Paper-16: Advanced Financial Accounting & Reporting

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

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

Working Notes should form part of the answer.

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

Part A questions are compulsory. Attempt all of them.

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

Part A (25 marks)

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

(i) M Ltd. entered into agreement with S Ltd. for sale of goods of ₹ 8 lakhs at a profit of 20% on cost. The sale transaction took place on 1st February, 2014. On the same day, S Ltd. entered into another agreement with M Ltd. to resell the same goods at ₹ 10.80 lakhs on 1st August, 2014. The pre-determined reselling price covers the holding cost of S Ltd.
Treatment as per AS 9 in the books of Moon Ltd.

A. Sales A/c will be credited with ₹ 9,60,000
B. Advance from S Ltd. A/c will be credited with ₹ 9,60,000
C. Financing Charges A/c will be debited with ₹ 1,20,000
D. None of these

Answer:

B — Advance from S Ltd. A/c will be credited with ₹ 9,60,000.

In the given case, M Ltd. concurrently agreed to repurchase the same goods from S Ltd. on 1st February, 2014. Also the re-selling price is pre-determined and covers purchasing and holding costs of S Ltd. Hence, the transaction between M Ltd. and S Ltd. on 1st February, 2014 should be accounted for as financing rather than sale. The resulting cash flow of ₹ 9.60 lakhs (₹ 8 lakhs + 20% of ₹ 8 lakhs) received by M Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition" and hence should be treated as Advance from S Ltd.

(ii) Ramesh Chandra Ltd. has provided the following information:
Depreciation as per accounting records ₹ 4,00,000, Depreciation as per income tax records ₹ 10,00,000. Unamortized preliminary expenses as per income tax records ₹ 6 0,000, Tax rate 50%. There is adequate evidence of future profit sufficiency. As per AS 22 Deferred Tax Asset/ Liability to be recognized will be
A. ₹ 3,00,000 (DTA)
B. ₹ 30,000 (DTL)
C. ₹ 2,70,000 (Net DTL)
D. None of these

Answer:

C — ₹2,70,000 (Net DTL).

Deferred tax liability = 50% (10,00,000 – 4,00,000)	= ₹3,00,000
Deferred tax asset = 50% of 60,000	= ₹30,000
Net Deferred tax liability	= ₹2,70,000

(iii) As per records of Play Fin Stock Ltd. Net Profit for the current year ₹199.20 lakhs, No. of Equity Shares outstanding 100 lakhs, No. of 12% Convertible Debentures of ₹100 each 2 lakhs, Each Debenture is convertible into 10 equity shares, Tax Rate 30%, As per AS 20, Diluted Earnings Per Share is :

A. ₹ 1.66
B. ₹ 1.86
C. ₹ 1.80
D. None of these

Answer:

C — ₹1.80.

Adjusted Net Profit for the current year (199.2 + 24 - 7.2) = ₹ 216 lakhs.
No. of equity shares resulting from conversion of debentures: 20,00,000 Shares.
No. of equity shares used to compute diluted EPS: (100,00,000 + 20,00,000) = 120,00,000 Shares.
Diluted earnings per share: (216,00,000/120,00,000) = ₹ 1.80.

(iv) Dhan Raj Ltd. issued certain callable convertible debentures at ₹ 60. The value of similar debentures without call or equity conversion option is ₹ 57. The value of call as determined using Black and Scholes model for option pricing is ₹ 2. The values of liability and equity component will be :

A. ₹ 57, ₹ 3
B. ₹ 58, ₹ 2
C. ₹ 59, ₹1
D. ₹ 55, ₹ 5

Answer:

D — ₹ 55, ₹ 5.

Liability component = ₹ 57 – ₹ 2 = ₹ 55, Equity component = ₹ 60 – ₹ 55 = ₹ 5.

(v) Vasundhara Construction Ltd. undertook a contract on December 1, 2012 to construct a building for ₹ 70 lakh. The Company found on March 31, 2013 that it had already spent ₹ 52 lakh on the construction. Prudent estimate of additional cost for completion was ₹ 28 lakh. Contract value to be recognized as Turnover in the final accounts for the year ended March 31, 2013 as per AS-7 (revised) will be

A. ₹ 52.5 lakh
B. ₹ 50.4 lakh
C. ₹ 45.5 lakh
D. None of these

Answer:

C — ₹45.50 lakh.

Contract work-in-progress (52 ÷ 80) lakh = 65%
Proportion of total contract value to be recognized as Turnover = 0.65 x ₹70,00,000
= ₹45.50 lakh.

(vi) Quick Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2014 at ₹ 600 lakh. As at that date value in use is ₹ 400 lakh. If the net selling price is ₹ 450 lakh, Impairment loss of the Asset as per AS-28 will be:
A. ₹ 200 lakh
B. ₹150 lakh
C. ₹ 50 lakh
D. None of (A), (B), (C)

Answer:

B — ₹150 lakh.

Recoverable amount is higher of Value in use ₹400 lakh and net selling price ₹450 lakh.
Recoverable amount = ₹450 lakh.
Impairment loss = Carried Amount – Recoverable amount
= ₹(600 – 450) = ₹150 lakh.

(vii)On 1-1-2013 Ashwin Ltd. has 3,600 equity shares outstanding. On 31-5-2013, it issued 1,200 equity shares for cash (without bonus claim). On 1-11-2013 it bought back 600 equity shares. Calculate the weighted average number of shares as on 31-12-2013?
A. 4,200 shares
B. 5,400 shares
C. 4,800 shares
D. None of the above

Answer:

A — 4,200 shares.

Computation of weighted average number of shares as per AS-20 is as follows:
$(3,600 \times \frac{5}{12}) + (4,800 \times \frac{5}{12}) + (4,200 \times \frac{2}{12}) = 4,200$ shares.

(viii) Umbrrella Ltd. reports quarterly and estimates an annual income of ₹ 400 crores. Assume Tax rates on first ₹200 crores at 30% and on the balance income at 40%. The estimated quarterly incomes are ₹30 crores, ₹100 crores, ₹150 crores and ₹120 crores respectively. The Tax expenses to be recognized in the last quarter as per AS-25 is
A. ₹ 24 crores
B. ₹ 21 crores
C. ₹ 19 crores
D. Insufficient Information

Answer:

B — ₹21 Crores.

Tax Expenses: 30% on ₹200 Crores = ₹60 Crores. 40% on remaining ₹200 Crores = ₹80 Crores. Total Tax = (60 + 80) = ₹140 Crores. Weighted average Annual Income Tax Rate [140 ÷ 400] = 35% Tax expenses to be recognized in last quarter: 35% on ₹120 Crores = ₹42 Crores.

(ix) Mega Ltd. deals in three products A1,B2 and C3, which are neither similar nor interchangeable. At the time of closing of its account for the year 2013-14 the historical cost and net realizable value of the items of closing stock are determined as below:

Items	Historical Cost (₹ in Lakhs)	Net realizable value (₹ in Lakhs)
A1	22	16
B2	18	18
C3	10	14

What will be the value of closing stock?
A. ₹44 Lakhs
B. ₹40 Lakhs
C. ₹48 Lakhs
D. None of these

Answer:

A — ₹44 Lakhs.

Computation of value of closing stock

Lower of Historical Cost and Net Realisable Value will be considered	₹
A1	16
B2	18
C3	10
Value of Closing Stock	44

(x) Tulip Ltd. holds 25% share in Lotus Ltd. at a cost of ₹ 7.50 lakhs as on 31.3.2006 out of Lotus's Share Capital and Reserve of ₹ 30 lakhs each. For the year ended 31.3.2013, Lotus Ltd. made a profit of ₹ 2,40,000 and 30% of it was distributed as dividend.
In the Consolidated Financial Statement, the carrying amount of investment as at 31.3.2013 will be -
A. ₹ 15.00 lakhs
B. ₹ 15.60 lakhs
C. ₹ 15.42 lakhs
D. ₹ 14.82 lakhs

Answer:

	₹ in lakhs
Share in Lotus Ltd. Share of Reserve (25% of ₹ 30 Lakh) Share of Profit (25% of ₹ 2.40 Lakh)	7.50 7.50 0.60

Less: Dividend (2.40 Lakh x 30% x 25%)	15.60 0.18
Carrying amount of investments in Consolidated financial statements.	15.42

(b) Aveer Ltd. wants to re-classify its Investment in accordance with AS-13.Decide on the treatment to be given in each of the following cases:

(i) A portion of Current Investments purchased for ₹20 lakhs to be reclassified as long-term Investments, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹25 lakhs.

(ii) Another portion of Current Investments purchased for ₹15 lakhs has to be reclassified as Long-term Investments. The market value of these investments as on the date of Balance Sheet was ₹6.5 lakhs.

(iii) Certain Long-term Investments no longer considered for holding purposes have to be re-classified as Current Investments. The original cost of theses was ₹18 lakhs but they had been written down to ₹12 lakhs to recognize permanent decline as per AS 13. [5]

Answer:

As per AS 13 'Accounting for Investments' where investments are reclassified from current to long term, transfers are made at the lower of cost and fair value at the date of transfer.

In the first case, the market value of the investment is ₹25 lakhs, which is higher than its cost ₹20 lakhs. Therefore, the transfer to long term investments should be carried at cost ₹20 lakhs.

In the second case, the market value of the investment is ₹6.5 lakhs, which is lower than its cost ₹15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value ₹6.5 lakhs. The loss of ₹8.5 lakhs should be charged to profit and loss account.

Where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

In the third case, the book value of the investments is ₹12 lakhs, which is lower than its cost ₹18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at ₹12 lakhs.

Part B (75 marks)

2. The summarized Balance Sheets of R Ltd. and S Ltd. for the year ending on 31.3.2014 are as under:

Equity and Liabilities	**R Ltd. (₹)**	**S Ltd. (₹)**
Shareholders' funds		
Share Capital		
Equity share capital (in shares of ₹10 each)	**24,00,000**	**12,00,000**
8% Preference Share Capital(in shares of ₹10 each)	**8,00,000**	**-**
10% Preference share Capital (in shares of ₹10 each)	**-**	**4,00,000**

Reserves and Surplus	**30,00,000**	**24,00,000**
Current Liabilities	**18,00,000**	**10,00,000**
Total	**80,00,000**	**50,00,000**
Assets		
Non-current Assets	**55,00,000**	**27,00,000**
Current Assets	**25,00,000**	**23,00,000**
Total	**80,00,000**	**50,00,000**

The following information is provided:

		R Ltd. (₹)	S Ltd. (₹)
	Profit before tax	10,64,000	4,80,000
	Taxation	4,00,000	2,00,000
	Preference Dividend	64,000	40,000
	Equity Dividend	2,88,000	1,92,000

The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.
R Ltd. proposes to absorb S Ltd. as on 31.03.2014. The terms of absorption are as under:

(i) Preference Shareholders of S Ltd. will receive 8% preference shares of R Ltd. sufficient to increase the income of preference shareholders of S Ltd. by 10%.

(ii) The equity shareholders of S Ltd. will receive equity shares of R Ltd. on the following basis:
- **The equity shares of S Ltd. will be valued by applying to the earnings per share of S Ltd.75% of price earnings ratio of R Ltd. based on the results of 2013-14 of both the companies.**
- **The market price of equity shares of R Ltd. is ₹40 per share.**
- **The number of shares to be issued to the equity shareholders of S Ltd. will be based on the above market value.**
- **In addition to equity shares , 8% preference shares of R Ltd. will be issued to equity shareholders of S Ltd. to make up for the loss in income arising from the above exchange od shares based on the dividends for the year 2013-14.**

The assets and liabilities of S Ltd. as om 31.03.2014 are revalued by professional valuer as under:

	Increased by (₹)	Decreased by (₹)
Fixed Assets	1,00,000	-
Current Assets	-	2,00,000
Current Liabilities	-	40,000

For the next two years, no increase in the rate of equity dividend is expected.
You are required to:
(i) Set out in detail the purchase consideration.
(ii) Give the Balance Sheet as on 31.03.2014 after absorption. [15]

Answer:

(i) Computation of Purchase Consideration

	(₹)

(i)Preference Shareholders	
Current income of Preference shareholders of S Ltd.	40,000
Add: 10% increase thereof	4,000
	44,000
Preference shares to be issued = 44,000 × 100/8	5,50,000
(ii)Equity shareholders	
Issue of Equity shares	
Profit before tax of R Ltd.	10,64,000
Less: Tax	(4,00,000)
	6,64,000
Less: Preference Dividend	(64,000)
Profit available for equity shareholders of R Ltd.	6,00,000

Basic EPS = Earnings available for shareholders / Average no of shares
Earnings per share (EPS) = 6, 00,000/2, 40,000 = ₹2.50
PE Ratio = Market Price/ EPS
Price earnings ratio (P/E) = 40/2.50 = 16

EPS of S Ltd.

	(₹)
Profit before tax	4,80,000
Less: Tax	(2,00,000)
Profit After Tax	2,80,000
Less: Preference Dividend	(40,000)
Profit available for equity shareholders	2,40,000

EPS = 2, 40,000/1, 20,000 = ₹2
Valuation of Equity shares of S Ltd.
= 1, 20,000 shares × (₹2 × 16 × 0.75) =₹28, 80,000
Number of equity shares to be issued = 28, 80,000/40 = 72,000.

	(₹)
Equity Share Capital	7,20,000
Securities Premium	21,60,000
	28,80,000
Issue of preference shares to make up loss to equity shareholders	(₹)
Current Equity dividend	1,92,000
Less: Expected equity dividend from R Ltd. i.e. in proportion of the existing dividend policy (₹7,20,000 × 2,88,000/24,00,000)	(86,400)
Loss in income	1,05,600
8% Preference Shares to be issued= 1,05,600/0.08	13,20,000
Total Purchase Consideration	(₹)
Preference shares to be issued (5,50,000 +13,20,000)	18,70,000
Equity shares to be issued (at premium)	28,80,000
	47,50,000

R Ltd.
Balance Sheet as at 31st March, 2014

(after absorption)

Particulars	Note No.	Amount (₹)
I. **Equity and Liabilities**		
(1) Shareholder' Funds		
(a) Share Capital	1	57,90,000
(b) Reserves and Surplus	2	51,60,000
(2) Current Liabilities	3	27,60,000
Total		**1,37,10,000**
II. **Assets**		
(1) Non-Current assets		
(a) Fixed Assets		
i. Tangible assets	4	83,00,000
ii. Intangible assets	5	8,10,000
(2) Current Assets	6	46,00,000
Total		**1,37,10,000**

Notes to Accounts

		Dr.(₹)	Cr.(₹)
	Share Capital		
	3,12,000 equity shares of ₹10 each(of the above shares 72,000 equity shares are allotted as fully paid up for consideration other than cash)	31,20,000	
	2,67,000 8% preference shares of ₹10 each (of the above 1,87,000 are allotted as fully paid up for consideration other than cash	26,70,000	
			57,90,000
	Reserves and Surplus		
	Reserves (as per last Balance Sheet)	30,00,000	
	Securities Premium	21,60,000	51,60,000
	Current Liabilities		
	As per last Balance Sheet	18,00,000	
	Taken over on absorption of S Ltd. ₹(10,00,000 -40,000)	9,60,000	27,60,000
	Tangible Assets		
	As per last Balance Sheet	55,00,000	
	Taken over on absorption of S Ltd.	28,00,000	
			83,00,000
	Intangible Assets		
	Goodwill (see working note)		8,10,000
	Current Assets		
	As per last Balance Sheet	25,00,000	
	Taken over on absorption of S Ltd. ₹(23,00,000 – 2,00,000)	21,00,000	46,00,000

Working Note:

		(₹)
Purchase consideration		47,50,000
Fixed assets taken over	28,00,000	
Current assets taken over	21,00,000	

	49,00,000	
Less: Current liabilities	(9,60,000)	(39,40,000)
Goodwill		8,10,000

3. (a) Mr. Investor buys a stock option of ABC Co. Ltd. in July, 2012 with a strike price on 30.07.2012 of ₹250 to be expired on 30.08.2012. The premium is ₹20 per unit and the market lot is 100. The margin to be paid is ₹ 120 per unit.

Show the accounting treatment in the books of Buyer when:
(i) the option is settled by delivery of the asset, and
(ii) the option is settled in cash and the index price is ₹260 per unit. **[8]**

Answer:

Accounting entries in the books of buyer

2012		At the time of inception	Dr.(₹)	Cr.(₹)
July		Stock option premium A/c Dr.	2,000	
		To Bank A/c		2,000
		(Being premium paid to buy a stock option)		
		Deposit for margin money A/c Dr.	12,000	
		To Bank A/c		12,000
		(Being margin money paid on stock option)		
		At the time of settlement		
August	(i)	Option is settled by delivery of the asset		
		Shares of ABC Ltd. A/c Dr.	25,000	
		To Deposit for margin money A/c		12,000
		To Bank A/c		13,000
		(Being option exercised and shares acquired, ₹ 12,000 margin money adjusted and the balance amount was paid)		
		Profit and loss A/c Dr.	2,000	
		To Stock option premium A/c		2,000
		(Being the premium transferred to Profit And Loss Account on exercise of option)		
	(ii)	Option is settled in cash		
		Profit and loss A/c Dr.	2,000	
		To Stock option premium A/c		2,000
		(Being the premium transferred to Profit And Loss Account)		
		Bank A/c (₹ 100 × 10) Dr.	1,000	
		To Profit and loss A/c		1,000
		(Being profit on exercise of option)		
		Bank A/c Dr.	12,000	
		To Deposit for margin money A/c		12,000
		(Being margin on equity stock option received back on exercise of option)		

(b) Discuss the concept of Cost v/s Fair value with reference to Indian Accounting Standards. [7]

Answer:

Cost vs. Fair value

Meaning of Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Meaning of Fair value: Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm's length transaction.

Indian Accounting Standards are generally based on historical cost with a very few exceptions:
AS 2 "Valuation of Inventories" – Inventories are valued at lower of net realizable value (NRV) and cost of inventories.
AS 10 "Accounting for Fixed Assets" – Items of fixed assets that have been retired from active use and are held for disposal are stated at net realizable value if their net book value is more than NRV.
AS 13 "Accounting for Investments" – Current investments are carried at lower of cost and fair value. The carrying amount of long term investments is reduced to recognise the permanent decline in value.
AS 15 "Employee Benefits" – The provision for defined benefits is made at fair value of the obligations.
AS 26 "Intangible Assets" – If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.
AS 28 "Impairment of Assets"– Provision is made for impairment of assets. On the other hand IFRS and US GAAPs are more towards fair value. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

4. The following are the summarized Balance Sheets of Sand Ltd. and Snow Ltd. as on 31.3.2014:

Particulars	**(₹ in thousands)**	
	Sand Ltd.	**Snow Ltd.**
Equity and Liabilities:		
Shareholders' Funds		
Share capital-		
Equity shares of 100 each fully paid up	**2,000**	**1,000**
Reserves and Surplus	**800**	**(800)**
Non-current Liabilities		
10% Debentures	**500**	**—**
Loans from Banks	**250**	**450**
Current Liabilities		

Bank overdrafts	—	50
Trade payables	300	300
Proposed dividend	200	—
Total	**4,050**	**1,000**
Assets		
Non-current assets		
fixed assets	2,700	850
Non-current Investments (including investments in Snow Ltd.)	700	—
Current assets		
Trade receivables	400	150
Cash at bank	250	—
Total	**4,050**	**1,000**

Snow Ltd. has acquired the business of Sand Ltd. The following scheme of merger was approved:

(i) Banks agreed to waive off the loan of ₹ 60 thousands of Snow Ltd.

(ii) Snow Ltd. will reduce its shares to ₹10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).

(iii) Shareholders of Sand Ltd. will be given one share (new) of Snow Ltd. in exchange of every share in Sand Ltd.

(iv) Proposed dividend of Sand Ltd. will be paid after merger to shareholders of Sand Ltd.

(v) Trade payables of Snow Ltd. includes ₹ 100 thousands payable to Sand Ltd.

(vi) Sand Ltd. will cancel 20% holding in Snow Ltd. as investment, which was held at a cost of ₹250 thousands.

Pass necessary entries in the books of Snow Ltd.

Answer: **[15]**

Journal Entries in the books of Snow Ltd.

Date		**(₹ in thousands)**	
2012		**Dr.**	**Cr.**
March,31	Loan from bank A/c Dr. To Reconstruction A/c (Being loan from bank waived off to the extent of ₹60 thousand)	60	 60
	Equity share capital A/c (₹ 100) Dr. To Equity share capital A/c (₹ 10) To Reconstruction A/c (Being Equity share of ₹ 100 each reduced to ₹ 10 each)	1,000	 100 900

		Dr. (₹)	Cr. (₹)
	Equity share capital A/c (₹ 10) Dr. To Equity share capital A/c (₹ 100 each) (Being 10 Equity shares of ₹10 each consolidated to one share of ₹100 each)	100	 100
	Reconstruction A/c Dr. To Profit and loss A/c To Capital Reserve A/c (Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)	960	 800 160
	Business purchase A/c Dr. To Liquidator of Sand Ltd. (Being purchase of business of Sand Ltd.)	1,980	 1,980
	Fixed asset A/c Dr. Investment A/c ₹ (700 - 250) Dr. Trade receivables A/c Dr. Cash at bank A/c Dr. To Trade payables A/c To Proposed dividend A/c To Loans from bank A/c To 10% Debenture A/c To Business purchase A/c To Reserves A/c [W.N.2] (Being assets, liabilities and reserves taken over under pooling of interest method)	2,700 450 400 250	 300 200 250 500 1,980 570
	Liquidator of Sand Ltd. A/c Dr. To Equity share capital A/c (Being payment made to liquidators of Sand Ltd. by allotment of 19,800 new equity shares)	1.980	 1,980
	Trade payables A/c Dr. To Trade receivables A/c (Being mutual owing cancelled)	100	 100
	Proposed dividend A/c Dr. To Bank A/c (Being dividend paid off)	200	 200

Working Notes:

Calculation of purchase consideration

	Shares
One share of Snow Ltd. will be issued in exchange of every share of Sand Ltd. (i.e. 20,000 equity shares of Snow Ltd. will be issued against 20,000 equity shares of Sand Ltd.)	20,000
Less: Shares already held (20% of 10,000) 2,000 shares converted in new equity shares	(200)

Number of shares to be issued by Snow Ltd. to shareholders of Sand Ltd.	19,800

Calculation of Reserves

Less: Cancellation of investment in Snow Ltd. ₹ 250 thousands

Balance of reserve on the amalgamation date ₹ 550 thousands

As per AS 14, the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves (of the transferee company - as explained in AS 14)

Amount recorded as share capital issued by Snow Ltd 1,980 thousands

Amount of share capital of Sand Ltd. ₹2,000 thousands

Amount transferred to the reserves of Snow Ltd. ₹ 20 thousands

Hence, net credit to reserves at the time of taking over of assets and liabilities will be ₹550 thousands + ₹20 thousands = ₹ 570 thousands.

5. (a) From the following information determine the amount of unrealized profits to be eliminated and the apportionment of the same, if C Ltd. Holds 75% of the equity shares of D Ltd.

Sales by C Ltd to D Ltd-

- **Goods costing ₹50,000 at a profit of 20% on sale price. Entire stock was lying unsold as on the Balance Sheet date.**
- **Goods costing ₹70,000 at a profit of 25% on cost price. 40% of the goods were included in closing stock of D Ltd.**

[6]

Answer:

Transaction	Sale by C Ltd.(Holding) to D Ltd.(Subsidiary)	
Nature of transaction	Downstream Transaction	
Profit on transfer	Cost ₹50,000 × Profit on sale 20% / Cost on sale 80% =₹12,500	Cost ₹ 70,000 × Profit on cost 25% = ₹17,500
% of stock included in closing stock	100%	40%
Unrealized Profits to be eliminated(transferred to Stock Reserve)	₹12,500 × 100% = ₹12,500	₹17,500 × 40% = ₹7,000
Share of Majority- reduced from Group Reserves	100% × ₹12,500 = ₹12,500	100% × ₹7,000 = ₹7,000
Share of Minority	Unrealized profit on downstream transactions is fully adjusted against group reserves. Minority Interest is not relevant.	

(b) **From the following details, compute the total value of human resources of skilled and unskilled group of employees according to Lev and Schwartz (1971) model.**

Particulars	Skilled	Unskilled
(i) Annual average earning of an employee till the retirement	₹60,000	₹40,000
(ii) Age of retirement	60 years	60 years
(iii) Discount rate	15%	15%
(iv) No. of employees in the group	30	40
(v) Average age	57 years	58 years

[9]

Answer:

Particulars	Skilled	Unskilled
Average Age	57 years	58 years
Age of Retirement	60 years	60 years
Remaining Period of employment	3 years	2 years
Annual Earnings / Employee	60,000	40,000
Annuity Factor at 15% for 3 / 2 Years	2.2832	1.6257
Value of Employees = Present Value of future earnings of employees = Annual Earnings x Annuity Factor		
(a) Skilled: (60,000 x Annuity Factor at 15% for 3 years)	**₹ 1,36,992**	
(b) Unskilled: (40,000 x Annuity Factor at 15% for 2 years)		**₹ 65,028**
No. of employees	**30**	**40**
Therefore, total Value of Human Resources	**₹ 41,09,760** (1,36,992 x 30 employees)	**₹ 26,01,120** (65,028 x 40 employees)

Total Value of Human Resources

Skilled	₹ 41,09,760
Unskilled	₹ 26,01,120
Total	**₹67,10,880**

6. D Ltd. own 80% of S, 40% of J and 40% of A. J is Jointly controlled entity and A is an Associate. Balance Sheet of four companies as on 31.03.2013 are:

I. Equity &Liabilities	D	S	J	A
Share Capital ₹1 equity share	**1,000**	**400**	**800**	**800**
Reserves and Surplus – Retained earnings	**4,000**	**3,400**	**3,600**	**3,600**
Trade payables-creditors	**200**	**300**	**250**	**250**
Total	**5,200**	**4,100**	**4,650**	**4,650**

II. Assets	D	S	J	A
Non-current assets – fixed assets	1,000	800	1,400	1,000
Non-current Investments				
Investment in S	800	-	-	-
Investment in J	600	-	-	-
Investment in A	600	-	-	-
Current assets	2,200	3,300	3,250	3,650
Total	5,200	4,100	4,650	4,650

D Ltd. acquired shares in S many years ago when retained earnings of S were ₹520. D Ltd acquired its shares in J at the beginning of the year when retained earnings of J were ₹400. D Ltd. acquired its shares in A on 01.04.2012 when retained earnings of A were ₹400.
The Balance of goodwill relating to S had been written off three years ago. The value of goodwill in J remains unchanged. Prepare the Consolidated Balance Sheet of D Ltd as on 31.03.2013 as per AS-21,23 and 27. [15]

Answer:

Basic Information

Company	S Ltd.	J Ltd.	A Ltd.
Nature	Subsidiary	Jointly controlled Entity	Associate
Nature of consolidation	Total consolidation	Proportionate Consolidation	Equity Method
Group Interest	80%	40%	40%
Minority Interest	20%	Not applicable	Not applicable

Analysis of Reserves

S Ltd.	₹
Date of consolidation	3,400
Date of Acquisition(pre-acquisition)	520
Date of Acquisition to date of consolidation(post acquisition)	2,880

J Ltd.	₹
Date of consolidation	3,600
Date of Acquisition(pre-acquisition)	400
Date of Acquisition to date of consolidation(post acquisition)	3,200

A Ltd.	₹
Date of consolidation	3,600
Date of Acquisition(pre-acquisition)	400
Date of Acquisition to date of consolidation(post acquisition)	3,200

Consolidation of balances

(Credit balances in positive debit balances in Negative)

Particulars	Minority of S	Invt. in S (Pre-acq))	Invt. in J (Pre-acq))	Invt. in A (Pre-acq))	Retained Profits

Balance as per Balance Sheet	-	(800)	(600)	(600)	4,000
Share in Equity Capital	80(400 × 20%)	320(400 × 80%)	320(800 × 40%)	320(800 × 40%)	-
Share in Pre-acquisition profits	104(520 × 20%)	416(520 × 80%)	160(400 × 40%)	160(400 × 40%)	-
Share in pre-acquisition value(320 +320)	-	(64)	(120)	(120)	
Share in post acquisition reserves					
From S	576 [2,880 × 20%]				2,304 [2880 × 80%]
From J [3,200 × 40%]					1,280
From A [3,200 × 40%]					1,280
Goodwill adjusted earlier					(64)
For Consolidated Balance Sheet	760 Minority Interest	-	(120) Goodwill	(120) Goodwill	8,800 Retained Earnings

Note: For A Ltd. investments will be retained in the Consolidated Balance Sheet based on Equity Method, i.e. at the Intrinsic value. Intrinsic value = share in the Net worth on the date of consolidation = 40% of (800 + 3,600)=1,760

Investment in A is also arrived at as follows-

Particulars	₹
Cost of investment	600
Less: Goodwill recognized separately	(120)
Net cost on date of acquisition	480
Add: Share in Post acquisition reserves [40% of 3,200]	1280
Value of investment on 31.03.2013 under equity method	1,760

Consolidated Balance Sheet of D as on 31.03.2013

	Particulars	**Note No.**	**Amount (₹)**
I	**Equity and Liabilities**		
(1)	Shareholders' Funds		
	(a) Share Capital		1,000
	(b) Reserves & Surplus		8,800
(2)	Minority Interest		760
(3)	Current Liabilities		
	Trade payables-creditors[D-200+S-300+J(0.4×250)]		600
	Total		**11,160**
II	**Assets**		
(1)	Non-current Assets		
	(a) Fixed Assets: (i)Tangible assets[D-1,000 +S 800+J(0.4×1,400)] (ii)Intangible assets – goodwill on		2,360

	consolidation(120+120)		240
	(b) Non-current investments – in A		1,760
(2)	Current Assets [D 2,200 +S 3,300+ J(0.4×3250)]		6,800
	Total		**11,160**

7. (a) AB Ltd. has entered into a contract by which it has the option to sell its specified asset to XY Ltd. for ₹ 100 lakhs after 3 years, whereas the current market price is ₹ 150 lakhs. Company always settles account by delivery. What type of option is this? Is it a financial instrument? Explain with reference to the relevant accounting standard. [4]

Answer:

As per AS-31 "Financial Instruments : Presentation", a financial asset of one entity and a financial liability or equity instrument of another entity. In the given case, AB Ltd. has entered into a contract with XY Ltd. and company settles its account by delivery, and does not give rise to any financial asset or financial liability. Hence there is no option.

Since, the above transaction does not give rise to a financial asset of one entity and a financial liability or equity instrument of another entity, this is not a financial instrument. It is only a financial contract.

(b) List the disclosures required by an enterprise as per AS-29 for each class of contingent liability at the balance sheet date. [5]

Answer:

An enterprise should disclose for each class of contingent liability at the balance sheet date –

- A brief description of the nature of the contingent liability where practicable.
- An estimate of the amount as per measurement principles as prescribed for provision.
- Indications of the uncertainties relating to outflow.
- The possibility of any reimbursement.
- Where any of the information required as above is not disclosed because it is not practicable to do so, that fact should be stated.

  An enterprise need not disclose any of the disclosure requirement if disclosure of any of this information is expected to prejudice seriously the case of the enterprise in disputes with other party.

(c) The following information is available for a concern. Compute EVA.

Debt Capital 12%	**₹4,000 crores**	**Risk free rate**	**9%**
Equity capital	**₹1,000 crores**	**Beta factor**	**1.05**
Reserves & Surplus	**₹15,000 crores**	**Market rate of return**	**19%**
Capital Employed	**₹20,000 crores**	**Equity(market) risk premium**	**10%**
Operating profit after tax	**₹4,200 crores**	**Tax rate**	**30%**

[6]

Answer:

Particulars	

Cost of Equity (k_e)= Risk free rate + (Beta × market risk premium)	9 + (1.05 × 10)=19.5%
Cost of Debt (K_d) = Interest × (100% - tax rate)	12 × 70% = 8.40%
Debt- Equity Ratio (as given in the question)	20% & 80%
WACC = [(K_d) × Debt % + (k_e) × Equity %]	(8.40 × 20% + 19.50 × 80%)=17.28%
Operating profit after tax	₹4,200 crores
Capital charge = Capital employed × WACC	₹3,456 crores
Economic Value Added	₹(4,200 – 3,456)=₹744 crores

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

(a) Environmental Accounting.
(b) List the functions of the Committee on Public Undertakings.
(c) Describe the process of election of Public Accounts Committee.
(d) Market Value Added (MVA)

Answer:

(a) Environmental Accounting can be defined as a system (methodology) for measuring environmental performance and communicating the results of these measurements to users. It helps in presenting the utilization of natural resources by an enterprise, the costs incurred to use them and the income earned there from in a transparent manner. Environmental accounting, entirely a new concept, is a faithful attempt to identify the resources exhausted and costs rendered reciprocally to the enterprise by a business corporation. Thus environmental accounting stands for recording and documenting environmental performance to facilitate effectiveness of environmental management system with reference to compliance, safety and quality control.

It provides a data base for taking corrective steps and future action for developing organization's environmental strategy and for identifying environmentally based opportunities for gaining an edge over one's competitors. If proper environmental accounting system is established, the enterprise will be able to anticipate environmental damage and therefore can prevent it from happening.

(b) The Committee on Public Undertakings exercises the same financial control on the public sector undertakings as the Public Accounts Committee exercises over the functioning of the Government Departments. The functions of the Committee are:

(i) to examine the reports and accounts of public undertakings.

(ii) to examine the reports of the Comptroller & Auditor General on public undertakings.

(iii) to examine the efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, in doing so, is not to focus only on the individual irregularity, but on the defects in the system which led to such irregularity, and the need for correction of such systems and procedures.

(c) In April each year a motion is moved in Lok Sabha by the Minister of Parliamentary Affairs or Chairman of the Committee, if in office, calling upon members of the House to elect from amongst themselves 15 members to the Public Accounts Committee. After the motion is adopted, a programme, fixing the dates for filing the nominations/withdrawal of candidatures and the election, if necessary, is notified in Lok Sabha Bulletin Part-II. On receipt of nominations, a list of persons who have filed nomination papers is put up on the Notice Boards. In case the number of members nominated is equal to the number of members to be elected, then, after expiry of time for withdrawal of candidatures, the members nominated are declared elected and the result published in Bulletin Part-II. If the number of members nominated after withdrawals is more than number of members to be elected, election is held on the stipulated date and result of election published in Bulletin Part-II.

(d) Market value Added (MVA) is the difference between the current market value of a firm and the capital contributed by investors. If MVA is positive, the firm has added value. If it is negative the firm has destroyed value.
To find out whether management has created or destroyed value since its inception, the firm's MVA can be used:
MVA=Market value of capital – capital employed

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

The higher the MVA, the better. A high MVA indicates the company has created substantial wealth for the shareholders. A negative MVA means that the value of the actions and investments of management is less than the value of the capital contributed to the company by the capital markets, meaning wealth or value has been destroyed.
The aim of the company should be to maximize MVA. The aim should not be to maximize the value of the firm, since this can be easily accomplished by investing ever-increasing amounts of capital.