FINAL EXAMINATION
GROUP IV
(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS
JUNE 2012

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.

Part A questions are compulsory. Attempt all *of them.*

Part B has seven questions. Attempt any five *of them.*

Please : (1) Write answers to all parts of a question together.
(2) Open a new page for answer to a new question.
(3) Attempt the required number of questions only.
(4) Indicate in the front page of the answer book the question attempted.

PART A (25 Marks)

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

(i) RAJASTHALI Ltd. purchased Fixed Assets costing ₹ 6,000 lakhs on 1.4.2011 and the same was fully financed by Foreign Currency Loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40 and ₹ 42.50 as on 1.04.2011 and 31.03.2012 respectively. First instalment was paid on 31.03.2012. As per AS-11, Exchange Difference to be charged to P & L A/c for the year 2011-12 will be :

A. ₹ 375 lakhs	B. ₹ 250 lakhs	C. ₹ Nil	D. None of these

(ii) PRARTHANA & PIYUSH Ltd. bought a forward contract for three months of US $ 2,00,000 on 1st March at 1 US $ = ₹ 50.10 when spot exchange rate was US $ 1 = ₹ 50.11. On 31 st March when the books were closed forward exchange rate for two months was US $ 1 = ₹ 50.15.

On 30th April, the contract was sold at ₹ 50.18 per dollar. As per AS 30, the profits from sale of contract to be recognized in the P & L A/c will be :

A. ₹ 2,000	B. ₹ 10,000	C. ₹ 6,000	D. None of these

(iii) BHARAT & TUSHAR Ltd. obtained a Loan from a bank for ₹ 240 lakhs on 30.04.2011. It was utilized for : Construction of a shed ₹ 100 lakhs, Purchase of a machinery ₹ 80 lakhs, Working Capital ₹ 40 lakhs, Advance for purchase of truck ₹ 20 lakhs, Construction of shed was completed in March 2012. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31.03.2012 was ₹ 36 lakhs. As per AS 16, Interest to be debited to Profit & Loss account will be :

A. ₹ 36 lakhs	B. ₹ 21 lakhs	C. ₹ 9 lakhs	D. None of these

(iv) M/s XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are: Segment X ₹ 2.00 crores, Segment Y ₹ 6.00 crores and Segment Z ₹ 12.00 crores. Deferred tax assets included in the assets of each Segments are X- ₹ 1 crore, Y- ₹ 0.80 crores and Z- ₹ 0.60 crores. The accountant contends that all the three Segments are reportable segments. As per AS 17 :

A. X, Y, and Z are reportable segments	B. Only X and Y are reportable segments	C. Only X and Z are reportable segments	D. Only Y and Z are reportable segments

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

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

(vi) As per records of NAVEEN ND Ltd. Accounting Profit ₹ 12,00,000, Book Profit as per MAT ₹ 7,00,000, Profit as per Income Tax Act ₹ 1,20,000, Tax Rate 20%, MAT Rate 7.50%. As per AS-22, Deferred Tax Asset/Liability will be :

A. ₹ 2,40,000	B. ₹ 2,16,000	C. ₹ 48,000	D. ₹ 2,68,500

(vii) As per records of PELF 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

(viii) Accountants of M. K. SHARDA Ltd. show a Net Profit of ₹ 14,40,000 for the third quarter of 2011 after incorporating the following :

(i) Bad debts of ₹ 80,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Extra ordinary loss of ₹ 70,000 incurred during the quarter has been fully recognized in this quarter.

(iii) Additional depreciation of ₹ 90,000 resulting from the change in the method of charge of depreciation.

As per AS 25, the Correct Quarterly Income is :

A. ₹ 14,00,000	B. ₹ 13,70,000	C. ₹ 13,33,000	D. None of these

(ix) SRIJAN Ltd. wishes to obtain a machine costing ₹ 60 lakhs by way of lease. The effective life of the machine is 15 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 6 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. As per AS 19, what should be recognized as an expense in the Statement of Profit and Loss in the books of Lessee :

A. Total Lease Payments	B. Only Finance Charges included in Lease payments	C. Depreciation of ₹ 4,00,000 p.a.	D. None of these

(x) S CHAND 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

(b) (i) In case of Demerger :

A. Demerged Company issues Shares to the Resulting Company.
B. Resulting Company issues Shares to the Demerged Company.
C. Resulting Company issues Shares to the Shareholders of Demerged Company.
D. Demerged Company issues Shares to the Shareholders of Resulting Company. [1]

(ii) Economic Activity of Investment Associate Ltd. is controlled by Holding Ltd. and Subsidiary Ltd. State the Relevant Accounting Standard (out of AS 13, AS 21, AS 23, AS 27) applicable if Holding Ltd. holds.

A. 19% Shares in Investment Associate Ltd.
B. 20% Shares in Investment Associate Ltd.
C. 50% Shares in Investment Associate Ltd.
D. 51 % Shares in Investment Associate Ltd. [1×4]

Answer 1. (a)

(i) **A** — ₹ 375

Foreign Currency Loan= ₹ 6,000 lakhs/ ₹ 40= 150 lakhs US Dollars

Exchange difference = 150 lakhs US Dollars × (42.50 – 40.00) = ₹ 375 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 375 lakhs should be charged to Profit and Loss Account for the year.

(ii) **C** — ₹ 6,000

Sale Rate	₹ 50.18
Less: Fair Value on 31.03.2012	₹ 50.15
Premium on Contract	₹ 0.03
Contract Amount	US$ 2,00,000
Total Profit (2,00,000 × 0.03)	₹ 6,000

(iii) **B** — ₹ 21 Lakhs

Qualifying Asset as per AS-16 = ₹ 100 lakhs (construction of a shed)

Borrowing cost to be capitalized = 36 × 100/240 = ₹ 15 lakhs

Interest to be debited to Profit or Loss account = ₹ (36 – 15) lakhs

= ₹ 21 lakhs

(iv) **D** — Only Y & Z are reportable segments.

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are 17.6 crores [20 crores - (1+0.8+0.6)].

Segment X holds total assets of 1 crore (2 crore - 1 crore); Segment Y holds 5.2 crores (6 crores - 0.8 crores); and Segment Z holds 11.4 crores (12 crores - 0.6 crores).

Thus, Only Y and Z hold more than 10% of the total assets and hence Only Y and Z are reportable segments.

(v) **A** — X Ltd., Y Ltd., W Ltd.

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

(vi) **B** — ₹ 2,16,000

Tax as per accounting profit	12,00,000 × 20% = 2,40,000
Tax as per Income-tax Profit	1,20,000 × 20% = 24,000

Therefore, Deferred Tax liability as on 31-03-2004 = 2,40,000 – 24,000 = 2,16,000

(vii) **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

(viii) **A** — ₹ 14,00,000

Bad debts of ₹ 80,000 have been incurred during the quarter. Out of this, the company has deferred 50% (i.e.) ₹ 40,000 to the next quarter. Therefore, ₹ 40,000 should be deducted from ₹ 14,40,000.

∴ The correct quarterly income = ₹ 14,40,000 – ₹ 40,000 = ₹ 14,00,000.

(ix) **A** — Total lease payments.

The given lease agreement is an operating lease since :

(a) the present value of minimum lease payment amount [₹ 20.10 lakhs (i.e. ₹ 6 lakhs × 3.35)] is substantially less than the fair value of leased asset (i.e. ₹ 60 lakhs).

(b) the lease term (5 years) is substantially less than economic life of the asset (15 years) As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially equal to the fair value of leased asset.

Therefore, Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Note : PVAF @ 15% for 5 years is 3.35

(x) **D** — ₹ 55, ₹ 5

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

Answer 1. (b)

(i) **C.** — Resulting Company issues Shares to the Shareholders of Demerged Company.

Tutorial Note : Demerger is the act of splitting off a part of an existing company to become a new company, which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. A demerger is often done to help each of the segments to operate more smoothly, as they can now focus on a more specific task.

(ii) **A.** — AS 27

If Holding Ltd holds 19% shares in Investment Associate Ltd. it is controlling the economic activity of the company. So it cannot be termed as mere investment. So AS 13 is not applicable.

It is controlling only 19% of shares, it cannot be the holding company. So AS 21 is not applicable.

An associate can have only significant influence, it is controlling the economic activity of Investment Associate Ltd.So it is not an associate. So AS is 23 not applicable.

So with only 19% investment, it is controlling economic activity with can happen only under contractual arrangement and joint control together which is joint venture. So AS 27 is applicable.

B. — AS 27 is applicable.

If Holding Ltd holds 20% shares in Investment Associate Ltd. it is controlling the economic activity of the company. So it cannot be termed as mere investment. So AS 13 is not applicable.

It is controlling only 20% of shares, it cannot be the holding company. So AS 21 is not applicable.

An associate can have only significant influence, it is controlling the economic activity of Investment Associate Ltd.So it is not an associate. So AS 23 is not applicable.

So with only 20% investment, it is controlling economic activity with can happen only under contractual arrangement and joint control together which is joint venture. So AS 27 is applicable.

C. — AS 27 is applicable.

If Holding Ltd holds 50% shares in Investment Associate Ltd. it is controlling the economic activity of the company. So it cannot be termed as mere investment. So AS 13 is not applicable.

It is controlling only 50% of shares, it cannot be the holding company. So AS 21 is not applicable.

An associate can have only significant influence, it is controlling the economic activity of Investment Associate Ltd.So it is not an associate. So AS 23 is not applicable.

So with only 50% investment, it is controlling economic activity with can happen only under contractual arrangement and joint control together which is joint venture. So AS 27 is applicable.

D. — AS 21 is applicable.

With holding 51% of shares, Holding Ltd. is the holding company. So AS 21 is applicable.

TUTORIAL NOTES :

AS-13: Accounting for investments — This Standard deals with accounting for investments in the financial statements of an enterprise and relevant disclosure requirement. Investments are assets held for earning income, capital appreciation or for other benefits to the investing enterprise, obviously investments held as 'stock-in-trade' are not 'Investments'.

AS-21: Consolidated financial statements — Consolidated financial statements are presented by the parent or holding enterprise to provide financial information about the economic activities of its group – information about the parent and subsidiaries as a single economic entity revealing economic resources controlled by the group, the obligation of the group and the result that the group achieved with its resources.

AS-21 lays down the principles and procedures for preparation and presentation of consolidated financial statements in the backdrop of the facts that the Company's Act '56 doesn't provide for consolidation vis-à-vis the compliance to be made by listed companies in terms of AS-21.

Thus in parent enterprise's separate financial statements, investment in subsidiaries should be accounted for as per AS-13, i.e. Accounting for Investments.

AS-23: Accounting for investments in associates in Consolidated Financial statements (CFS)

An enterprise that presents CFS should account for investments in Associates as per this standard. This standard is not applicable for preparing and presenting stand-alone Investors' financial statement (in such cases AS] 3 is followed).

An Associate is an enterprise in which the investor has significant influence (power to participate in the financial/operating policy decisions of the investee but not control over those policies) and which is neither a subsidiary nor a joint venture of the Investor. The 'control' for the purpose of AS-23 is similar to that of AS-21.

AS-27: Financial reporting of interest in joint venture

AS-27 is applicable for accounting in joint venture interest and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturer and investors, regardless ofthe structure or forms under which the joint venture activities take place. A joint venture is a contractual arrangement between two or more parties undertaking an economic activity, subject to joint control (control is the power to govern the financial and operating policies of an economic activity to obtain benefit from it).

The arrangement may be :

(a) Jointly controlled operations.

(b) Jointly controlled asset.

(c) Jointly controlled entities.

PART B (75 Marks)

Q. 2. (a) As on 1st April, 2011 the Fair Value of Plan Assets was ₹ 1,00,000 in respect of a pension plan of X Ltd. On 30th September, 2011 the plan paid out benefits of ₹ 20,000 and received inward contributions of ₹ 50,000. On 31 st March, 2012 the fair value of plan assets was ₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,48,000. Actuarial losses on the obligations for the year 2011-12 were ₹ 1,000. On 1 st April, 2011 the company made the following estimates, based on its market studies, understanding and prevailing prices :

Interest & Dividend Income, after tax payable by the fund	9.50%
Realized and unrealized gains on Plan Assets (after tax)	2.00%
Fund Administrative Costs	(1.25%)
Expected Rate of Return	10.25%

Required : Find the Expected & Actual Returns on Plan Assets for the year 2011-12. [5]

(b) Y Ltd. gives the following estimates of cash flows relating to fixed asset on 31.12.2010. The discount is 15%.

Year	2011	2012	2013	2014	2015
Cash Flow (₹ in lakhs)	4000	6000	6000	8000	4000

Residual value at the end of 2015 : ₹ 1000 lakhs, Fixed Asset purchased on 1.1.2008 :
₹ 40,000 lakhs, Useful Life : 8 years, Net Selling Price on 31.12.2010 : ₹ 20,000 lakhs.

Year	**1**	**2**	**3**	**4**	**5**
PVF @15%	0.870	0.756	0.658	0.572	0.497

Required : Calculate on 31-12-2010: (a) Value in use on 31-12-2010, (b) Carrying amount at the end of 2010, (c) Impairment Loss to be recognized for the year ended 31-12-2010, (d) Revised Carrying Amount, (e) Depreciation charge for 2011. [5]

(c) At the beginning of year 1, Z Ltd. issued 20,000 Convertible Debentures with face value ₹ 100 per debenture, at par. The debentures have six-year term. The interest at annual rate of 9% is paid half-yearly. The bondholders have an option to convert half of the face value of debentures into 2 Equity Shares at the end of year 3. The bondholders not exercising the conversion option will be repaid at par to the extent of ₹ 50 per debenture at the end of year 3. The non-convertible portion will be repaid at 10% premium at the end of year 6. At the time of issue, the prevailing market interest rate for similar debt without conversion option was 10%. Compute Value of Embedded Derivative assuming that all the bondholders will exercise an option to convert debentures into Equity Shares. (Use Present Value Factors upto 3 digits after decimal point). [5]

Answer 2. (a)

A. Closing Balance of Fair Value of Plan Assets	₹ 1,50,000
B. Add : Benefit Paid	₹ 20,000
C. Less : Contributions Received	(₹ 50,000)
D. Less : Opening Balance of Fair Value of Plan Assets	(₹ 1,00,000)
E : Actual Return on Plan Assets	**₹ 20,000**

A. Return on Opening Balance of Fair Value of Plan Assets [₹ 1,00,000 × 10.25% × 12/12]	₹ 10,250
B. Return on Net Contributions Received [Contributions - Benefits Paid] [(₹ 50,000 - ₹ 20,000) × 5%]	₹ 1,500
C : Expected Return on Plan Assets	**₹ 11,750**

Note : Equivalent Half Yearly Compounding Interest Rate = $\sqrt{(1+\text{EXPECTED RATE OF RETURN})}-1$

$=\sqrt{(1+\cdot1025)}-1$ **= .05 or 5%**

Answer 2. (b)

(a) Calculation of Value in use

Year	Cash Flow	Discount factor as per 15%	Discounted cash flow
2011	4000	0.870	3480
2012	6000	0.756	4536
2013	6000	0.658	3948
2014	8000	0.572	4576
2015	4000	0.497	1988
2015	1000	0.497	497

Value in use = ₹ 19025 lakhs

Recoverable Amount (being Net Selling Price or Value in use whichever is higher) = 20,000 lakhs

Carrying amount on 31-12-2010= Original Cost - Depreciation for 3 years

= 40,000 –[(40,000 – 1000) × 3/8] = ₹ 25,375

Impairment Loss = Carrying amount- Recoverable amount = ₹ (25,375-20,000) = ₹ 5,375 lakhs
Revised carrying amount = ₹ (25,375-5,375) = ₹ 20,000 lakhs
Depreciation Charge for 2011 = (20,000-1000)/5 = ₹ 3,800

Answer 2. (c)

	Cash Flow	**DF**	**PV**
Half-year	₹ '000	(5%)	₹ '000
1-6	90	5.076	456.84
7 -12	45	3.787	170.41
12	1,100	0.557	612.70
Value of host (Liability component)			1,239.95
Value of embedded derivative (Equity component) (bal. fig.)			760.05
Issue proceeds			2,000.00

Q. 3. The Balance Sheet of RAJASTHALI Ltd. as at 31st March, 2012 is given below :

Liabilities	₹	*Assets*	₹
Equity Shares of ₹ 10 each fully paid up	1,00,000	Goodwill	90,000
Equity Shares of ₹ 10 each ₹ 8 paid up	1,60,000	Patents & Trade Marks	2,00,000
Equity Shares of ₹ 5 each fully paid up	1,50,000	Tangible Fixed Assets	2,10,000
Less: Calls-in-arrears @ ₹ 2	(20,000)	10% Investments: [Face Value	
Equity Shares of ₹ 1 each fully paid up	50,000	₹ 80,000]	1,00,000
15% Preference Shares of		Current Assets	3,36,000
₹ 100 each fully paid	1,00,000	Underwriting Commission	2,00,000
Less : Calls-in-arrears @ ₹ 20	(4,000)		
General Reserve	50,000		
Profit & Loss A/c.	2,00,000		
Non-Current Liabilities	1,00,000		
Current Liabilities	88,960		
Proposed Dividend (Equity & Pref.)	1,46,400		
Dividend Distribution Tax	14,640		
	11,36,000		11,36,000

Additional Information :

(a) Goodwill is found undervalued by ₹ 1,26,300. On 01.04.2011, a new machinery costing ₹ 1,00,000 was purchased but wrongly charged to revenue. Machinery is subject to Depreciation @ 10% (No rectification has yet been made).

(b) 50% of Total Tangible Fixed Assets are found undervalued by 50% of market value and 50% of the remaining are found overvalued by 50% of market value.

(c) Of the investments 10% is trade and the balance non-trade. All trade investments are to be valued at 10% below cost.

(d) Disputed Bonus claim of ₹ 29,000 not yet provided in the accounts for 2011-12 is to be settled at ₹ 19,000.

Required: Calculate the Ex-Dividend and Cum-Dividend Intrinsic Value of Equity Shares. [15]
(Assume Income Tax Rate of 30%)

Answer 3.

Statement showing the Valuation of Equity Shares on Net Assets basis

	Particulars	₹
A.	**Total Assets at their current values :**	
	Goodwill [90,000 + 1,26,300]	2,16,300
	Patents & Trade Marks	2,00,000
	* Tangible Fixed Assets [50% of (2,10,000 + 90,000) + 100% of 1,50,000] + [50% of 1,50,000 – 1/3 of ₹ 75,000] + [50% of ₹ 1,50,000]	4,25,000
	Trade Investments [(10% of 1,00,000) - (10% of 10,000)]	9,000
	Non-trade Investments [90% of 1,00,000]	90,000
	Current Assets	3,36,000
	Notional Uncalled Call on Partly-paid-up Shares [20,000 × ₹ 2]	40,000
	Calls-in-arrears on Equity Shares [10,000 × ₹ 2]	20,000
	Calls-in-arrears on Preference Shares [200 × ₹ 20]	4,000
	Total Assets	13,40,300
B.	Less : **Outsiders' Liabilities :**	
	Non-Current Liabilities	1,00,000
	Current Liabilities	88,960
	Unrecorded Liability (Bonus)	19,000
	Proposed Dividend (Equity & Pref.)	1,46,400
	Dividend Distribution Tax	14,640
	Tax Payable on Adjustment [30% (1,00,000 – 10,000 – 19,000)]	21,300
	Total	3,90,300
C.	Net Assets available for Share holders [A - B]	9,50,000
D.	Less : Preference Share Capital	(1,00,000)
E.	Net Assets available for Equity Share holders [C- D]	8,50,000
F.	Total Equivalent Number of Equity Shares of ₹ 10 each [10,000 (₹ 10 each) + 20,000 (₹ 8) + 15,000 (₹ 5) + 5,000 (₹ 1)]	50,000
G.	**Ex-Dividend Value per Equity Share of ₹ 10 each fully paid up [*E*/*F*]**	17.00
	Ex-Dividend Value per Equity Share of ₹ 10 each, ₹ 8 paid-up = ₹ 17 - ₹ 2	15.00
	Ex-Dividend Value per Equity Share of ₹ 5 each = ₹ 17 * 5/10	8.5
	Ex-Dividend Value per Equity Share of ₹ 5 each, ₹ 3 paid-up = ₹ 8.5 - ₹ 2	6.5
	Ex-Dividend Value per Equity Share of Re 1 each fully paid-up = ₹ 17 * 1/10	1.70
H.	**Cum-Dividend Value Per Equity Share = Ex-Dividend Value + Proposed Equity Dividend per Share**	
	Value per Equity Share of ₹ 10 each fully paid up = ₹ 17 + 30% of ₹ 10	20.00
	Value per Equity Share of ₹ 10 each, ₹ 8 paid-up = ₹ 15 + 30% of ₹ 8	17.40
	Value per Equity Share of ₹ 5 each fully paid up = ₹ 8.50 + 30% of ₹ 5	10.00
	Value per Equity Share of ₹ 5 each, ₹ 3 paid-up = ₹ 6.50 + 30% of ₹ 3	7.40
	Value per Equity Share of Re 1 each fully paid-up = ₹ 1.70 + 30% of ₹ 1	2.00

Notes :

***** (i) Tangible Fixed Asset = ₹ 2,10,000 + ₹ 90,000 (1,00,000 – 10,000)

50% of Tangible Fixed Asset under valued by 50% of Market Value.

∴ Market Value of under valued asset = ₹ 3,00,000

50% of remaining 50% of Tangible Asset overvalued by 50%.

∴ Market value of overvalued asset = $\frac{75,000}{50} \times 100$ = ₹ 50,000.

Market value of rightly valued asset = ₹ 75,000

∴ Total value of Tangible Fixed Asset = ₹ (3,00,000 + 75,000 + 50,000)

= ₹ 4,25,000.

(ii) Proposed Equity Dividend = Total Proposed Dividend - Proposed Pref. Dividend

= ₹ 1,46,400 – (15% of ₹ 96,000) = ₹ 1,32,000

(iii) Equity Dividend as % of Paid-up Equity Share Capital = $\frac{₹\ 1,32,000}{₹\ 4,40,000} \times 100 = 30\%$

Q. 4. The following are the Balance Sheets of P Ltd. and V Ltd. as at 31st March, 2012 :

Liabilities	P Ltd. ₹	V. Ltd. ₹	*Assets*	P Ltd. ₹	V. Ltd. ₹
Equity Share of ₹ 10 each	6,00,000	2,00,000	Goodwill	—	1,25,000
General Reserve	1,50,000	20,000	Tangible Fixed Assets	4,75,000	1,50,000
Profit & Loss A/c	1,91,500	11,500	Investments	1,09,000	—
Investment Allowance			Stock	95,000	55,000
Reserve	—	2,000	Debtors	1,40,000	65,000
Export Profit Reserve	—	3,000	Cash at Bank	1,50,000	37,000
10% Debentures	—	50,000	Preliminary Expenses	10,000	17,500
Loan from Bank	—	23,000			
Trade Creditors	37,500	1,40,000			
	9,79,000	4,49,500		9,79,000	4,49,500

The business of V Ltd. is taken over by P Ltd. as on that date on the following terms:

(a) Prior to absorption, V Ltd. and P Ltd. decide to declare and pay dividend @ 5%. (Assume Dividend Distribution Tax @ 15%).

(b) 50% of Tangible Fixed Assets are taken over at 100% more than the book value and 50% of the remaining Tangible Fixed Assets are taken over at $33\frac{1}{3}$% less than the book value.

(c) Goodwill is to be valued at 4 years' purchase of the excess of average of five years' profits over 8% of the combined amount of Share Capital and General Reserve.

(d) Stock and Debtors are taken over at book value less 10%.

(e) The issue of such an amount of fully paid 14% Debentures in P Ltd. at 96 per cent is sufficient to discharge 10% Debentures in V Ltd. at a premium of 20 per cent.

(f) Trade Creditors are to be taken over subject to a discount of 5% and other liabilities (including Unrecorded Loan Liability of ₹ 15,500) to be discharged by P Ltd. at book value.

(g) The purchase consideration is to be discharged to the extent of 20% in cash and the balance in the form of equity shares of Rs. 10 each, ₹ 8 paid up at a premium of ₹ 7 per share. The market value of an equity share of P Ltd. at present is ₹ 100.

(h) Expenses of liquidation of V Ltd. are to be reimbursed by P Ltd. to the extent of ₹ 10,000. Actual Expenses amounted to ₹ 12,000.

(i) The investment Allowance Reserves and Export Profit Reserve are to be maintained for 2 more years.

The average of the five years' profit is ₹ 30,100. Prior to 31st March 2012 V Ltd. sold goods costing ₹ 30,000 to P Ltd. for ₹ 40,000. ₹ 25,000 worth of goods were still in stock of P Ltd. Debtors include ₹ 20,000 still due from P Ltd. On the date of absorption, V Ltd. owed P Ltd. ₹ 60,000 for the purchases of stock from P Ltd. which made a profit of 20% on cost. Four-fifth of such stock were sold till 31.3.2012. Investments of P. Ltd. include ₹ 9,000 representing the cost of 10% Debentures of V Ltd.

Required: Pass Journal Entries in the books of P Ltd. [15]

Answer 4.

Journal of P Ltd.

Particulars		*L.F.*	***Dr.*** **(₹)**	***Cr.*** **(₹)**
Profit & Loss A/c	Dr.		34,500	
To Dividend Payable A/c				30,000
To Dividend Distribution Tax A/c				4,500
(Being the Dividend declared @ 5% and DDT payable @ 15%)				
Dividend Payable A/c	Dr.		30,000	
Dividend Distribution Tax A/c	Dr.		4,500	
To Bank A/c				34,500
(Being the Dividend and Dividend Tax paid)				
Business Purchase A/c	Dr.		1,62,557	
To Liquidators of V Ltd.				1,62,557
(Being the purchase price agreed to be paid for the business of V Ltd.)				
Goodwill (Balancing figure)	Dr.		57,557	
Tangible Fixed Assets	Dr.		2,12,500	
Stock	Dr.		49,500	
Debtors	Dr.		58,500	
Bank	Dr.		23,500	
Reserve for Discount on Creditors [5% of ₹ (1,40 000 - 60,000)]	Dr.		4,000	
To Provision for Doubtful Debts [10% of ₹ (65,000 - 20,000)]				4,500
To Sundry Creditors				1,40,000
To 10% Debentures [₹ 50,000 + 20%]				60,000
To Loan from Bank				23,000
To Unrecorded Loan				15,500
To Business Purchase A/c				1,62,557
(Being the assets and liabilities taken over from V Ltd.)				

Liquidators of V Ltd.	Dr.		1,62,557	
To Bank A/c				32,567
To Equity Share Capital A/c				69,328
To Securities Premium A/c				60,662
(Being the issue of Shares and payment in cash in satisfaction of purchase consideration)				
Goodwill A/c	Dr.		10,000	
To Bank A/c				10,000
(Being the payment of Realization Expenses of V Ltd.)				
Goodwill	Dr.		6,250	
To Stock A/c				6,250
(Being the Elimination of unrealized profit on unsold goods worth ₹ 25,000 bought from V Ltd. still unsold (25,000 × 10,000/40,000)				
Creditors A/c	Dr.		20,000	
To Debtors (V Ltd.) A/c				20,000
(Being Elimination of the amount owed by us to V Ltd.)				
Goodwill A/c	Dr.		800	
To Stock				800
(Being the elimination of unrealized profit included in goods purchased by V Ltd.)[(20% of ₹ 60,000 × 1/6) - (10% of ₹ 12,000)]				
Creditors (V Ltd.) A/c	Dr.		60,000	
To Debtors A/c				60,000
(Being the cancellation of Inter Co. Owing)				
10% Debentures of V Ltd.	Dr.		60,000	
Discount on Issue of 14% Debentures A/c	Dr.		2,000	
To Investments in 10% Debentures of V Ltd.				9,000
To 14% Debentures A/c				50,000
To Capital Reserve A/c				3,000
(Being the Investment in 10% Debentures of V Ltd. cancelled and the remaining debentures redeemed by issue of 500, 14% Debentures of ₹ 100 each at a discount of 4%) [Face Value of Debentures = ₹ 48,000/.96 = ₹ 50,000]				
Loan from Bank A/c	Dr.		23,000	
Unrecorded Loan A/c	Dr.		15,500	
To Bank A/c				38,500
(Being the liabilities of V Ltd. discharged)				
Amalgamation Adjustment A/c	Dr.		5,000	
To Investment Allowance Reserve A/c				2,000
To Export Profit Reserve A/c				3,000
(Being the identity of Statutory Reserves retained)				

Capital Reserve A/c To Goodwill A/c (Being the goodwill adjusted against Capital Reserve)	Dr.		3,000	 3,000

Working Notes :

(i) *Calculation of Goodwill :*

Super Profit = Average Profit - Normal Profit = 30,100 - (8% of ₹ 2,20,000) = 12,500

Goodwill at 4 years' Purchase of Super Profit = (12,500 × 4) = 50,000

(ii) *Calculation of Purchase Consideration:*

A	Assets taken over at agreed values		₹
	Tangible Fixed Assets [(₹ 1,50,000 × 50%) + 100%]		1,50,000
	Tangible Fixed Assets [(₹ 75,000 × 50%) - $33\frac{1}{3}$%]		25,000
	Tangible Fixed Assets [₹ 75,000 × 50%]		37,500
	Stock [₹ 55,000 - ₹ 5,500]		49,500
	Debtors [₹ 65,000 - ₹ 6,500]		58,500
	Cash at Bank [37,000 - 10,000 - 1,500 - 2,000]		23,500
	Goodwill as per (i) above		50,000
			3,94,000
B	*Less:* Liabilities taken over :		
	Trade Creditors	1,40,000	
	Less : Reserve for Discount @ 5%	7,000	1,33,000
	10% Debentures [₹50,000 + 20%]		60,000
	Loan from Bank		23,000
	Unrecorded Loan		15,500
			2,31,500
B	Net Assets taken over (Purchase Consideration) *(A* - B)		1,62,500

(iii) *Discharge of Purchase Consideration:*

Payable in Cash (20% of ₹1,62,500)	32,500
In shares- [(80% of ₹1,62,500)/₹15]	
8,666 shares of ₹10 each, ₹8 paid up valued at ₹15 per share	1,29,990
Cash for Fractional Share (.67 × ₹100)	67
	1,62,557

Q. 5. The following is the Balance Sheet of Road Block Ltd. as at 31st March, 2012 :

₹ in lakhs

Liabilities		₹	*Assets*	₹
Equity Shares of ₹ 10 each		500	Goodwill	10
6% cum-Pref. Shares of ₹ 100 each		100	Patents & Copy Rights	5
Capital Reserve		6	Plant & Machinery	719.6
Workmen's Compensation Fund:			10% Government Loan Earmarked	
Pune	2		Against Workmen's Compensation	
Bombay	1	3	Fund	3
10% First Debentures		60	Investments in Shares in Q Ltd.	32.4
10% Second Debentures		100	Stock	60
Debentures Interest outstanding		16	Debtors	10
Trade Creditors		165	Cash at Bank	104
Provision for Tax		10	Discount on issue of Debentures	1
			Profit and Loss Account	15
		960		960

Note : Dividend on Preference Shares are in arrears for three years.

The following scheme of internal reconstruction was approved by the Court and implemented:

(a) All the equity shares be converted into the same number of equity shares of ₹ 5 each, ₹ 2.50 paid up.

(b) The preference shares are converted from 6% to 15% but revalued in a manner in which the total return on them remains unaffected. Four equity shares of ₹ 5 each, ₹ 2.50 paid up to be issued for each ₹ 100 of arrears of preference dividend.

(c) Mr. A holds 10% first debentures for ₹ 40 lacs and 10% second debentures for ₹ 60 lacs. He is also a creditor for ₹ 10 lacs. Mr. 'A' is to cancel ₹ 60 lacs of his total debt and to pay ₹ 10 lacs to the company and to receive new 12% Debentures for the balance amount.

(d) Mr. B holds 10% first debentures for ₹ 20 lacs and 10% second debentures for ₹ 40 lacs and is also a creditor for ₹ 5 lacs. Mr. 'B' is to cancel ₹ 30 lacs of his total debt and to accept new 12% Debentures for the balance amount.

(e) Trade Creditors (other than A and B) are given the option of either to accept equity shares of ₹ 5, ₹ 2.50 paid up each, for the amount due to them or to accept 80% of the amount due in cash. 40% Creditors accepted equity shares whereas the balance accepted cash in full settlement.

(f) There were capital commitments totalling ₹ 300 lacs. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(g) The Directors refund ₹ 11 lacs of the fees previously received by them.

(h) Workmen's Compensation Fund (Bombay) disclosed the fact that actually there was a liability of ₹ 20,000 only. As a result the relevant fund amount balance was to be brought down to the required amount. Investments were realised at 10% above the book value.

(i) The taxation liability of the company is settled at ₹ 8.88 lacs and the same is paid immediately.

(j) Road Block Ltd. holds 21,600 shares in Q Ltd. This represents 15% of the share capital of that company.

Q Ltd. is not a quoted company. The average net profit (after tax) of the company is ₹ 25 lacs. The shares would be valued based on 12% capitalization rate.

(k) A dissentient shareholder transferred his 100 shares to a director.

(l) Stock is to be valued at 114% of book value. 80% of Debtors are considered as Bad and 20% of the balance Debtors are considered as Doubtful. Any surplus after writing off the various losses should be utilized in writing down the value of plant & machinery.

(m) All equity share holders paid the balance to make the shares fully paid up and then all equity shares were consolidated into the shares of ₹ 10 each.

Required: Prepare the Reconstruction Account. [15]

Answer 5.

(i) Valuation of Investments in Shares of Q Ltd.= (₹ 25 lacs/.12) × 15% = ₹ 31.25 lacs

(ii) Reduction in the Value of Investment in Shares of Q Ltd.

= ₹ 32.40 lacs – ₹ 31.25 = ₹ 1.15 lacs

(iii) The transfer of 100 Shares by a dissentient shareholder to the director concerned and waiver of the right to arrears of pref., dividend need not be accounted for.

Dr. **Reconstruction Account** ***Cr.***

Particulars	₹ (lacs)	*Particulars*	₹ (lacs)
To Equity Share Capital A/c (₹ 5 each)	1.80	By Equity Share Capital (₹ 10 each)	375.00
To Bank A/c	15.00	By 6% Cum. Pref. Share Capital	60.00
To Investment in Shares in Q Ltd.	1.15	By Mr. A (Sundries)	60.00
To Debtors	8.00	By Mr. B (Sundries)	30.00
To Provision for Doubtful Debts	0.40	By Trade Creditors	18.00
To Goodwill A/c	10.00	By Bank A/c	11.00
To Profit & Loss A/c	15.00	By Workmen's Compensation Fund (Bombay) A/c	0.88
To Discount on Issue of Debentures A/c	1.00	By Provision for Tax A/c	1.12
To Plant & Machinery A/c	518.05	By Capital Reserve A/c	6.00
		By Stock A/c	8.40
	570.40		570.40

Working Notes :

Particulars		**Debit (₹ in Lakhs)**	**Credit (₹ in Lakhs)**
Restructuring of Equity Share Capital :			
Equity Share Capital A/c	Dr.	500	
To Equity Share Capital (₹ 5 each ₹ 2.50 paid up)			125
To Reconstruction A/c			375
Restructuring of Preference Share Capital :			
(a) 6% Preference Share Capital A/c	Dr.	100	
To 15% Preference share capital A/c			40
To Reconstruction A/c			60
₹ $\left[100 \text{ Lakhs} - \left(\dfrac{₹100 \times 6\%}{15\%}\right)\right]$			
(b) *Settlement of arrear Preference Dividend* :			
Preference Shareholders A/c	Dr.	120	
To Equity Share Capital A/c			120
{(₹ 100 Lakhs × 6%) ÷ ₹ 100} × 4 shares × ₹ 5 each			
Restructuring of A's Liabilities :			
(a) *Ascertainment of Amount Due :*			
First Debenture A/c	Dr.	40	
Second Debenture A/c	Dr.	60	
Creditors A/c	Dr.	10	
To A's A/c			110
(b) *Waiver :*			
A's A/c	Dr.	60	
To Reconstruction A/c			60
(c) *Cash brought in* :			
Bank A/c	Dr.	10	
To A's A/c			10
(d) *Conversion of Liabilities* :			
A's A/c	Dr.	60	
To 12% Debenture A/c			60

(₹ in Lakhs)

Restructuring of B's Liabilities :		
(a) *Ascertainment of amount due* :		
First Debenture A/c Dr.	20	
Second Debenture A/c Dr.	40	
Creditors A/c Dr.	5	
To B's A/c		65
(b) *Waiver* :		
B's A/c Dr.	30	
To Reconstruction A/c		30
(c) *Conversion of other creditors* :		
B's A/c Dr.	35	
To 12% Debenture A/c		35
Restructuring of other Creditors :		
₹ (165 Lakhs – 10 Lakhs – 5 Lakhs) = ₹ 150 Lakhs		
Creditors A/c Dr.	150	
To Equity Share Capital A/c		30
To Calls-in-arrear A/c		30
To Bank A/c (₹ 90 Lakhs × 80%)		72
To Reconstruction A/c		18
Adjustment to Equity Share Capital Account :		
Reconstruction A/c Dr.	180	
To Equity Share Capital A/c		180
(To Preference Shareholders ₹ 120 lakhs and to the Creditors ₹ 60 lakhs i.e. total ₹ 180 lakhs)		
Penalty on Cancellation of Contract :		
Reconstruction A/c Dr.	15	
To Bank A/c		15
Refund of Directors Fees :		
Bank A/c Dr.	11	
To Reconstruction A/c		11
Workmen's Compensation Fund :		
Workmen's Compensation Fund A/c Dr.	0.88	
To Reconstruction A/c		0.88
(₹ 1 lakhs – ₹ 0.2 lakhs) × 110%		

			(₹ in Lakhs)
Payment of Tax :			
Tax Expenses A/c	Dr.	8.88	
To Bank A/c			8.88
Adjustment to Provision for Account :			
Provision for tax A/c	Dr.	1.12	
To Reconstruction A/c			1.12
(₹ 10 lakhs – Tax paid i.e. ₹ 8.88 lakhs)			
Revaluation of Stock :			
Stock A/c	Dr.	8.40	
To Reconstruction A/c			8.40
(₹ 60 Lakhs × 14%)			
Bad Debt :			
Reconstruction A/c	Dr.	8.00	
To Debtors A/c			8.00
(₹ 10 Lakhs × 80%)			
Adjustment to Provision for Doubtful Debts :			
Rconstruction A/c	Dr.	0.40	
To Provision for Doubtful Debts A/c			0.40
[₹ (10 – 8) Lakhs × 20%)]			
Balance Amount Received from the Equtity Shareholders :			
Bank A/c	Dr.	215	
To Calls-in-arrear A/c			215
[₹ (125 + 30 + 60) Lakhs i.e. ₹ 215 Lakhs]			
Allocation of Surplus in Reconstruction Account :			
Reconstruction A/c	Dr.	544.50	
To Goodwill A/c			10.00
To Profit & Loss A/c			15.00
To Discount on Issue of Debenture A/c			1.00
To Plant & Machinery A/c			518.05
(Balance in Reconstruction A/c)			

Q. 6. The following are the Balance Sheets of H Ltd. and S Ltd. as at 31st March, 2012 :

Liabilities	H Ltd. ₹	S Ltd. ₹	*Assets*	H Ltd. ₹	S Ltd. ₹
Equity Shares of ₹ 10 each	10,00,000	7,00,000	Land and Building	6,00,000	2,70,000
			Plant and Machinery	2,00,000	2,70,000
12% Preference Shares of	1,00,000	50,000	Shares in S Ltd.	7,10,000	—
₹ 10 each			900, 12% Debentures		
General Reserve	2,00,000	4,48,000	in S Ltd.	80,000	—
Profit & Loss A/c	3,60,000	1,77,000	Stock	1,00,000	3,00,000
12% Debentures	2,00,000	2,00,000	Debtors	4,00,000	10,10,000
Sundry Creditors	3,00,000	5,35,000	Cash at Bank	60,000	2,75,000
Bills Payable	1,40,000	1,40,000	Bills Receivable	1,00,000	1,00,000
			Preliminary Expenses	50,000	25,000
	23,00,000	22,50,000		23,00,000	22,50,000

Note : Contingent liability in respect of Bills discounted by H Ltd. ₹ 50,000.

Contingent liability in respect of Bills discounted by S Ltd. ₹ 25,000 of which Bills of ₹ 5,000 were accepted by H Ltd.

Additional Information **:**

(a) H Ltd. acquired 40,000 Equity Shares of S Ltd. and 2,000. 12% Pref. Shares in S Ltd. on 1.7.2011 at a cost of ₹ 6,80,000 and ₹ 30,000 respectively. The credit balance of Profit and Loss Account of S Ltd. as on 1.4.2011 was ₹ 2,25,000 and that of General Reserve on that date was ₹ 6,00,000.

(b) On 30.9.2011, S Ltd. declared dividend @ 20% on equity shares for the year 2010-2011. H Ltd. credited the receipt of dividend to its Profit and Loss Account.

(c) On 1.1.2012, S Ltd. issued 2 shares for every 5 shares held, as bonus shares. No entry has been made in the books of H Ltd. for the receipt of these bonus shares.

(d) H Ltd. purchased goods for ₹ 3 lakhs from S Ltd. which made at a profit of 20% on cost. 80% of these goods were sold by H Ltd. at a profit of 20% on cost till 31.03.2012.

(e) On 1.1.2012, H Ltd. sold to S Ltd. a Machine costing ₹ 2,40,000 at a profit of 25% on selling price. Depreciation at 10% p.a. was provided by S Ltd. on this Machine.

(f) H Ltd. owed S Ltd. ₹ 2,90,000 but S Ltd. is owed ₹ 3,00,000 by H Ltd.

(g) The Land and Building of S Ltd. which stood at ₹ 3,00,000 on 1.4.2011, was considered as worth of ₹ 6,92,500 on 1.7.2011, for which necessary adjustments are yet to be made.

(h) All the Bills Payables of S Ltd. were drawn upon by H Ltd.

(i) The management of H Ltd. and S Ltd. wish to recommend a dividend of 15% p.a. and 10% p.a. respectively on equity shares for the year 2011-2012.

Required : Calculate Minority Interest, Cost of Control and the Balance of Consolidated Profit and Loss Account to be shown in the Consolidated Balance Sheet of H Ltd. and its subsidiary, as at 31 st March, 2012. [15]

Answer 6.

Minority Interest

Particulars	₹
Paid up Value of Equity shares (including Bonus Shares)	1,40,000
Paid up Value of Preference Shares presently held by Minority	30,000
Share of Minority in Capital Profits of S Ltd.	1,84,700
Share of Minority in Revenue Profits of S Ltd.	900
Share of Minority in Revenue Reserves of S Ltd.	7,200
Share of Minority in Proposed Preference Dividend of S Ltd.	3,600
Total	3,66,400

Goodwill/Capital Reserve on Consolidation

	Particulars	₹
A.	**Corrected Net Cost of Investments**	
	(a) Net Cost of Equity Investments	6,80,000
	(b) *Less* : Equity Dividend out of Pre-acquisition Profits	(80,000)
	(c) Cost of Investments in Preference Shares	30,000
	(d) *Less* : Pref. Dividend receivable by Holding Co, out of pre-acquisition profits [1,500 × 2,000/5,000]	(600)
		6,29,400
B.	**Holding Co.'s Share in Net Assets of Subsidiary Co.**	
	(a) Paid up Value of Equity Shares (including Bonus Shares)	5,60,000
	(b) Paid up Value of Preference Shares presently held by Holding Co.	20,000
	(c) Share of Holding Co .. in Capital Profits of Subsidiary Co.	7,38,800
		13,18,800
C.	Capital Reserve (B - A)	6,89,400

Consolidated Profit and Loss Account

Particulars	₹
A. Balance as given in the Balance Sheet of H Ltd.	3,60,000
B. Add: (a) Holding Co.'s Share in Revenue Profits of S Ltd.	3,600
(b) Holding Co.'s Share in Proposed Pref. Dividend of S Ltd. [4,500 × 2,000/5,000]	1,800
(c) Profit on Debentures held in S Ltd. [90,000 (Face Value) - 80,000 (Cost)]	10,000
C. Less: (a) Dividend out of pre-acquisition profits wrongly credited to this account instead on Investment Account	(80,000)
(b) Unrealized Profit on Stock [(20% of 3,00,000) × 20/120)]	(10,000)
(c) Unrealized Profit on Machine [(2,40,000 × 1/3) - (80,000 × 10% × 3/12)]	(78,000)
(d) Proposed Equity Dividend [10,00,000 × 15%]	(1,50,000)
(e) Proposed Pref. Dividend [1,00,000 × 12%]	(12,000)
D. Closing Balance to be taken to the Consolidated Balance Sheet (A + B - C)	45,400

Workings :

Dr. **(i) General Reserve Account of S Ltd.** *Cr.*

Particulars	₹	*Particulars*	₹
To Equity Share Capital (Bonus)	2,00,000	By Balance b/d	6,00,000
To Balance c/d	4,48,000	By Profit and Loss A/c (b/f.)	48,000
	6,48,000		6,48,000

(ii) Profit and Loss Account of S Ltd. *Cr.*

Particulars	₹	*Particulars*	₹
To Final Dividend for previous year	1,00,000	By Balance b/d	2,25,000
To General Reserve	48,000	By Profit earned (b/f.)	1,00,000
To Proposed Preference Dividend	6,000		
To Balance c/d [1,77,000 – 6,000]	1,71,000		
	3,25,000		3,25,000

(iii) Calculation of Change in the Value of Fixed Asset and Provision of Depreciation

Particulars	₹
A. Book Value as on opening date	3,00,000
B. Depreciation upto date of revaluation [₹ 3,00,000 × 10/100 × 3/12]	(7,500)
C. Book value as on the date of revaluation (A - B)	2,92,500
D. Revalued figure as on the date of revaluation	6,92,500
E. Increase in Value (D - C)	4,00,000
F. Short Depreciation since the date of revaluation [₹ 4,00,000 × 10/100 × 9/12]	30,000

(iv) Analysis of Profits and Reserves of S Ltd.

Particulars	*Capital Profits* ₹	*Revenue Profits* ₹	*Revenue Reserves* ₹
Opening Balance of General Reserve	6,00,000		
Less: Utilized for issue of Bonus Shares	(2,00,000)		
Reserve created	12,000		36,000
Opening Balance of Profits and Loss A/c	2,25,000		
Less: Final Dividend for the previous year	(1,00,000)		
Less: Miscellaneous Expenditure	(25,000)		
Profits earned	25,000	75,000	
Less: Transfer to General Reserve	(12,000)	(36,000)	
Less: Proposed Preference Dividend	(1,500)	(4,500)	
Add: Increase in value of Fixed Assets	4,00,000		
Less: Short Provision of Depreciation		(30,000)	
Total	9,23,500	4,500	36,000
Share of Minority @ 20%	1,84,700	900	7,200
Share of Holding Company @ 80%	7,38,800	3,600	28,800

Q. 7. Following are the Balance Sheets of BHARAT TUSHAR Ltd. :

Liabilities	31.3.12 ₹	31.3.11 ₹	*Assets*	31.3.12 ₹	31.3.11 ₹
Equity Share Capital	7,41,000	6,00,000	Goodwill	15,000	—
18% Preference Share Capital	2,00,000	4,00,000	Land	50,000	5,000
General Reserve	2,21,000	58,000	Plant & Machinery	12,65,000	10,15,000
Profit & Loss A/c	12,57,500	82,000	10% Investments (at par)	2,00,000	1,00,000
Securities Premium	—	1,000	Investment in Shares	35,000	10,000
Capital Redemption Reserve	1,30,000	—	Accrued Interest on Investments	2,000	3,000
Debentures Redemption Reserve	—	4,800	Marketable Securities	20,000	30,000
Capital Reserve	70,000	5,000	Stock	4,10,000	3,60,000
Capital Grant	8,00,000	—	Debtors	1,85,000	1,80,000
10% Debentures	—	2,00,000	Cash & Bank	18,82,000	2,62,000
12% Debentures	2,07,000	2,00,000	Advance Tax	80,000	30,000
Unpaid Interest on Debentures	12,000	2,000	Underwriting Commission	5,720	5,000
Unpaid Dividend	24,000	4,000	Discount on issue of Debentures	280	—
Bank Overdraft	50,000	55,200			
Creditors	1,50,000	1,40,000			
Provision for Doubtful Debts	30,000	20,000			
Proposed Dividend	1,50,000	1,20,000			
Dividend Distribution Tax	22,500	18,000			
Provision for Tax	85,000	90,000			
	41,50,000	20,00,000		41,50,000	20,00,000

Additional Information :

(a) The provision for depreciation on Machinery stood at ₹ 3,00,000 on 31.03.2011, and at ₹ 3,65,000 on 31.03.2012. A machine costing ₹ 1,40,000 (book value ₹ 80,000) was disposed off at a loss of 37.5%. One fully depreciated machine costing ₹ 15,000 was also discarded and written off.

(b) On 30.09.2011 An Interim Dividend @ 30% p.a. was paid on equity shares for the half year ended on 30.09.2011. Dividend Distribution Tax @ 15% was also paid. On 01.10.2011, some Investments were purchased.

(c) On 01.10.2011, Preference Shares were redeemed at a premium of 15%. Dividend on Redeemed Preference Shares was duly paid. Dividend Distribution Tax @ 15% was also paid.

(d) On 01.01.2012, 10% Debentures were redeemed at a premium of 5% and some 12% Debentures were issued.

(e) An Income Tax liability upto 31 st March, 2011 has been settled and paid for ₹ 75,000.

(f) On 01.01.2012, the Business of Y Ltd. was purchased for ₹ 60,000 payable in fully paid equity shares of ₹ 10 each at 20% premium. The assets included Stock ₹ 15,000. Debtors ₹ 10,000 and Machine ₹ 30,000. Creditors of ₹ 15,000 were also taken over.

(g) It was decided to value stock at cost whereas previously the practice was to value stock at cost less 10%. However, the Stock on 31.03.2012 was correctly valued at cost.

(h) Dividend received amounted to ₹ 2,100 which included pre-acquisition dividend of ₹ 600.

(i) Insurance proceeds from earthquake disaster settlement (₹ 1,00,000) were credited to Profit & Loss A/c.

(j) Grant of ₹ 10,00,000 amortised in P & L A/c.

(k) Marketable Securities costing ₹ 10,000 were disposed off at a profit of 20%. Debtors of ₹ 10,000 were written off against the provision for doubtful debts account during the year.

Required: Calculate Net Cash Flow from Operating Activities as per AS 3. [15]

Answer 7.

Cash Flow Statement of BHARAT TUSHAR Ltd. for the year ending 31/03/2012

Particulars	₹
I Cash Flow from Operating Activities	
A Closing Balance as per Profit & Loss A/c	12,57,500
Less: Opening Balance as per Profit & Loss A/c	82,000
Add: Proposed Dividend during the year	1,50,000
Add: Interim dividend paid during the year [₹ 6,00,000 × 30% × 6/12]	90,000
Add: Pref.dividend paid during the year [₹ 2,00,000 × 18% × 6/12]	18,000
Add: Dividend Distribution Tax paid [(₹ 90,000+18,000) × 15%]	16,200
Add: Dividend Distribution Tax on Proposed Dividend	22,500
Add: Transfer to General Reserve [Refer to WN (ix)]	63,000
Add: Transfer to Capital Redemption Reserve	1,30,000
Add: Transfer to Debentures Redemption Reserve [Refer to WN (viii)]	95,200
Add: Transfer to Capital Reserve	65,000
Add: Provision for Tax	85,000
Add: Premium on Red of Pref. Shares [₹ 30,000 – ₹ 1,000]	29,000
Less: Excess Provision for Tax for previous year	15,000
Less: Extraordinary item (i.e. Insurance proceeds from earthquake disaster settlement)	1,00,000
B Net Profit before taxation, and extraordinary item	18,24,400
C *Add*: **Items to be added**	
Depreciation [Refer to WN (ii)]	1,40,000
Interest on Debentures [(2,00,000 × 10% × 9/12) + (2,00,000 × 12%) + (7,000 × 12% × 3/12)]	39,210
Goodwill amortised [₹ 20,000 – ₹ 15,000] [Refer to WN (vii)]	5,000
Loss on sale of Machinery [Refer to WN (iii)]	30,000

D *Less*: **Items to be deducted**	
Interest on Investments	
[(1,00,000 × 10% × 6/12) + (2,00,000 × 10% × 6/12)]	15,000
Under Valuation of Opening Stock (3,60,000 x 10/90)	40,000
Dividend Income (₹ 2,100 – ₹ 600)	1,500
Capital Grant amortised	10,00,000
E Operating Profit before Working Capital changes [B + C – D]	9,82,110
F *Add*: Decrease in Current Assets & Increase in Current Liabilities	
Decrease in Stock [(41 0000 – 15000) – (360000 + 40000)]	5,000
Decrease in Debtors (Gross)[(185000-10000)-180000]	5,000
Increase in Provision for doubtful debts [30000-20000]	10,000
G *Less*: Increase in Current Assets & Decrease in Current Liabilities	
Decrease in Creditors [(150000-15000)-140000]	5,000
H Cash generated from operations [E + F - G]	9,97,110
I *Less*: Income taxes paid (₹ 45,000 for PY + ₹ 80,000 for CY] [Refer to WN (iv) & (v)]	1,25,000
J Cash Flow before extraordinary item [H - I]	8,72,110
K *Add*: Extraordinary item (i.e. Insurance proceeds from earthquake disaster settlement)	1,00,000
L ***Net Cash Flow from Operating Activities***	9,72,110

Working Notes :

Dr. **(i) Plant and Machinery Account (at Cost)** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	13,15,000	By Machine Disposal A/c (Sold)	1,40,000
To Business Purchase A/c	30,000	By Machinery Disposal A/c (Discarded)	15,000
To Bank A/c (Purchase) (b/f)	4,40,000	By Balance c/d	16,30,000
	17,85,000		17,85,000

Dr. **(ii) Accumulated Depreciation Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Machinery Disposal A/c	60,000	By Balance b/d	3,00,000
To Machinery Disposal A/c	15,000	By Profit and Loss A/c (b/f)	1,40,000
To Balance c/d	3,65,000		
	4,40,000		4,40,000

Dr. **(iii) Machinery Disposal and Discarded Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Plant and Machinery A/c (Cost)	1,40,000	By Accumulated Depreciation A/c	60,000
To Plant and Machinery A/c (Cost)	15,000	By Accumulated Depreciation A/c	15,000
		By Bank A/c	50,000
		By Profit and Loss A/c (Loss)	30,000
	1,55,000		1,55,000

Dr. **(iv) Provision for Tax Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Advance Tax A/c	30,000	By Balance b/d	90,000
To Bank A/c (Paid)(b.f.)	45,000	By P & L A/c (Provision)	85,000
To P & L A/c (Excess Provision)	15,000		
To Balance c/d	85,000		
	1,75,000		1,75,000

Dr. **(v) Advance Tax Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance b/d	30,000	By Provision for Tax A/c	30,000
To Bank A/c (b.f.)	80,000	By Balance c/d	80,000
	1,10,000		1,10,000

Dr. **(vi) Securities Premium Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Premium on Red of Pref. Shares A/c	1,000	By Balance b/d	1,000
To Premium on Red of Debentures A/c	10,000	By Y Ltd.	10,000
	11,000		11,000

(vii) Goodwill Amortised = Goodwill Purchased – Closing Balance of Goodwill A/c
60,000 – [₹ 15,000 + ₹ 10,000 + ₹ 30,000 – ₹ 15,000] – ₹ 15,000
= ₹ 5,000

Dr. **(viii) Debentures Redemption Reserve Account** *Cr.*

Particulars	₹	*Particulars*	₹
To General Reserve	1,00,000	By Balance b/d	4,800
		By Profit & Loss A/c	95,200
		[(50% of ₹ 2,00,000) – ₹ 4,800]	
	1,00,000		1,00,000

Dr. **(ix) General Reserve Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Balance c/d	2,21,000	By Balance b/d	58,000
		By Profit & Loss A/c	
		[(50% of ₹ 2,00,000)]	1,00,000
		As per Sec. 117(c)	
		By Profit & Loss A/c (balance figure)	63,000
	2,21,000		2,21,000

(x) Profit on sale of short term investments and debtors written off against provision for doubtful debts do not require any further adjustment

Q. 8. Answer *any three* of the following :

(a) Differences between Future Contracts and Option Contracts;

(b) Role of Committee on Public Undertakings;

(c) Objections to Segmental Reporting;

(d) Economic Value Added. [3×5=15]

Answer 8. (a)

Differences between Future Contracts and Option Contracts :

Future Contracts differ from Option Contracts in the following respects :

Basis of Difference	Future Contracts	Option Contracts
1. Rights & Obligations of Buyer/Seller	Both the Parties (Buyer and Seller) have obligation to perform the contract.	Only the Seller of an option is under an obligation to sell/buy the underlying asset as and when the Buyer exercises his right.
2. Option Premium	No such premium is paid by the Buyer to the Seller	Buyer of an option pays the Option Premium in full to the Seller of an option at the time of buying an option.
3. Extent of Profits/ Losses	For Both the Buyer and Seller of a Futures Contract, Profits & Losses are unlimited.	1. For Buyer of an option, Profits are potentially unlimited and losses are limited to the Option Premium paid to the Seller. 2. For Seller of an option, profits are limited to the Option Premium received from the Buyer and losses are potentially unlimited.
4. Margin Requirements	Both Buyer and Seller of a Futures Contract are required to pay the margin.	Only Seller is required to pay the margin.

Answer 8. (b)

Role of Committee on Public Undertakings :

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

1. To examine the Reports and Accounts of public undertakings.
2. To examine the Reports of the Comptroller and Auditors General on public undertakings.
3. 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 undertakings. 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.

Answer 8. (c)

Objections to Segmental Reporting :

The possible objections to Segmental Reporting can be enumerated as below :

1. It is generally felt that Segmental Revenues and Expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence of a strong product line. Also many joint costs are only separable arbitrarily.
2. Much of segmental results depend on the inter-departmental transfer pricings which are not always logically established.
3. Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio.
4. Since the users are not in position to know the proper base for cost allocation, the segment results would be less than meaningful.
5. The last objection consists of the competitive implications to the firm. Some academics contend that company secrets will be disclosed while others referred to the competitive hardship suffered by some firms if segmented data is required. Suppose that Company X, a small company, has a segment identical to one in Company Y, a huge conglomerate. Company X would have to disclose the segment while Company Y would not because the segment is not considered material to Y's operations.

However, considering the problems of joint cost allocation, often it is suggested to follow a contribution margin approach for reporting segmental results. By this only identifiable costs are deducted from segment revenues and gross segment margins may only be indicated. But for all practical purposes, this becomes a useless exercise when proportion of identifiable cost is insignificant.

Answer 8. (d)

Economic Value Added :

Meaning	Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the Operating Profit after tax less a Charge for the Capital-Employed, used in the business.
How to Calculate	EVA = Net Operating Profit before Interest but after Tax - Cost of Total Capital **Note :** Cost of Capital = Capital Employed (CE) x Weighted Average Cost of Capital (WACC) where, Capital Employed = Debt. + Pref. Share Capital + Equity Share Capital + Net Retained Earnings - Non-Trading Assets (e.g. Non-Trade Investments, Advance for Purchase of Fixed Assets, Capital Work-in-progress) $\text{WACC} = \left[\frac{\text{Debt.}}{\text{CE}} \times k_d\right] + \left[\frac{\text{Pref. Share Capital}}{\text{CE}} \times k_p\right] + \left[\frac{\text{Equity}}{\text{CE}} \times k_e\right]$ Where k_d = Interest (1 - Tax Rate), k_p = Rate of Pref. Dividend k_e = Risk Rate + (Beta) × Market Risk Premium (i.e., Market Rate – Risk. free Rate)