10.70 lakhs, General reserve ₹ 7.50 lakhs.

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	18.00	
Cash Credit	13.30	
Sundry Creditors	2.70	
Provision for Taxation	6.40	45.40
Capital Employed as on 31.03.2006		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 X 50 %	12.35
Average capital employed		87.05

Question 3

The Balance Sheets of X Ltd. are as follows:

(₹ in lakhs)

Liabilities	As at 31.3.2010	As at 31.3.2011
Share Capital	1,000.00	1,000.00
General Reserve	800.00	850.00
Profit and Loss Account	120.00	175.00
Term Loans	370.00	330.00
Sundry Creditors	70.00	90.00
Provision for Tax	22.50	25.00
Proposed Dividend	200.00	250.00
	2,582.50	2,720.00

Assets		
Fixed Assets and Investments (Non-trade)	1,600.00	1,800.00
Stock	550.00	600.00
Debtors	340.00	220.00
Cash and Bank	92.50	100.00
	2,582.50	2,720.00

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.2010 ₹ 2,200 lakhs and on 31.3.2011 ₹ 2,532.8 lakhs.
2. Current cost of stock on 31.3.2010 ₹ 670 lakhs and on 31.3.2011 ₹ 750 lakhs.
3. Non-trade investments in 10% government securities ₹ 490 lakhs.
4. Debtors include foreign exchange debtors amounting to $ 70,000 recorded at the rate of $ 1 = ₹ 43.50 but the closing exchange rate was $ 1 = ₹ 47.50.
5. Creditors include foreign exchange creditors amounting to $ 1,20,000 recorded at the rate of $ 1 = ₹ 42.50 but the closing exchange rate was $ 1 = ₹ 47.50.
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 the profit and loss account. This expenditure is not likely to recur.
8. Tax rate 35%.
9. Normal rate of return is expected at 14%.

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

Answer

(₹ 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	2,200.00	2,532.80
Current cost of stock	670.00	750.00
Debtors	340.00	222.80
Cash and Bank	92.50	100.00
	3,302.50	3,605.60
Less: Outside Liabilities:		
Term loans	370.00	330.00
Sundry creditors	70.00	96.00
Tax provision	22.50	25.00
	462.50	451.00
Capital Employed	**2,840.00**	**3,154.60**

	Average Capital Employed at current value = $\frac{2,840.0 + 3,154.6}{2}$ =		2,997.30
(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 × (47.50 – 42.5)]	6.00	
	Subsidy	120.00	
			175.00
			535.00
	Add: Exchange gain on debtors [0.7 lakhs × (47.5 – 43.5)]	2.80	
	R & D costs	247.00	
	Stock adjustment	30.00	
			279.80
	Adjusted pre-tax profit		814.80
	Less: Tax @ 35%		285.18
	Future maintainable profit		529.62

Valuation of Goodwill

		(₹ in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{529.62}{0.14}\right)$	3,783.00
	Less: Average Capital Employed	2,997.30
	Goodwill	785.70
(2)	Super Profit Method	
	Future Maintainable Profit	529.62
	Normal Profit @ 14% on average capital employed	419.62
	Goodwill	110.00

Under capitalisation 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

Question 4

On the basis of the following information, calculate the value of goodwill of Gee Ltd. at three years' purchase of super profits, if any, earned by the company in the previous four completed accounting years.

Balance Sheet of Gee Ltd. as at 31st March, 2011

Liabilities	₹ in lakhs	Assets	₹ in lakhs
Share Capital:		Goodwill	1,240
Authorised	30,000	Land and Buildings	7,400
Issued and Subscribed		Machinery	15,040
20 crore equity shares of		Furniture and Fixtures	4,060
₹10 each, fully paid up	20,000	Patents and Trade Marks	128
Capital Reserve	1,040	9% Non-trading Investments	2,400
General Reserve	10,172	Stock	3,492
Surplus i.e. credit balance of		Debtors	2,456
Profit and Loss (appropriation) A/c	1,908	Cash in hand and at Bank	2,184

Trade Creditors	2,272	Preliminary Expenses	80
Provision for Taxation (net)	88		
Proposed Dividend for 2009-2010	3,000		
	38,480		38,480

The profits before tax of the four years have been as follows:

Year ended 31st March	Profit before tax in lakhs of Rupees
2007	12,760
2008	10,000
2009	12,432
2010	11,600

The rate of income tax for the accounting year 2006-2007 was 40%. Thereafter it has been 38% for all the years so far. But for the accounting year 2010-2011 it will be 35%.

In the accounting year 2006-2007, the company earned an extraordinary income of ₹ 4 crore due to a special foreign contract. In August, 2007 there was an earthquake due to which the company lost property worth ₹ 200 lakhs and the insurance policy did not cover the loss due to earthquake or riots.

9% Non-trading investments appearing in the above mentioned Balance Sheet were purchased at par by the company on 1st April, 2008.

The normal rate of return for the industry in which the company is engaged is 20%. Also note that the company's shareholders, in their general meeting have passed a resolution sanctioning the directors an additional remuneration of ₹ 200 lakhs every year beginning from the accounting year 2010-2011.

Answer

(1) Capital employed as on 31st March, 2011

(Refer to 'Note')

		₹ in lakhs
Land and Buildings		7,400
Machinery		15,040
Furniture and Fixtures		4,060
Patents and Trade Marks		128
Stock		3,492
Debtors		2,456
Cash in hand and at Bank		2,184
		34,760
Less: Trade creditors	2,272	
Provision for taxation (net)	88	2,360
		32,400

(2) Future maintainable profit **(Amounts in lakhs of rupees)**

	2006-07	2007-08	2008-09	2009-2010
	₹	₹	₹	₹
Profit before tax	12,760	10,000	12,432	11,600
Less: Extra-ordinary income due to foreign contract	400			
Add: Loss due to earthquake		200		
Less: Income from non-trading investments			216	216
	12,360	10,200	12,216	11,384

As there is no trend, simple average profits will be considered for calculation of goodwill.

Total adjusted trading profits for the last four years = ₹ (12,360 + 10,200 + 12,216 + 11,384)
= ₹ 46,160 lakhs

	₹ in lakhs	
Average trading profit before tax = $\left(\frac{₹\ 46{,}160 \text{ lakhs}}{4}\right)$	11,540	
Less: Additional remuneration to directors	200	
Less: Income tax @ 35% (approx.)	3,969	(Approx)
	7,371	

(3) Valuation of goodwill on super profits basis

Future maintainable profits	7,371
Less: Normal profits (20% of ₹ 32,400 lakhs)	6,480
Super Profits	891

Goodwill at 3 years' purchase of super profits = 3 x ₹ 891 lakhs = ₹ 2,673 lakhs

Note:

In the above solution, goodwill has been calculated on the basis of closing capital employed (i.e. on 31st March, 2011). Goodwill should be calculated on the basis of 'average capital employed' and not 'actual capital employed' as no trend is being observed in the previous years' profits. The average capital employed cannot be calculated in the absence of details about profits for the year ended 31st March, 2011. Since the current year's profit has not been given in the question, goodwill has been calculated on the basis of capital employed as on 31st March, 2011.

Question 5

The following Balance Sheet of X Ltd. is given:

X Ltd.

Balance Sheet as on 31st March, 2011

Liabilities	₹	Assets	₹
9,000 shares of ₹ 100 each fully paid	90,00,000	Goodwill	7,20,000
		Land and building at cost	57,60,000
Bank overdraft	33,48,000	Plant and machinery at cost	50,40,000
Creditors	37,98,000	Stock	57,60,000
Provision for taxation	9,18,000	Debtors considered good	36,00,000
Profit and Loss Appropriation A/c	38,16,000		
	2,08,80,000		2,08,80,000

In 2002 when the company commenced operation the paid up capital was same. The Loss/Profit for each of the last 5 years was – years 2006-2007 – Loss (₹ 9,90,000); 2007-2008 ₹ 17,67,600; 2008-2009 ₹ 21,06,000; 2009-2010 ₹ 26,10,000; 2010-2011 ₹ 30,60,000;

Although income-tax has so far been paid @ 40% and the above profits have been arrived at on the basis of such tax rate, it has been decided that with effect from the year 2010-2011 the Income-tax rate of 45% should be taken into consideration. 10% dividend in 2007-2008 and 2008-2009 and 15% dividend in 2009-2010 and 2010-2011 have been paid. Market price of shares of the company on 31st March, 2011 is ₹ 125. With effect from 1st April, 2011 Managing Director's remuneration has been approved by the Government to be ₹ 14,40,000 in place of ₹ 10,80,000. The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at ₹ 7,20,000 per annum for the next five years.

Ascertain goodwill at 3 year's purchase of super profit (for calculation of future maintainable profit weighted average is to be taken).

Answer

(i) **Future Maintainable Profit**

Year	Profit (P) ₹	Weight (W)	Product (PW) ₹
2007-2008	17,67,600	1	17,67,600
2008-2009	21,06,000	2	42,12,000
2009-2010	26,10,000	3	78,30,000
2010-2011	30,60,000	4	1,22,40,000
		10	2,60,49,600

Weighted average annual profit (after tax) = $\frac{\sum PW}{\sum W} = ₹\ \frac{2,60,49,600}{10} = \underline{26,04,960}$

Weighted average annual profit before tax $\left(₹\ 26{,}04{,}960 \times \frac{100}{60}\right)$	43,41,600
Less: Increase in Managing Director's remuneration	3,60,000
	39,81,600
Add: Saving in cost of materials	7,20,000
	47,01,600
Less: Taxation @ 45%	21,15,720
Future maintainable profit	25,85,880

(ii) **Average Capital Employed**

		₹	₹
Assets:			
Land and Buildings			57,60,000
Plant and Machinery			50,40,000
Stock			57,60,000
Sundry Debtors			36,00,000
			2,01,60,000
Less: Outside liabilities:			
	Bank overdraft	33,48,000	
	Creditors	37,98,000	
	Provision for taxation	9,18,000	80,64,000
Capital employed at the end of the year			1,20,96,000
Add: Dividend @ 15% paid during the year			13,50,000
			1,34,46,000
Less: Half of the profit (after tax) for the year i.e.			
	₹ 30,60,000× ½		15,30,000
Average capital employed			1,19,16,000

(iii) **Normal Profit**

Average dividend for the last 4 years $\left(\frac{10+10+15+15}{4}\right)$ = 12.5%

Market price of share ₹ 125

Normal rate of return = $\frac{12.5}{125} \times 100 = 10\%$

Normal profit (10% of ₹ 1,19,16,000) = ₹ 11,91,600

(iv) Valuation of goodwill

	₹
Future maintainable profit	25,85,880
Less: Normal profit	11,91,600
Super profit	13,94,280
Goodwill at 3 years' purchase of super profits (₹ 13,94,280 × 3)	41,82,840

Question 6

The following is the extract from the Balance Sheets of Popular Ltd.:

Liabilities	As at 31.3.2010 ₹ in lakhs	As at 31.3.2011 ₹ in lakhs	Assets	As at 31.3.2010 ₹ in lakhs	As at 31.3.2011 ₹ in lakhs
Share capital	1,500	1,500	Fixed assets	1,650	1,950
General reserve	1,200	1,275	10% investment	750	750
Profit and Loss account	180	270	Stock	780	900
18% term loan	540	495	Debtors	510	330
Sundry creditors	105	135	Cash at bank	138	135
Provision for tax	33	39	Fictitious assets	30	24
Proposed dividend	300	375			
	3,858	4,089		3,858	4,089

Additional information:

(i) Replacement values of Fixed assets were ₹ 3,300 lakhs on 31.3.10 and ₹ 3,750 lakhs on 31.3.2011 respectively.

(ii) Rate of depreciation adopted on fixed assets was 5% p.a.

(iii) 50% of the stock is to be valued at 120% of its book value.

(iv) 50% of investments were trade investments.

(v) Debtors on 31st March, 2011 included foreign debtors of $35,000 recorded in the books at ₹35 per U.S. Dollar. The closing exchange rate was $ 1= ₹39.

(vi) Creditors on 31st March, 2011 included foreign creditors of $60,000 recorded in the books at $ 1 = ₹33. The closing exchange rate was $ 1 = ₹39.

(vii) Profits for the year 2010-11 included ₹ 180 lakhs of government subsidy which was not likely to recur.

(viii) ₹ 375 lakhs of Research and Development expenditure was written off to the Profit and Loss Account in the current year. This expenditure was not likely to recur.

(ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.

(x) Tax rate during 2010-11 was 50%, effective future tax rate will be 40%.

(xi) Normal rate of return expected is 15%.

One of the directors of the company Arvind, fears that the company does not enjoy a goodwill in the prevalent market circumstances. Critically examine this and establish whether Popular Co. has or has not any goodwill. If your answers were positive on the existence of goodwill, show the leverage effect it has on the company's result. Industry average return was 12% on long-term funds and 15% on equity funds.

Answer

1. Calculation of Capital employed (CE)

		₹ in lakhs
	As on 31.3.10	As on 31.3.11
Replacement Cost of Fixed Assets	3,300.00	3,750.00
Trade Investment (50%)	375.00	375.00
Current cost of stock		
$390 + 390 \times \frac{120}{100}$	858.00	
$450 + 450 \times \frac{120}{100}$		990.00
Debtors	510.00	334.20
Cash-at-Bank	138.00	135.00
Total (A)	5,181.00	5,584.20
Less: Outside Liabilities		
18% term loan	540.00	495.00
Sundry creditors	105.00	145.80
Provision for tax	33.00	39.00
Total (B)	678.00	679.80
Capital employed (A-B)	4,503.00	4,904.40

Average Capital employed at current value = $\frac{\text{CE as on 31.3.2010} + \text{CE as on 31.3.2011}}{2}$

$= \frac{4,503 + 4,904.40}{2} = 4,703.70$ Lakhs

2. Future Maintainable Profit

	₹ in Lakhs
Increase in General Reserve	75
Increase in Profit and Loss Account	90

Proposed Dividends		375	
Profit After Tax		540	
Pre-Tax Profit = $\frac{540}{1-0.5}$			1,080
Less:	Fictitious Assets written off (30 –24)	6.00	
	Non-Trading investment income (10% of ₹375)	37.50	
	Subsidy	180.00	
	Exchange Loss on creditors [0.6 lakhs × (117-99)]	10.80	
	Additional Depreciation on increase in value of Fixed Assets (current year) (3,750 – 1,950 = $1{,}800\times\frac{5}{100}$) i.e.,	90.00	324.30
			755.70
Add:	Exchange Gain on Debtors [0.35 lakhs × (117-105)]	4.20	
	Research and development expenses written off	375.00	
	Stock Adjustment (90-78)	12.00	391.20
			1,146.90
Add:	Expected increase of 10%		114.69
Future Maintainable Profit before Tax			1,261.59
Less:	Tax @ 40% (40% of Rs1,261.59)		504.63
Future Maintainable Profit			756.95

3. Valuation of Goodwill — ₹ in lakhs

(i) According to Capitalisation of Future Maintainable Profit Method

Capitalised value of Future Maintainable Profit		
= $\frac{768.84}{15}\times 100$		5,049.39
Less:	Average capital employed	4,703.70
Value of Goodwill		345.69

Or

(ii) According to Capitalisation of Super Profit Method — ₹ In lakhs

Future Maintainable Profit		756.95
Less:	Normal Profit @ 15% on average capital employed (4,703.70 ×15%)	705.56

Super Profit	51.39
Capitalised value of super profit $\frac{51.39}{15}\times 100$ i.e. Goodwill	342.60

Goodwill exists, hence director's fear is not valid.

Leverage Effect on Goodwill

₹ in lakhs

Future Maintainable Profit on equity fund		756.95
Future Maintainable Profit on Long-term Trading Capital employed		
Future Maintainable Profit After Tax	756.95	
Add: Interest on Long-term Loan (Term Loan)		
(After considering Tax) $495\times 18\% = 89.1\times \frac{50}{100}$	44.55	712.40
Average capital employed (Equity approach)		4,703.70
Add: 18% Term Loan (540+495)/2		517.50
Average capital employed (Long-term Fund approach)		5,221.20

Value of Goodwill

(A) Equity Approach

Capitalised value of Future Maintainable Profit = $\frac{756.96}{15} x 100$ =	5,046.39
Less: Average capital employed	4,703.70
Value of Goodwill	342.69

(B) Long-Term Fund Approach

Capitalised value of Future Maintainable Profit = $\frac{801.51}{12}\times 100 =$	6,679.25
Less: Average capital employed	5,221.20
Value of Goodwill	1,458.05

Comments on Leverage effect of Goodwill:

Adverse Leverage effect on goodwill is 371.79 lakhs (i.e., ₹486.02-114.23). In other words, Leverage Ratio of Popular Ltd. is low as compared to industry for which its goodwill value has been reduced when calculated with reference to equity fund as compared to the value arrived at with reference to long term fund.

Working Notes:

(1)	Stock adjustment	₹ in lakhs
(i)	Excess current cost of closing stock over its Historical cost (990 –9300)	90.00
(ii)	Excess current cost of opening stock over its Historical cost (858-780)	78.00
(iii)	Difference [(i– ii)]	12.00

(2)	Debtors' adjustment	
(i)	Value of foreign exchange debtors at the closing exchange rate ($1,05,000×39)	40.95
(ii)	Value of foreign exchange debtors at the original exchange rate ($1,05,000×35)	36.75
(iii)	Difference [(i) – (ii)]	4.20
(3)	Creditors' adjustment	
(i)	Value of foreign exchange creditors at the closing exchange rate ($1,80,000×39)	70.20
(ii)	Value of foreign exchange creditors at the original exchange rate($1,80,000×33)	59.40
(iii)	Difference [(i) – (ii)]	10.80

Question 7

The Balance Sheet of Domestic Ltd. as on 31st March, 2011 is as under:

(All figures are in lacs)

Liabilities		₹	Assets	₹
Equity Shares ₹10 each		1,500	Goodwill	372
Reserves (including provision for taxation of ₹150 lacs)		500	Premises and Land at cost	200
5% Debentures		1,000	Plant and Machinery	1,500
Secured Loans		100	Motor Vehicles	20
Sundry Creditors		150	(purchased on 1.10.10)	
Profit & Loss A/c			Raw materials at cost	460
Balance from previous B/S	16		Work-in-progress at cost	65

Profit for the year (After taxation)	550	566	Finished Goods at cost	90
			Book Debts	200
			Investment (meant for replacement of Plant and Machinery)	800
			Cash at Bank and Cash in hand	96
			Discount on Debentures	5
			Underwriting Commission	8
		3,816		3,816

The resale value of Premises and Land is ₹ 600 lacs and that of Plant and Machinery is ₹ 1,200 lacs. Depreciation @ 20% is applicable to Motor Vehicles. Applicable depreciation on Premises and Land is 2%, and that on Plant and Machinery is 10%. Market value of the Investments is ₹750 lacs. 10% of book debts is bad. In a similar company the market value of equity shares of the same denomination is ₹25 per share and in such company dividend is consistently paid during last 5 years @ 20%. Contrary to this, Domestic Ltd. is having a marked upward or downward trend in the case of dividend payment.

Past 5 years' profits of the company were as under:

2005-06		₹33.50 lacs
2006-07	(-)	₹652.50 lacs (loss)
2007-08		₹234.50 lacs
2008-09		₹273.00 lacs
2009-10		₹202.50 lacs

The unusual negative profitability of the company during 2006-07 was due to the lock out in the major manufacturing unit of the company which happened in the beginning of the second quarter of the year 2005-06 and continued till the last quarter of 2006-07.

Value the Goodwill of the Company on the basis of 4 years' purchase of the Super Profit. (Necessary assumption for adjustment of the Company's inconsistency in regard to the dividend payment, may be made by the examinee).

Answer

1. Calculation of capital employed

Present value of assets:	₹ (in lacs)
Premises and land	600
Plant and machinery	1,200
Motor vehicles (book value less depreciation for ½ year)	18

Raw materials		460
Work-in-progress		65
Finished goods		90
Book debts (400 x 90%)		180
Investments		750
Cash at bank and in hand		96
		3,459
Less: Liabilities:		
Provision for taxation	600	
5% Debentures	1,000	
Secured loans	100	
Sundry creditors	150	1,400
Total capital employed on 31.3.11		2,059

2. Profit available for shareholders for the year 2010-11

Profit for the year as per Balance Sheet		550
Less: Depreciation to be considered		
Premises and land	12	
Plant & machinery	120	
Motor vehicles	2	134
		416
Less: Bad debts		20
Profit for the year 2010-11		396

3. Average capital employed

Total capital employed	2,059
Less: ½ of profit for the current year [Refer point 2]	198
Average capital employed	1,861

₹ (in lacs)

4. Average profit to determine Future Maintainable Profits

Profit for the year 2010-11	396.00	

Profit for the year 2009-10	202.50	
Profit for the year 2008-09	273.00	
Profit for the year 2007-08	234.50	
	1,106 / 4	276.50

5. Calculation of General Expectation:

Domestic Ltd. pays ₹ 2 as dividend (20%) for each share of ₹10.

Market value of equity shares of the same denomination is ₹25 which fetches dividend of 20%.

Therefore, share of ₹10 (Face value of shares of Domestic Ltd.) is expected to fetch (20/25)x10 = 8% return.

Since Domestic Ltd. is not having a stable record in payment of dividend, in its case the expectation may be assumed to be slightly higher, say 10%.

6.	**Calculation of super profit**	₹ (in lacs)
	Future maintainable profit [See point 4]	276.50
	Normal profit (10% of average capital employed as computed in point 3)	186.10
	Super Profit	89.50
7.	Valuation of Goodwill	
	Goodwill at 4 years' purchase of Super Profit	361.60

Notes:

(1) It is evident from the Balance Sheet that depreciation was not charged to Profit & Loss Account.

(2) It is assumed that provision for taxation already made is sufficient.

(3) While considering past profits for determining average profit, the years 2005-06 and 2006-07 have been left out, as during these years normal business was hampered.

Question 8

Yogesh Ltd. showed the following performance over 5 years ended 31st March, 2011:

Ended 31st March	*Net profit before tax		Prior period adjustment	Remarks
	₹		₹	
2007	4,00,000	(–)	1,00,000	Relating to 2005-06
2008	3,50,000	(–)	2,50,000	Relating equally to 2005-06 and 2006-07
2009	6,50,000	(+)	1,50,000	Relating to 2007-08
2010	5,50,000	(–)	1,75,000	Relating to 2007-08

2011	6,00,000	(–)	1,00,000	Relating to 2007-08
		(+)	25,000	Relating to 2009-2010

*Net profit before tax is after debiting or crediting the figures of loss (–) or Gains (+) mentioned under the columns for prior period adjustments.

The net worth of the business as per the balance sheet of 31st March, 2006 is ₹ 6,00,000 backed by 10,000 fully paid equity shares of ₹ 10 each. Reserves and surplus constitute the balance net worth. Yogesh Ltd. has not declared any dividend till date.

You are asked to value equity shares on:

(a) Yield basis as on 31.3.2011 : Assuming:

(i) 40% rate of tax

(ii) anticipated after tax yield of 20%.

(iii) differential weightage of 1 to 5 being given for the five years starting on 1.4.2006 for the actual profits of the respective years.

(b) Net asset basis as per corrected balance sheets for each of the six years ended 31.3.2011.

Looking to the performance of the company over the 5 years period, would you invest in the company?

Answer

(a) Valuation of Shares on Yield basis

as on 31st March, 2011

Year ended 31st March	Profits as given	Adjustments Increase	Adjustments Decrease	Revised Profits	Tax Provision	After tax Profits	Weight	Weighted profits
	₹	₹	₹	₹	₹	₹		₹
2007	4,00,000	1,00,000	1,25,000	3,75,000	1,50,000	2,25,000	1	2,25,000
2008	3,50,000	2,50,000	1,00,000	4,75,000	1,90,000	2,85,000	2	5,70,000
		1,50,000	1,75,000					
2009	6,50,000	Nil	1,50,000	5,00,000	2,00,000	3,00,000	3	9,00,000
2010	5,50,000	1,75,000	Nil	7,50,000	3,00,000	4,50,000	4	18,00,000
		25,000						
2011	6,00,000	1,00,000	25,000	6,75,000	2,70,000	4,05,000	5	20,25,000
							15	55,20,000

Weighted average profit (after tax) = $\frac{₹\ 55,20,000}{15}$ = ₹ 3,68,000

Value of business = $\frac{₹\ 3,68,000}{20\%}$ = ₹ 18,40,000

Value of equity share = $\frac{₹\ 18,40,000}{10,000}$ = ₹ 184

(b) **Valuation of Shares on Net Asset Basis**

(i) Revised Net worth as on 31st March, 2006

	₹	₹
Net worth		6,00,000
Less: Adjustments since made during		
2006-07	1,00,000	
2007-08	1,25,000	
	2,25,000	
Less: Relief from tax @ 40%	90,000	
		1,35,000
		4,65,000

(ii) Net asset value (No. of shares = 10,000)

As on 31st March		₹	₹
2006:	Revised net worth	4,65,000	
	Value per share		46.50
2007:	Revised net worth as on 31.3.2006	4,65,000	
	Add: After tax revised profits of 2006-07	2,25,000	
	Net worth as on 31.3.2007	6,90,000	
	Value per share		69.00
2008:	Revised net worth as on 31.3.2007	6,90,000	
	Add: After tax revised profits of 2007-08	2,85,000	
	Net worth as on 31.3.2008	9,75,000	
	Value per share		97.50
2009:	Revised net worth as on 31.3.2008	9,75,000	
	Add: After tax revised profits of 2008-09	3,00,000	
	Net worth as on 31.3.2009	12,75,000	
	Value per share		127.50
2010:	Revised net worth as on 31.3.2009	12,75,000	

	Add: After tax revised profits of 2009-10	4,50,000	
	Net worth as on 31.3.2010	17,25,000	
	Value per share		172.50
2011:	Revised net worth as on 31.3.2010	17,25,000	
	Add: After tax revised profits of 2010-11	4,05,000	
	Net worth as on 31.3.2011	21,30,000	
	Value per share		213.00

Performance Appraisal

Revised net worth as on 31st March		Profit during the year ended 31st March		Return on net worth
	₹		₹	%
2006	4,65,000	1993	2,25,000	48.39
2007	6,90,000	1994	2,85,000	41.30
2008	9,75,000	1995	3,00,000	30.77
2009	12,75,000	1996	4,50,000	35.29
2010	17,25,000	1997	4,05,000	23.48

The company's return has fallen from 48.39% to 23.48%. This may be perhaps due to the fact that the company has been ploughing back its profits without having adequate reinvestment opportunities. Unless the company has profitable investment opportunities, it may not be advisable to invest in the company.

Question 9

Capital structure of Lot Ltd. as at 31.3.2011 as under:

	(₹ in lakhs)
Equity share capital	10
10% preference share capital	5
15% debentures	8
Reserves	4

Lot Ltd. earns a profits 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.

(b) Capital gearing ratio is .75.

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

Lot Ltd. has been regularly paying equity dividend of 10%.
Compute the value per equity share of the company.

Answer

(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
(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 = $\frac{3,48,000}{1,70,000} = 2.05 \text{ times}$

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 = $\frac{13,00,000}{14,00,000} = 0.93 \text{ (approximately)}$

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

(v) Expected yield of equity shares:

	%
Normal return	12.00
Add: For low coverage of fixed interest and fixed dividends (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.

Question 10

The Balance Sheet of RNR Limited as on 31.12.2010 is as follows :

Liabilities	(Rupees in Lakhs)	Assets	(Rupees in Lakhs)
1,00,000 equity shares of ₹ 100 each fully paid	100	Goodwill	50
		Fixed assets	150
1,00,000 equity shares of ₹ 60 each, fully paid up	60	Other tangible assets	50
		Intangible assets (market value)	30
Reserves and Surplus	40		
Liabilities	100	Miscellaneous expenditure to the extent not written off	20
	300		300

Fixed assets are worth ₹ 240 lakhs. Other Tangible assets are revalued at ₹ 30 lakhs. The company is expected to settle the disputed bonus claim of ₹ 1 lakh not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years' purchase of average super-profit for the last 4 years.

After tax, profits and dividend rates were as follows :

Year	PAT (₹ in Lakhs)	Dividend %
2007	30.00	11%
2008	35.00	12%
2009	40.00	13%
2010	41.00	14%

Normal expectation in the industry to which the company belongs is 10%.

Akbar holds 20,000 equity shares of ₹ 100 each fully paid and 10,000 equity shares of ₹ 60 each, fully paid up. He wants to sell away his holdings.

(i) Determine the break-up value and market value of both kinds of shares.

(ii) What should be the fair value of shares, if controlling interest is being sold ?

Answer

(i) Break up value of Re. 10 of share capital $= \dfrac{₹\ 289.80 \text{ lakhs}}{₹\ 160.00 \text{ lakhs}}$

= ₹ 18.10

Break up value of ₹ 100 paid up share = 18.10 × 100 = ₹ 181.00

Break up value of ₹ 60 paid up share = 18.10 × 60 = ₹ 108.60

Market value of shares :

Average dividend = $\left(\dfrac{11\% + 12\% + 13\% + 14\%}{4}\right)$ = 12.5%

Market value of ₹ 100 paid up share = $\dfrac{12.5\%}{10\%}$ × 100 = ₹ 125.00

Market value of ₹ 60 paid up share = $\dfrac{12.5\%}{10\%}$ × 60 = ₹ 75.00

(ii) Break up value of share will remain as before even if the controlling interest is being sold. But the market value of shares will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Average Profit *}}{\text{Paid up value of shares}} \times 100 = \frac{₹\ 34 \text{ lakhs}}{₹\ 160 \text{ lakhs}} \times 100 = 21.25\%$$

Market value of shares :

For ₹ 100 paid up share = $\frac{21.25\%}{10\%} \times 100 =$ ₹ 212.50

For ₹ 60 paid up share = $\frac{21.25\%}{10\%} \times 60 =$ ₹ 127.50

Fair value of shares = $\frac{\text{Breakup value} + \text{Market value}}{2}$

Fair value of ₹ 100 paid up share = $\frac{181.00 + 212.50}{2}$ = ₹ 196.75

Fair value of ₹ 60 paid up share = $\frac{108.60 + 127.50}{2}$ = ₹ 118.05

* (Transfer to reserves has been ignored)

Working Notes:

(₹ in lakhs)

(a) Calculation of average capital employed

Fixed assets		240.00
Other tangible assets		30.00
Intangible assets		30.00
		300.00
Less : Liabilities	100	
Bonus	10	110.00
		190.00
Less : ½ of profits [½ (41 – Bonus 10)]		15.50
Average capital employed		174.50

(b) Calculation of super profit

Average profit	= ¼ (30 + 35 + 40 + 41 – Bonus 10)	
	= ¼ × 136	34.00
Less : Normal profit	= 10 % of ₹ 174.50 lakhs	17.45
Super profit		16.55

(c) Calculation of goodwill

3 Years' purchase of average super-profit = 3 × 16.55 = ₹ 49.65 lakhs

Increase in value of goodwill = ½ (book value + 3 years' super profit)

= ½ (50 + 49.65)

= ₹ 49.825 lakhs

Net assets as revalued including	
book value of goodwill	240.00
Add : Increase in goodwill (rounded-off)	49.80
Net assets available for shareholders	289.80

Question 11

Following are the information of two companies for the year ended 31st March, 2011 :

Particulars	Company A	Company B
Equity Shares of ₹ 100 each	8,00,000	10,00,000
10% Pref. Shares of ₹ 100 each	6,00,000	4,00,000
Profit after tax	3,00,000	3,00,000

Assume the Market expectation is 18% and 80% of the Profits are distributed.

(i) What is the rate you would pay to the Equity Shares of each Company ?

(a) If you are buying a small lot.

(b) If you are buying controlling interest shares.

(ii) If you plan to invest only in preference shares which company's preference shares is better ?

(iii) Would your rates be different for buying small lot, if the company 'A' retains 30% and company 'B' 10% of the profits?

Answer

(i) (a) Buying a small lot of equity shares: If the purpose of valuation is to provide data base to aid a decision of buying a small (non-controlling) position of the equity of the companies, dividend capitalisation method is most appropriate. Under this method, value of equity share is given by:

$$\frac{\text{Dividend per share}}{\text{Market capitalisation rate}} \times 100$$

Company A : ₹ $\frac{24}{18} \times 100$ = ₹ 133.33

Company B : ₹ $\frac{20.8}{18} \times 100$ = ₹ 115.60

(b) Buying controlling interest equity shares

If the purpose of valuation is to provide data base to aid a decision of buying controlling interest in the company, EPS capitalisation method is most appropriate. Under this method, value of equity is given by:

$$\frac{\text{Earning per share(EPS)}}{\text{Market capitalisation rate}} \times 100$$

Company A : ₹ $\frac{30}{18} \times 100$ = ₹ 166.67

Company B : ₹ $\frac{26}{18} \times 100$ = ₹ 144.44

(ii) Preference Dividend coverage ratios of both companies are to be compared to make such decision.

Preference dividend coverage ratio is given by:

$$\frac{\text{Profit after tax}}{\text{Preference Dividend}} \times 100$$

Company A : $\frac{₹\ 3,00,000}{₹\ 60,000} = 5 \text{ times}$

Company B : $\frac{₹\ 3,00,000}{₹\ 40,000} = 7.5 \text{ times}$

If we are planning to invest only in preference shares, we would prefer shares of B Company as there is more coverage for preference dividend.

(iii) Yes, the rates will be different for buying a small lot of equity shares, if the company 'A' retains 30% and company 'B' 10% of profits.

The new rates will be calculated as follows:

Company A : ₹ $\frac{21}{18} \times 100$ = ₹ 116.67

Company B : ₹ $\frac{23.40}{18} \times 100$ = ₹ 130.00

Working Notes:

1. Computation of earnings per share and dividend per share (companies distribute 80% of profits)

	Company A	Company B
Profit before tax	3,00,000	3,00,000
Less: Preference dividend	60,000	40,000
Earnings available to equity shareholders (A)	2,40,000	2,60,000
Number of Equity Shares (B)	8,000	10,000
Earnings per share (A/B)	30.0	26.00
Retained earnings 20%	48,000	52,000

Dividend declared 80% (C)	1,92,000	2,08,000
Dividend per share (C/B)	24.00	20.80

2. Computation of dividend per share (Company A retains 30% and Company B 10% of profits)

Earnings available for Equity Shareholders	2,40,000	2,60,000
Number of Equity Shares	8,000	10,000
Retained Earnings	72,000	26,000
Dividend Distribution	1,68,000	2,34,000
Dividend per share	21.00	23.40

Question 12

The following is the Balance Sheet of N Ltd. as on 31st March, 2011:

Balance Sheet

Liabilities	₹	Assets	₹
Equity shares of ₹ 10 each fully paid		Goodwill	80,000
	8,00,000	Building	4,80,000
13.5% Redeemable preference shares		Machinery	4,40,000
of ₹ 100 each fully paid	4,00,000	Furniture	2,00,000
General Reserve	3,20,000	Vehicles	3,60,000
Profit and Loss Account	64,000	Investments	3,20,000
Bank Loan (Secured against fixed assets)	2,40,000	Stock	2,20,000
Bills Payable	1,20,000	Debtors	3,60,000
Creditors	6,20,000	Bank Balance	64,000
		Preliminary Expenses	40,000
	25,64,000		25,64,000

Further information:

(i) Return on capital employed is 20% in similar businesses.

(ii) Fixed assets are worth 30% more than book value. Stock is overvalued by ₹ 20,000, Debtors are to be reduced by ₹ 4,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.

(iii) Trade investments were purchased on 1.4.2010. 50% of non-Trade Investments were purchased on 1.4.2009 and the rest on 1.4.2008. Non-Trade Investments yielded 15% return on cost.

(iv) In 2008-2009 new machinery costing ₹ 40,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) In 2009-2010 furniture with a book value of ₹ 20,000 was sold for ₹ 12,000.

(vi) For calculating goodwill two years purchase of super profits based on simple average profits of last four years are to be considered. Profits of last four years are as under:

2007-2008 ₹ 3,20,000, 2008-2009 ₹ 3,60,000, 2009-2010 ₹ 4,20,000, 2010-2011 ₹ 4,40,000.

(vii) Additional depreciation provision at the rate of 10% on the additional value of Plant and Machinery alone may be considered for arriving at average profit.

Find out the intrinsic value of the equity share. Income-tax and Dividend tax are not to be considered.

Answer

Calculation of intrinsic value of equity shares of N Ltd.

1. Calculation of Goodwill

(i) Capital employed

Fixed Assets	₹	₹
Building	4,80,000	
Machinery (₹ 4,40,000 + ₹ 29,160)	4,69,160	
Furniture	2,00,000	
Vehicles	3,60,000	
	15,09,160	
Add: 30% increase	4,52,748	
	19,61,908	
Trade investments (₹3,20,000 × 10% × 90%)	28,800	
Debtors (₹ 3,60,000 – ₹ 4,000)	3,56,000	
Stock (₹ 2,20,000 – ₹ 20,000)	2,00,000	
Bank balance	64,000	26,10,708
Less: Outside liabilities		
Bank Loan	2,40,000	
Bills payable	1,20,000	
Creditors	6,20,000	9,80,000
Capital employed		16,30,708

(ii) Future maintainable profit

Calculation of average profit

	2007-08	2008-09	2009-2010	2010-2011
	₹	₹	₹	₹
Profit given	3,20,000	3,60,000	4,20,000	4,40,000
Add: Capital expenditure of machinery charged to revenue	-	40,000	-	-

Loss on sale of furniture	-	-	8,000	-
	3,20,000	4,00,000	4,28,000	4,40,000
Less: Depreciation on machinery		4,000	3,600	3,240
Income from non-trade investments		21,600	43,200	43,200
Reduction in value of stock				1,00,000
Bad debts				4,000
Adjusted profit	3,20,000	3,74,400	3,81,200	3,69,560

	₹
Total adjusted profit for four years (2007-2008 to 2010-2011)	14,45,160
Average profit (₹ 14,45,160/4)	3,61,290
Less: Depreciation at 10% on additional value of machinery	
(4,40,000 + 29,160) × 30/100 i.e. ₹ 1,40,748	14,075
Adjusted average profit	3,47,215

(iii) Normal Profit

20% on capital employed i.e. 20% on ₹ 16,30,708 ₹ 3,26,142

(iv) Super profit

Expected profit – normal profit

₹ 3,47,215 – ₹ 3,26,142 = ₹ 21,073

(v) Goodwill

2 years' purchase of super profit

₹ 21,073 × 2 = ₹ 42,146

2. Net assets available to equity shareholders

	₹	₹
Goodwill as calculated in 1(v) above		42,146
Sundry fixed assets		19,61,908
Trade and Non-trade investments		3,16,800
Debtors		3,56,000
Stock		2,00,000
Bank balance		64,000
		29,40,856

Less: Outside liabilities		
Bank loan	2,40,000	
Bills payable	1,20,000	
Creditors	6,20,000	9,80,000
Preference share capital		4,00,000
Net assets for equity shareholders		15,60,856

3. Valuation of equity shares

Value of equity share = $\frac{\text{Net assets available to equity shareholders}}{\text{Number of equity shares}}$

$= \frac{₹ 15,60,856}{80,000}$

= ₹ 19.51

Note:

1. Depreciation on the overall increased value of assets (worth 30% more than book value) has not been considered. Depreciation on the additional value of only plant and machinery has been considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.
2. Loss on sale of furniture has been taken as non-recurring or extraordinary item.
3. It has been assumed that preference dividend has been paid till date.

Question 13

The Capital Structure of M/s XYZ Ltd., on 31st March, 2011 was as follows:

		₹
Equity Capital	72,000 Shares of ₹ 100 each	72,00,000
12% Preference Capital	20,000 Shares of ₹ 100 each	20,00,000
12% Secured Debentures		20,00,000
Reserves		20,00,000
Profit earned before Interest and Taxes during the year		28,80,000
Tax Rate		40%

Generally the return on equity shares of this type of Industry is 15%.

Subject to:

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

(b) The Debt Equity ratio is at least 2;

(c) Yield on shares is calculated at 60% of distributed profits and 10% of undistributed profits;

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

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

Find out the value of Equity shares of the Company.

Answer

Calculation of profit after tax (PAT)		₹
Profit before interest & tax (PBIT)		28,80,000
Less: Debenture interest (₹ 20,00,000 × 12/100)		2,40,000
Profit before tax (PBT)		26,40,000
Less: Tax @ 40%		10,56,000
Profit after tax (PAT)		15,84,000
Less: Preference dividend $\left(₹\ 20,00,000 \times \frac{12}{100}\right)$	2,40,000	
Equity dividend $\left(₹\ 72,00,000 \times \frac{15}{100}\right)$	10,80,000	13,20,000
Retained earnings (undistributed profit)		2,64,000

Calculation of Interest and Fixed Dividend Coverage

$$= \frac{\text{PAT} + \text{Debenture interest}}{\text{Debenture interest} + \text{Preference dividend}}$$

$$= \frac{₹\ 15,84,000 + 2,40,000}{₹\ 2,40,000 + 2,40,000}$$

$$= \frac{₹\ 18,24,000}{₹\ 4,80,000} = 3.8 \text{ times}$$

Calculation of Debt Equity Ratio

$$\text{Debt Equity Ratio} = \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}}$$

$$= \frac{\text{Debentures}}{\text{Preference share capital} + \text{Equity share capital} + \text{Reserves}}$$

$$= \frac{₹\,20,00,000}{₹\,20,00,000 + 72,00,000 + 20,00,000}$$

Debt Equity Ratio = $\frac{₹\ 20,00,000}{₹\,1,12,00,000} = 0.179$

The ratio is less than the prescribed ratio.

Calculation of Yield on Equity Shares

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

60% of distributed profits (60% of ₹ 10,80,000)	6,48,000
10% of undistributed profits (10% of ₹ 2,64,000)	26,400
	6,74,400

Yields on equity shares $= \frac{\text{Yield on shares}}{\text{Equity share capital}} \times 100$

$= \frac{₹\ 6,74,400}{₹\ 72,00,000} \times 100$

= 9.37%

Calculation of Expected Yield on Equity Shares

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

Value of an Equity Share

$= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid up value of a share}$

$= \frac{9.37}{16} \times 100 =$ ₹ 58.56

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

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

Question 14

The following abridged Balance Sheet as at 31st March, 2011 pertains to Glorious Ltd.

Liabilities	₹ in lakhs	Assets	₹ in lakhs
Share Capital:		Goodwill, at cost	840
360 lakh Equity shares of ₹ 10 each, fully paid up	3,600	Other Fixed Assets	22,332
		Current Assets	5,820
180 lakh Equity shares of ₹ 10 each, ₹ 8 paid up	1,440	Loans and Advances	1,866
		Miscellaneous Expenditure	342
150 lakh Equity shares of ₹ 5 each, fully paid-up	1,500		
Reserves and Surplus	11,256		
Secured Loans	9,000		
Current Liabilities	2,484		
Provisions	1,920		
	31,200		31,200

You are required to calculate the following for each one of the three categories of equity shares appearing in the above mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;

(ii) Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industry is 15%, whereas Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2011 the company has earned ₹ 2,742 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹ ₹ 10 of a Company in the same industry is ₹ 2.

Answer

(i) Intrinsic value on the basis of book values

	₹ in lakhs	₹ in lakhs
Goodwill		840
Other Fixed Assets		22,332
Current Assets		5,820
Loans and Advances		1,866
		30,858
Less: Secured loans	9,000	
Current liabilities	2,484	
Provisions	1,920	13,404
		17,454

Add: Notional call on 180 lakhs equity shares @ ₹ 2 per share	360
	17,814

Equivalent number of equity shares of ₹ 10 each.

	₹ in lakhs
Fully paid shares of ₹ 10 each	360
Partly-paid shares after notional call	180
Fully paid shares of ₹ 5 each, $\left[\frac{₹\ 300\ lakhs}{₹\ 10} \times ₹\ 5\right]$	150
	690

Value per equivalent share of ₹ 10 each = ₹ $\frac{17{,}814 \text{ lakhs}}{690 \text{ lakhs}} =$ ₹ 25.82

Hence, intrinsic values of each equity share are as follows:

Value of fully paid share of ₹ 10 = ₹ 25.82 per equity share.

Value of share of ₹ 10, ₹ 8 paid-up = ₹ 25.82 – ₹ 2 = ₹ 23.82 per equity share.

Value of fully paid share of ₹ 5 = $\frac{₹\ 25.82}{2} =$ ₹ 12.91 per equity share.

(ii) Valuation on dividend yield basis:

Value of fully paid share of ₹ 10 = $\frac{20}{15} \times$ ₹ 10 = ₹ 13.33

Value of share of ₹ 10, ₹ 8 paid-up = $\frac{20}{15} \times$ ₹ 8 = ₹ 10.67

Value of fully paid share of ₹ 5 = $\frac{20}{15} \times 5 =$ ₹ 6.67

(iii) Valuation on the basis of EPS:

Profit after tax = ₹ 2.742 lakhs

Total share capital = ₹ (3.600 + 1,440 + 1,500) lakhs = ₹ 6,540 lakhs

Earning per rupee of share capital = ₹ $\frac{2{,}742\ lakhs}{6{,}540\ lakhs} =$ ₹ 0.419

Earning per fully paid share of ₹ 10 = Re. 0.419 × 10 = ₹ 4.19

Earning per share of ₹ 10 each, ₹ 8 paid-up = Re. 0.419 × 8 = ₹ 3.35

Earning per share of ₹ 5, fully paid-up = Re. 0.419 × 5 = ₹ 2.10

Value of fully paid share of ₹ 10 = ₹ $\frac{4.19}{2} \times 10 =$ ₹ 20.95

Value of share of ₹ 10, ₹ 8 paid-up = ₹ $\frac{3.35}{2} \times 10 =$ ₹ 16.75

Value of fully paid share of ₹ 5 = ₹ $\frac{2.10}{2} \times 10 =$ ₹ 10.50

Question 15

The directors of a public limited company are considering the acquisition of the entire share capital of an existing company X Ltd engaged in a line of business suited to them. The directors feel that acquisition of X will not create any further risk to their business interest.

The following is the Balance Sheet of X Ltd., as at 31st December, 2010:

Liabilities	₹	Assets	₹
Share Capital:		Fixed assets	3,00,000
2,000 equity shares of ₹100 each fully		Current assets:	
paid-up	2,00,000	Stock	1,00,000
General reserve	1,50,000	Sundry debtors	1,70,000
Bank overdraft	1,20,000	Cash and bank balances	50,000
Sundry creditors	1,50,000		
	6,20,000		6,20,000

X's financial records for the past five years were as under:

	2010	2009	2008	2007	2006
	₹	₹	₹	₹	₹
Profits	40,000	37,000	35,000	30,000	31,000
Extra ordinary item(s)	1,750	2,000	(3,000)	(4,000)	500
	41,750	39,000	32,000	26,000	30,500
Dividends	24,000	20,000	20,000	16,000	16,000
	17,750	19,000	12,000	10,000	14,500

Additional information:

(i) There were no changes in the issued capital of X during this period.

(ii) The estimated values of X Ltd.'s assets on 31.12.2010 are:

	Replacement cost	Realisable value
	₹	₹
Fixed assets	4,00,000	2,70,000
Stock	1,50,000	1,60,000

(iii) It is anticipated that 1% of the debtors may prove to be difficult to be realized.

(iv) The cost of capital to the acquiring company is 10%.

(v) The current return of an investment of the acquiring company is 10%. Quoted companies with similar businesses and activities as X have a P/E ratio approximating to 8, although these companies tend to be larger than X.

Required:

Estimate the value of the total equity capital of X Ltd., on 31.12.2010 using each of the following bases:

(a) Balance sheet value

(b) Replacement cost

(c) Realisable value

(d) Gordon's dividend growth model

(e) P/E ratio model.

Answer

			₹	₹
(a)	**Balance Sheet Value**			
	Capital		2,00,000	
	Reserve		1,50,000	3,50,000
(b)	**Replacement cost value**			
	Capital		2,00,000	
	Reserve		1,50,000	
	Appreciation:			
	Fixed assets	1,00,000		
	Stock	50,000	1,50,000	5,00,000
(c)	**Realizable value**			
	Capital		2,00,000	

Reserve	1,50,000	
Appreciation in stock	60,000	
Depreciation in fixed assets	(30,000)	
Book debts (Bad)*	(1,700)	3,78,300

(d) Gordon's dividend growth model

The formula to be used is P= $\frac{E(1-b)}{k-br}$

Where

P	Price of share
E	Earning per share
b	retention ratio
k	cost of capital
br	growth rate
r	rate of return on investment.

Profits retained: ₹17,750+ 19,000 + 12,000+ 10,000 + 14,500 = ₹ 73,250

Profits earned: ₹41,750 + 39,000 + 32,000+ 26,000+30,500 = ₹ 1,69,250

Retention ratio: $\frac{₹\ 73,250}{₹\ 1,69,250} = 0.43$

Return on investment for the year 2010 = $\frac{₹\ 40,000}{2,00,000+1,50,000+\frac{1}{2} of\ 17,750}$ x 100

$= \frac{40,000}{3,58,875} \times 100 = 11.14$

Growth rate = Return on investment x retention ratio

= 11.14 x 0.43 = 4.79 %

Average profits = $\frac{₹\ 1,69,250}{5} = ₹\ 33,850$

Market value =

$$\frac{₹\ 33,850(1-.43)}{0.10-0.0479} = \frac{₹\ 33,850 \times 0.57}{.0521} = ₹\ 3,70,336(approx.)$$

(e) P/E ratio model

Comparable quoted companies have a P/E ratio of 8. X Ltd. is prima facie small company.

If a P/E ratio of 6 is adopted, the valuation will be 40,000 x 6 = ₹ 2,40,000

If a P/E ratio of 7 were to be adopted, the valuation will be 40,000 x 7 = ₹ 2,80,000

5

VALUE ADDED STATEMENT

Question 1

From the following Profit and Loss Account of Kalyani Ltd., prepare a Gross Value Added Statement. Show also the reconciliation between Gross Value Added and Profit before Taxation.

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

Income	Notes		Amount
		(₹ in lakhs)	(₹ in lakhs)
Sales			619.26
Other Income			30.60
			649.86
Expenditure			
Production and Operational Expenses	1	499.71	
Administration Expenses	2	18.36	
Interest and Other Charges	3	24.00	
Depreciation		17.07	599.14
Profit before Taxes			90.72
Provision for taxes			9.00
			81.72
Investment Allowance Reserve Written Back			1.38
Balance as per Last Balance Sheet			4.05
			87.15
Transferred to:			
General Reserve		72.90	
Proposed Dividend		9.00	81.90
Surplus Carried to Balance Sheet			5.25
			87.15

Notes:

(1) Production and Operational Expenses

	(₹ in lakhs)
Increase in Stock	91.50
Consumption of Raw Materials	241.71
Consumption of Stores+	15.90
Salaries, Wages, Bonus and Other Benefits	38.40
Cess and Local Taxes	9.60
Other Manufacturing Expenses	102.60
	499.71

(2) Administration expenses include inter-alia Audit fees of ₹ 3 lakh, Salaries and commission to directors ₹ 6.60 lakhs and Provision for doubtful debts ₹ 7.50 lakhs.

(3) Interest and Other Charges:

	(₹ in lakhs)
On Fixed Loans from Financial Institutions	11.70
Debentures	5.40
On Working Capital Loans from Bank	6.90
	24.00

Answer

Kalyani Ltd.

Value Added Statement for the year ended 31st March, 2011

	₹ in lakhs	₹ in lakhs
Sales		619.26
Less: Cost of bought in material and services:		
Production and operational expenses	451.71	
Administration expenses	11.76	
Interest on working capital loans	6.90	470.37
Value Added by manufacturing and trading activities		148.89
Add: Other income		30.60
Total Value Added		179.49
Application of Value Added:		
To Pay Employees:		
Salaries, Wages, Bonus and other benefits		38.40
To Pay Directors:		
Salaries and Commission		6.60
To Pay Government:		
Cess and Local Taxes	9.60	
Income Tax	9.00	
		18.60
To Pay Providers of Capital:		
Interest on Debentures	5.40	
Interest on Fixed Loans	11.70	
Dividend	9.00	
		26.10
To Provide for maintenance and Expansion of	the company:	
Depreciation	17.07	
General Reserve (72.90 – 1.38)	71.52	
Retained profit (5.25 – 4.05)	1.20	
		89.79
		179.49

Reconciliation Between Total Value Added and Profit Before Taxation:

	(₹ in lakhs)	(₹ in lakhs)
Profit before tax		90.72
Add back:		
Depreciation	17.07	
Salaries, Wages, Bonus and other benefits	38.40	
Directors' Remuneration	6.60	
Cess and Local Taxes	9.60	
Interest on Debentures	5.40	
Interest on Fixed Loans	11.70	88.77
Total Value Added		179.49

Question 2

From the following Profit & Loss Account of Brightex Co. Ltd., prepare a gross value added statement for the year ended 31.12.2011:

Show also the reconciliation between gross value added and profit before taxation.

Profit and Loss Account for the year ended 31.12.2011

	Notes		(₹'000)	
(₹'000)				
Income :				
Sales			31,200	
Other Income			275	
			31,475	
Expenditure:				
Production and operational expenses	1	21,600		
Administration expenses (Factory)	2	900		
Interest & Other charges	3	3,120		
Depreciation		80		25,700
Profit before tax				5,775
Provision for tax				275
				5,500
Balance as per last Balance Sheet				300
				5,800
Transferred to fixed assets replacement reserve		2,000		
Dividend paid		800		
				2,800
Surplus carried to Balance Sheet				3,000

Notes:

1. Production & Operation expenses :

Consumption of raw materials	16,050
Consumption of stores	200
Local tax	40
Salaries to administrative staff	3,100
Other manufacturing expenses	2,210
	21,600

2. Administration expenses include salaries and commission to directors 25
3. Interest on other charges include :

(a) Interest on bank overdraft (Overdraft is of temporary nature)	545
(b) Fixed loan from I.C.I.C.I.	205
(c) Working capital loan from I.F.C.I.	100

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

Answer

Brightex Co. Ltd

Value Added Statement for the year ended 31st December, 2011

	₹ In Thousands	₹ In thousands
Sales		31,200
Less: Cost of bought in material and services:		
Production and operational expenses (21,600 – 40 – 3,100)	18,460	
Administration expenses (900 – 25)	875	
Interest on bank overdraft	545	
Interest on working capital loan	100	
Excise duties (Refer to working note)	900	
Other/miscellaneous charges(2,220 – 900)	1,320	22,200
Value added by manufacturing and trading activities		9,000
Add: Other income		275
Total Value Added		9,275
Application of Value Added:		
To pay Employees :		
Salaries to Administrative staff		3,100
To pay Directors:		
Salaries and Commission		25
To Pay Government :		
Local Tax	40	
Income Tax	275	315
To Pay Providers of Capital :		
Interest on Fixed Loan	255	
Dividend	800	1,055
To provide For Maintenance and Expansion of the Company :		
Depreciation	80	
Fixed Assets Replacement Reserve	200	
Retained Profit (600 - 60)	2,700	4,780
		9,275

Reconciliation of Total Value Added and Profit Before Taxation:

	₹ In Thousands	₹ In thousands
Profit before Tax		5,775
Add back:		
Depreciation	80	
Salaries to Administrative Staff	3,100	
Director's Remuneration	25	
Interest on Fixed Loan	255	
Local Tax	40	3,500
Total Value Added		9,275

Working Note :

Calculation of Excise Duty

		₹ In thousands
Interest and other charges		3,120
Less : Interest on bank overdraft	545	
Interest on loan from ICICI	255	
Interest on loan from IFCI	100	900
Excise duties and other/miscellaneous charges		2,220

Assuming that these miscellaneous charges have to be taken for arriving at Value Added (in the first part of Value Added Statement), the excise duty will be computed as follows.

Let excise duty be x; thus miscellaneous/ other charges = 2,220 - x

Thus x = 1/10 × [31,200 - {18,460 + 875 + 545 + 100 + x + (2,220 - x)}]

$= \frac{1}{10}$ x [31,200 – 22,200] = 900

Other/ miscellaneous charges = 2,220 - 900 = 1,320

The above solution is given accordingly.

However, if other/miscellaneous charges are taken as any type of application of Value Added. (i.e, to be taken in the application part), then excise duty (x) will be computed as follows:

x = 1/10 x [31,200 - (18,460 + 875 + 545 + 100 + x)]

x = 1/10 x [11,220 - x]

or, 11x = 11,220

x = 1,020

And thus total value added will be 10200 + 275 (other income) = 10,475

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

₹ ('000) 1,200 [i.e, 2,220 – 1,020] as the application of value added.

Question 3

From the following Profit and Loss Account of X Limited, prepare Gross Value Added Statement and show the reconciliation between Gross Value Added and Profit before taxation:

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

Income	(₹ in lakhs)	(₹ in lakhs)
Sales		2,400
Other Income		150
		2,550
Expenditure		
Production and Operational Expenses	1,800	
Administrative Expenses	90	
Interest and Other Charges	90	
Depreciation	60	2,040
Profit before taxes		510
Provision for taxes		90
		420
Balance as per last Balance Sheet		30

	450
Transferred to:	
General Reserve	240
Proposed Dividend	60
Surplus carried to Balance Sheet	150
	450

Break-up of some of the Expenditure is as follows:

Production and Operational Expenses:	
Consumption of Raw Materials and Stores	960
Salaries, Wages and Bonus	180
Cess and Local Taxes	60
Other Manufacturing Expenses	600
	1,800
Administrative Expenses:	
Audit Fee	18
Salaries and Commission to Directors	24
Provision for Doubtful Debts	18
Other Expenses	30
	90
Interest and other Charges:	
On Working Capital Loans from Bank	30
On Fixed Loans from ICICI	45
On Debentures	15
	90

Answer

X Limited

Gross Value Added Statement

for the year ended 31st March, 2011

	₹ in lakhs	₹ in lakhs
Sales		
Less: Cost of bought in material or services:		2,400
Production and Operational Expenses (960 + 600)	1,560	
Administrative Expenses (18 + 18 +30)	66	
Interest on working capital loans	30	1656
Value added by manufacturing and trading activities		744
Add: Other Income		150
Total Value Added		894

Application of Value Added:

To	Pay Employees:		
	Salaries, Wages and Bonus		180
To	Pay Directors:		
	Salaries and Commission		24
To	Pay Government:		
	Cess and Local taxes	60	
	Income Tax	90	150
To	Pay Providers of Capital:		
	Interest on Debentures	15	
	Interest on Fixed Loans	45	
	Dividend	60	120
To	Provide for Maintenance and Expansion of the Company:		
	Depreciation	60	
	General Reserve	240	
	Retained Profit (150 – 30)	120	420
			894

Reconciliation between Gross Value Added and Profit before Taxation

	₹ in lakhs	₹ in lakhs
Profit before tax		510
Add back:		
Depreciation	60	
Salaries, Wages and Bonus	180	
Directors' Remuneration	24	
Cess and Local Taxes	60	
Interest on Debentures	15	
Interest on Fixed Loans	45	384
Total Value Added		894

Question 4

On the basis of the following income statement pertaining to Brite Ltd., you are required to prepare:

(a) Gross value added statement; and

(b) Statement showing reconciliation of gross value added with Profit before Taxation.

Profit and Loss Account of Brite Ltd. for the year ended 31st March,2011

		₹ in thousands	₹ in thousands
Income			
Sales less returns			30,55,912
Dividends and interest			260
Miscellaneous income			948
	(A)		30,57,120
Expenditure			
Production and operational expenses:			
Decreases in inventory of finished goods		52,108	
Consumption of raw materials		14,81,642	
Power and lighting		2,40,060	
Wages, salaries and bonus		7,63,520	
Staff welfare expenses		52,480	
Excise duty		29,080	
Other manufacturing expenses		65,130	26,84,020
Administrative expenses:			
Directors' remuneration		15,620	
Other administrative expenses		65,280	80,900
Interest on:			
9% Mortgage debentures		28,800	
Long-term loan from financial institution		20,000	
Bank overdraft		200	49,000
Depreciation on fixed assets			1,01,200
	(B)		29,15,120
Profit before Taxation, (A) — (B)			1,42,000
Provision for Income-tax @ 35.875%			50,940
Profit after Taxation			91,060
Balance of account as per last Balance Sheet			12,600
			1,03,660
Transferred to:			
General reserve 40% of ₹ 91,060		36,424	
Proposed dividend @ 22%		44,000	
Tax on distributed profits @ 12.81%		5,636	86,060
Surplus carried to Balance Sheet			17,600

Answer

Brite Ltd.

Value Added Statement for the year ended 31st March, 2011

	₹ in thousands	₹ in thousands
Sales less returns		30,55,912
Less: Cost of bought in materials and services, as per working note	18,38,940	
Administrative expenses	65,280	
Interest on bank overdraft	200	19,04,420
Value added by manufacturing and trading activites		11,51,492
Add: Dividends and interest		260
Miscellaneous income		948
Total value added		11,52,700

Application of valued added

	₹ in thousands	₹ in thousands
To pay Employees:		
Wages, salaries and bonus	7,63,520	
Staff welfare expenses	52,480	9,16,000
To pay Directors:		
Directors' remuneration		15,620
To pay Government:		
Excise duty	29,080	
Income tax	50,940	
Tax on distributed profits	5,636	85,656
To pay providers of capital:		
Interest on 9% debentures	28,800	
Interest on long-term loan from financial institution	20,000	
Dividend to shareholders	44,000	92,800
To provide for maintenance and expansion of the company:		
Depreciation on Fixed assets	1,01,200	
Transfer to General reserve	36,424	
Retained profit, ₹(17,600-12,600)(in 000's)	5,000	1,42,624
		11,52,700

Statement showing reconciliation of Total value added with Profit before taxation

	₹ in thousands	₹ in thousands
Profit Before Taxation		1,42,000
Add back:		
Wages, salaries and bonus	7,63,520	
Staff welfare expenses	52,480	
Excise duty	29,080	
Directors' remuneration	15,620	
Interest on 9% mortgage debentures	28,800	

Interest on long-term loan from financial institution	20,000	
Depreciation on fixed assets	1,01,200	10,10,700
Total Value Added		11,52,700

Working Note:

Calculation of cost of bought in materials and services:

	₹ in thousands
Decrease in inventory of finished goods	52,108
Consumption of raw materials	14,81,642
Power and lighting	2,40,060
Other manufacturing expenses	65,130
	18,38,940

Question 5

The following is the Profit and Loss Account of Galaxy Ltd. for the year ended 31.03.2011. Prepare a Gross Value Added Statement of Galaxy Ltd. and show also the reconciliation between Gross Value Added and Profit before taxation.

Profit and Loss Account for the year ended 31.03.2011

	Notes		Amount (₹ in lakhs)
Income:			
Sales		–	3,560
Other Income		–	220
			3,780
Expenditure:			
Production and operational expenses	(a)	2,564	–
Administration expenses (Factory)	(b)	132	–
Interest	(c)	116	–
Depreciation		68	2,880
Profit before taxes		–	900
Provision for taxes	(d)	–	120
Profit after tax		–	780
Balance as per last Balance Sheet		–	40
			820
Transferred to General Reserve		180	–
Dividend paid		380	–
		560	–
Surplus carried to Balance Sheet		260	–
		820	–

Notes:

(a)	Production and Operational expenses	₹ in lakhs
	Consumption of raw materials	1,172
	Consumption of stores	236
	Salaries, Wages, Gratuities etc. (Admn.)	328

Cess and Local taxes	392
Other manufacturing expenses	436
	2,564

(b) Administration expenses include salaries, commission to Directors ₹ 36.00 lakhs Provision for doubtful debts ₹ 25.20 lakhs.

		₹ in lakhs
(c)	Interest on loan from ICICI Bank for working capital	36
	Interest on loan from ICICI Bank for fixed loan	40
	Interest on loan from IFCI for fixed loan	32
	Interest on Debentures	8
		116

(d) The charges for taxation include a transfer of ₹ 12.00 lakhs to the credit of Deferred Tax Account.

(e) Cess and Local taxes include Excise Duty, which is equal to 10% of cost of bought-in material.

Answer

Galaxy Ltd.

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

	₹ in lakhs	₹ in lakhs
Sales		3,560
Less: Cost of bought in materials and services:		
Production and operational expenses (1,172+236+436)	1,844	
Administration expenses (132 – 36)	96	
Interest on working capital loan	36	
Excise duty (Refer working note)	220	2,196
Value added by manufacturing and trading activities		1,364
Add: Other income		220
Total value added		1,584

Application of Value Added

To Employees		
Salaries, wages, gratuities etc.		328
To Directors		
Salaries and commission		36
To Government		
Cess and local taxes (392 – 220)	172	
Income tax	108	280
To Providers of capital		
Interest on debentures	8	
Interest on fixed loan	76	
Dividends	380	460
To Provide for maintenance and expansion of the company		

Depreciation	68	
General reserve	180	
Deferred tax	12	
Retained profits (260 – 40)	220	480
		1,584

Statement showing reconciliation of Gross Value Added with Profits before taxation

		₹ in lakhs
Profits before taxes		900
Add:		
Depreciation	68	
Directors' remuneration	36	
Salaries, wages & gratuities etc.	328	
Cess and local taxes	172	
Interest on debentures	8	
Interest on fixed loan	76	684
Total value added		1,584

Working Note:

Calculation of Excise Duty

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

Excise Duty is 10% of x = x/10

x = 1,844+96+36 + x/10

x = 1,976 + x/10 = 2,196 (approx.)

Excise Duty = 2,196 – 1,976 = ₹ 220

Question 6

On the basis of the following Profit and Loss Account of Zed Limited and the supplementary information provided thereafter, prepare Gross Value Added Statement of the company for the year ended 31st March, 2011. Also prepare another statement showing reconciliation of Gross Value Added with Profit before Taxation.

Profit and Loss Account of Zed Limited for the year ended 31st March, 2011.

	Amount (₹ in lakhs)	Amount (₹ in lakhs)
Income		
Sales		12,525
Other Income		325
		12,850
Expenditure		
Production and Operational Expenses	8,875	
Administrative Expenses	462.50	

Interest	587.50	
Depreciation	925.00	10,850
Profit before Taxation		2,000
Provision for Taxation		700
Profit after Taxation		1,300
Credit Balance as per last Balance Sheet		100
		1,400
Appropriations		
Transfer to General Reserve		250
Preference Dividend (Interim) paid		125
Proposed Preference Dividend (Final)		125
Proposed Equity Dividend		750
Balance carried to Balance Sheet		150
		1,400
Supplementary Information		
Production and Operational Expenses consist of:		
Raw Materials and Stores consumed		4,750
Wages, Salaries and Bonus		1,525
Local Taxes including Cess		550
Other Manufacturing Expenses		2,050
		8,875
Administrative Expenses consist of:		
Salaries and Commission to Directors		150
Audit Fee		60
Provision for Bad and Doubtful Debts		50
Other Administrative Expenses		202.50
		462.50
Interest is on:		
Loan from Bank for Working Capital		87.50
Debentures		500.00
		587.50

Answer

Gross Value Added Statement of Zed Ltd. for the year ended 31st March, 2011

		₹ in lakhs	₹ in lakhs
Sales			12,525
Less:	Cost of raw materials, stores and other services consumed	6,800	

	Administrative expenses	312.50	
	Interest on loan from bank for working capital	87.50	7,200
Value added by manufacturing and trading activities			5,325
Add:	Other income		325
	Total value added		5,650

Application of Value Added

		₹in lakhs	₹ in lakhs
To	pay employees		
	Wages, salaries and bonus		1,525
To	pay directors		
	Salaries and commission to Directors		150
To	pay Government		
	Local taxes including cess	550	
	Income tax	700	1,250
To	pay providers of capital		
	Interest on debentures	500	
	Preference dividend	250	
	Equity dividend	750	1,500
To	provide for the maintenance and expansion of the company:		
	Depreciation	925	
	Transfer to general reserve	250	
	Retained profit ₹ (150 – 100) lakhs	50	1,225
			5,650

Statement showing Reconciliation between Gross Value Added with Profit before Taxation

	₹ in lakhs	₹ in lakhs
Profit before taxation		2,000
Add back:		
Wages, salaries and bonus	1,525	
Salaries and commission to Directors	150	
Local taxes including cess	550	
Interest on debentures	500	
Depreciation	925	3,650
Gross Value Added		5,650

Question 7

Value Added Ltd. furnishes the following Profit and Loss A/c:

Profit and Loss A/c for the year ended 31st March, 2011

Income	Notes	₹('000)
Turnover	1	74,680
Other Income		2,605
		77,285
Expenditure		
Operating expenses	2	66,853
Interest on 8% Debenture		2,468
Interest on Cash Credit	3	377
Excise duty		4,880
		74,578
Profit before depreciation		2,708
Less: Depreciation		855
Profit before tax		1,853
Provision for tax	4	940
Profit after tax		913
Less: Transfer to Fixed Assets Replacement Reserve		163
		750
Less: Dividend paid		313
Retained Profit		437

Notes:

(1) Turnover is based on invoice value and net of sales tax.

(2) Salaries, wages and other employee benefits amounting to ₹ 36,903 ('000) are included in operating expenses.

(3) Cash Credit represents a temporary source of finance. It has not been considered as a part of capital.

(4) Transfer of ₹ 135 ('000) to the credit of deferred tax account is included in provision for tax.

Prepare value added statement for the year ended 31st March, 2011 and reconcile total value added with profit before taxation.

Answer

Value Added Ltd.

Value Added Statement for the year ended 31st March, 2011

	₹('000)	₹('000)
Turnover		74,680
Less: Cost of bought in materials and services:		
Operating expenses (66,852.50 –36,902.50)	29,950	
Excise duty	4,880	
Interest on Cash Credit	377	35,207
Value added by manufacturing and trading activities		39,473
Add: Other income		2,605
Total value added		42,078
Application of value added:		
To Pay to employees:		
Salaries, wages and other employee benefits		36,903
To Pay to Government:		
Corporation tax (940 – 135)		805
To Pay to providers of capital:		
Interest on 8% Debentures	2,468	
Dividends	312	2,780
To Provide for maintenance and expansion of the company:		
Depreciation	855	
Fixed Assets Replacement Reserve	163	
Deferred Tax Account	135	
Retained Profit	437	1,590
		42,078

Note: Deferred tax account could alternatively be shown as an item 'To pay to government'.

Reconciliation between total value added and profit before taxation

		₹('000)	₹('000)
Profit before tax			1,853
Add back:	Depreciation	855	
	Wages, salaries and other benefits	36,903	

Debenture interest	2,467	40,225
Total Value Added		42,078

Question 8

From the following Profit and Loss account of Happy Ltd., prepare a gross value added statement for the year ended 31st March,2011. Show also the reconciliation between GVA and Profit before taxation:

Profit and Loss Account

	₹'000s	₹'000s
Income		
Sales	12,960	
Other income	110	13,070
Expenditure		
Production and Operational expenditure	9,120	
Administrative expenses	360	
Interest and other charges	1,248	
Depreciation	32	10,760
Profit before tax		2,310
Less: Provision for tax		110
Profit after tax		2,200
Add: balance as per last Balance Sheet		120
		2,320
Less: Transfer to Fixed assets replacement Reserve	800	
Dividend paid	320	1,120
Surplus carried to Balance Sheet		1,200

Additional information:

(i) Production and Operational expenses consists of

	₹
Consumption of Raw materials	64,20,000
Consumption of Stores	80,000
Local tax	16,000

Salaries to Administrative staff	17,20,000
Other Manufacturing expenses	8,84,000

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

(iii) Interest and other charges include-

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

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

Answer

(a) **Happy Ltd.**

Value Added Statement for the year ended 31st March, 2011

(Figures in ₹'000)

Sales			12,960
Less:	Cost of Materials and Services:		
	Production and Operational Expenses (9,120 – 16- 1,720)	7,384	
	Administrative Expenses (360 – 10)	350	
	Interest on Bank Overdraft	218	
	Interest on Working Capital Loan	40	
	Excise Duties (Refer to working note)	360	
	Other/miscellaneous charges (888 – 360)	528	8,880
Value added by manufacturing and trading activities			4,080
Add:	Other Income		110
Gross value added from operations			4,190

Application of Gross Value Added

		₹ in '000	₹in'000
To	Pay Employees:		
	Salaries to Administrative Staff		1,720
To	Pay Directors:		
	Salaries and Commission		10
To	Pay Government:		

	Local Taxes	16	
	Income Tax	110	126
To	Pay Providers of Capital:		
	Interest on Fixed Loan	102	
	Dividend	320	422
To	Provide for maintenance and expansion of the company:		
	depreciation	32	
	Fixed Assets Replacement Reserve	800	
	Retained Profit (1200 – 120)	1080	1912
			4,190

Reconciliation between Gross Value added and Profit before Taxation

			₹ in'000
Profit before Tax			2,310
Add Back:	Depreciation	32	
	Salaries to Administrative Staff	1,720	
	Directors' Salaries and Commission	10	
	Interest on Fixed Loan	102	
	Local Tax	16	1,880
Total value added			4,190

Working Note:

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

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

Let Excise Duties be denoted by - E

Then, other charges = 888 - E

Excise duty are $1/10^{th}$ of value added

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

= $1/10^{th}$ [12,480 – 8,880]

= $1/10^{th}$ × 3,600= 360

Other/miscellaneous charge 888 – 360 = ₹528

The above solution has been given accordingly.

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

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

E = $\frac{1}{10th}$ × (4,488 - E)

11E = 4,488

E = ₹408

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

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

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

6

SEGMENT REPORTING

Question 1

M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

		₹ ('000)
Division A		
	Sales to B	9,150
	Other Sales (Home)	180
	Export Sales	12,270
		21,600
Division B		
	Sales to C	90
	Export Sales to Europe	600
		690
Division C		
	Export Sales to America	540

	Head Office	Divisions A	B	C
	₹ ('000)	₹ ('000)	₹('000)	₹('000)
Operating Profit or Loss before tax		480	60	(24)
Re-allocated cost from Head Office		144	72	72
Interest cost		12	15	3
Fixed assets	150	600	120	360
Net current assets	144	360	120	270
Long-term liabilities	114	60	30	360

Prepare a Segmental Report for publication in M Ltd. Group.

Answer

M Ltd.

Segmental Report

₹ ('000)

	Divisions			Inter segment	Consolidated Total
	A	B	C	Eliminations	
Segment Revenue					
Sales:					
Domestic	180	–	–	–	180
Export	12,270	600	540	–	13,410
External Sales	12,450	600	540	–	13,590
Inter-segment Sales	9,150	90	–	9,240	–
Total Revenue	21,600	690	540	9,240	13,590
Segment result (given)	480	60	(24)		516
Head office expenses					(288)
Operating profit					228
Interest expense					(30)
Profit before tax					198
Other information					
Fixed assets	600	120	360		1,080
Net current assets	360	120	270		750
Segment assets	960	240	630		1,830
Unallocated corporate assets					294
Segment liabilities	60	30	360		450
Unallocated corporate liabilities					114

Sales Revenue by Geographical Market

(₹'000)

	Home Sales	Export Sales (by division A)	Export to Europe	Export to America	Consolidated Total
External Sales	180	12,270	600	540	13,590

Question 2

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

	₹('000)
Forging Shop Division	
Sales to Bright Bar Division	13,725
Other Domestic Sales	270
Export Sales	18,405
	32,400
Bright Bar Division	
Sales to Fitting Division	135
Export Sales to Rwanda	900
	1,035
Fitting Division	
Export Sales to Maldives	810

Particulars	Head Office	Forging Shop Division	Bright Bar Division	Fitting Division
	₹ ('000)	₹ ('000)	₹ ('000)	₹ ('000)
Pre-tax operating result		720	90	(36)
Head office cost reallocated		216	108	108
Interest costs		18	24	6
Fixed assets	225	900	180	540
Net current assets	216	540	180	405
Long-term liabilities	171	90	45	540

Answer

Diversifiers Ltd.

Segmental Report

(₹'000)

Particulars	Divisions Forging shop	Bright Bar	Fitting	Inter Segment Eliminations	Consolidated Total
Segment revenue					
Sales:					
Domestic	270	–	–	–	270
Export	18,405	900	810	–	20,115
External Sales	18,675	900	810	–	20,385
Inter-segment sales	13,725	135	–	13,860	–
Total revenue	32,400	1,035	810	13,860	20,385
Segment result (given)	720	90	(36)		774
Head office expenses					(432)
Operating profit					342
Interest expense					(48)
Profit before tax					294
Information in relation to assets and liabilities:					
Fixed assets	900	180	540	–	1,620
Net current assets	540	180	405	–	1,125
Segment assets	1,440	360	945	–	2,745
Unallocated corporate assets (225 + 216)	–	–	–	–	441
Total assets					3,186
Segment liabilities	90	45	540	–	675
Unallocated corporate liabilities					171
Total liabilities					846

Sales Revenue by Geographical Market

(₹'000)

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	Consolidated Total
External sales	270	18,405	900	810	20,385