FINAL EXAMINATION

GROUP IV

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2013

Paper-16 : ADVANCED FINANCIAL ACCOUNTING AND 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 seen 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 books the question attempted.

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): **2x8=16**

(i) SMITH LTD. had 1000000 equity shares outstanding on April 01, 2012. The average fair value per share during the year 2012-13 was ₹ 50. The Company has given share option to its employees of 2,00,000 shares at option price of ₹ 40. If net profit attributable to equity shareholders for the year ended March 31, 2013 is ₹ 21 lakh, what would be DILUTED EPS as per AS-20?

A. ₹ 2.10
B. ₹ 2.06
C. ₹ 2.02
D. None of (A), (B), (C)

(ii) VASUDA CONSTRUCTION LTD. undertook a contract on January 1, 2013 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. SContract 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

(iii) BANSAL LTD. had acquired 75% share of NAVINA LTD. for ₹ 27 lakh. The Net Assets of NAVINA LTD. on the day are ₹ 24 lakh. During the year Bansal Ltd. sold the investment for ₹ 32 lakh and Net Assets of Navina Ltd. on the date of disposal was ₹ 40 lakh. The Profit/Loss on disposal of this investment to be recognized in consolidated financial statement is

A. Profit ₹ 800 lakh
B. Profit ₹ 200 lakh

C. Loss ₹ 700 lakh
D. Insufficient Information

(iv) The fair values of Pension Plan Assets of ZOOM LTD. at the beginning and end of the year 2012-13 were ₹ 5,60,000 and ₹ 6,20,000 respectively. The actual return on Pension Plan Assets for the year was ₹ 63,000. If benefit payments made to the retirees are ₹ 64,000, the employer's contribution to the plan during the year as per AS-15 would be
A. ₹ 52,000
B. ₹ 61,000
C. ₹ 65,000
D. None of (A), (B), (C)

(v) MS. DEEPASHREE purchased 1000 shares in SPECTRUM LTD. at ₹ 600 per share in 2010. There was a rights issue in 2013 at one share for every two held at price of ₹ 150 per share. If Ms. Deepashree subscribed to the rights, what would be carrying cost of 1,500 shares as per AS-13.
A. ₹ 6,00,000
B. ₹ 6,75,000
C. ₹ 7,00,000
D. Data insufficient

(vi) SWIFT LTD. has an asset, which is carried in the Balance Sheet on 31.3.2013 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)

(vii) PARTHAN LTD. reports quarterly and estimates an annual income of ₹ 200 crores. Assume Tax rates on first ₹ 100 crores at 30% and on the balance income at 40%. The estimated quarterly incomes are ₹ 15 crores, ₹ 50 crores, ₹ 75 crores and ₹ 60 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

(viii) BHARAT LTD. bought a forward contract for three months of US $ 150000 on 1st March, 2013 at 1 US $ = ₹ 54.10 when exchange rate was 1US $ = ₹ 54.12. On 31st March, 2013 when the books were closed forward exchange rate for two months was US $ 1= ₹ 54.16. On 30th April, 2013 the contract was sold at ₹ 54.20 per US Dollar. As per AS-30 the profits from sale of contract to be recognized in the Profit & Loss A/c will be
A. ₹ 6,000
B. ₹ 8,000
C. ₹ 12,000
D. None of these

(b) Choose the most appropriate one from the stated options and write it down (only indicate A,B,C,D as you think correct). 1x5=5

(i) The objective of AS-1 is
A. To prohibit any change in accounting policies
B. To ensure disclosure of accounting policies
C. To ensure that the effect of any change in accounting policy is adequately disclosed
D. Both B and C above

(ii) As per AS-3 (Revised) Interest and Dividends received in the case of a manufacturing

enterprise should be classified as cash flow from

A. Operating activities
B. Financing activities
C. Investing activities
D. Both (B) and (C)

(iii) According to AS-28, estimates of future cash flow should not include

A. Cash flow from financing activities
B. Cash flow from the continuing use of the assets
C. Cash flow to be received for disposal of asset at the end of its useful life
D. None of (A), (B), (C)

(iv) M Ltd. holds 51% of N Ltd. N Ltd. holds 51% of P Ltd. and O Ltd. holds 49% of P Ltd. The Related parties as per AS-18 are

A. M Ltd., N Ltd. and P Ltd.
B. M Ltd. and P Ltd.
C. N Ltd. and P Ltd.
D. M Ltd. and N Ltd. only

(v) According to AS-11 (Revised) the difference between the forward rate and the exchange rate at the date of transaction should be

A. Ignored
B. Recognized as income or expense
C. Adjusted to Shareholders' interests
D. None of (A), (B), (C)

(c) (i) From the following information, determine the possible value of brand under potential earning model:

Particulars	₹ in lakhs
Profit before tax	650
Income Tax	150
Tangible Fixed Assets	1000
Identifiable Intangibles other than brand	500
Expected normal return on Tangible Fixed Assets	300
Appropriate Capitalisation Factor for Intangibles	25 %

2

(ii) Mohan Ltd. purchased a plant for US $ 15000 on 31st December, 2012, payable after 4 months. The Company entered into a forward contract for 4 months @ ₹ 52.50 per Dollar. On 31st December, 2012, the exchange rate was ₹ 51.10 per Dollar. How the Company will recognize the profit or loss on forward contract in its books for the year ended 31st March, 2013. **2**

Answer 1.

(a) (i) C : ₹2.02

Number of incremental Shares issued for no consideration

[200000 x (50 – 4)] ÷ 50	40,000
Weighted number of Equity Shares: (1000000 + 40000)	10,40,000
Adjusted earning :	₹21 lakh
Diluted EPS: (21 lakh ÷ 10.40 lakh) =	₹2.02

(ii) 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.

(iii) C : Loss ₹7.00 lakh

	in Lakh
Proceeds from the sale of investment:	32.00
Less: Bansal Ltd.'s Share in net Assets (40 lakh x 0.75) =	30.00
	2.00

Less: Goodwill in the Consolidated Financial Statement:

	₹in lakh	
Cost of Investment:	27.00	
Less: Bansal Ltd.'s share in net asset on the date (24 lakh x 0.75)	18.00	9.00
		7.00

(iv) B: ₹61,000

As per As – 15 the employer's Contribution
= the difference in values of the assets on opening and closing dates + benefit payments – Actual Return on plan.

= (620000 – 560000) + 64000 – 63000 ₹61000

(v) B: ₹675000

Cost of original holding (Purchase) (1000 x 600) =	6,00,000
Amount paid for Rights (500 x 150) =	75,000
Total carrying cost of 1500 shares:	**₹6,75,000**

(vi) 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) B : ₹21 Crores.

Tax Expenses : 30% on ₹100 Crores = ₹30 Crores.
40% on remaining ₹100 Crores = ₹40 Crores.
Total Tax = (30 + 40) = ₹70 Crores.

Weighted average Annual Income Tax Rate [70 ÷ 200] = 35%
Tax expenses to be recognized in last quarter:
35% on ₹60 Crores = ₹21 Crores.

(viii) A : ₹6000

	Rs.
Sales Rate :	54.20
Less: Fair Value on 31.03.2013 :	54.16
	0.04
Premium on Contract:	US$ 150,000

Contract Amount:
Total Profit (15000 x 0.04) : ₹6,000

(b) (i) D
(ii) C
(iii) A
(iv) A
(v) B

(c) (i)

Calculation of Possible Value of Brand

Particulars	₹in lakh
Profit after Tax (650 – 150):	500
Less: Profit allocated to transible fixed assets:	300
Profit relating to intangible assets including Brand:	200

Capitalization factor 25% Capitalized value of intangibles including brand $\left[\frac{200}{25} x100\right]$ Less: Indentified intangibles other than Brand:	800 500
Brand Value	300

(ii)

Calculation of profit or loss to be recognized
In the books of Mohan Ltd.

Forward contract rate: ₹52.50

Less: Spot rate : ₹51.10
Loss: ₹ 1.40

Forward Contract Amount: $ 15,000
Total loss on entering into forward contract
= ($ 15,000 x ₹1.40): ₹21.00

Contract period: 4 months
Loss for the period 1st January, 2013 to 31st March, 2013, i.e.,

3 months falling in the year 2011 – 12 will be ₹21,000 x $\frac{3}{4}$ = ₹15,750

Balance loss of ₹5,250 (i.e., ₹21,000 – ₹15,750)
for the months of April, 2013 will be recognized in the financial year 2013 – 2014.

PART B : (75 Marks)
Attempt any five questions.

2. (a) ALEENA LTD. is in the business of manufacturing and export of its product. Sometimes back in 2010, the Government put restriction on export of goods exported by Aleena Ltd. Due to that restriction Aleena Ltd. impaired its assets. The Company acquired at the end of the year 2006 identifiable assets worth ₹ 5,000 lakh and paid ₹ 7,500 lakh, balance is treated as Goodwill. The useful life of the identifiable assets are 15 years and depreciated on straight-line basis. When Government put the restriction at the end of year 2010, the Company recognized the impairment loss by determining the recoverable amount of assets at ₹ 3,400 lakh.
In 2012, Government lifted the restriction imposed on the export and due to this favourable change, Aleena Ltd. re-estimated recoverable amount, which was estimated at ₹ 4,275 lakh.
The amortization period of Goodwill to be taken as 5 years as per AS-14.
Required:
(i) Calculation and allocation of Impairment loss in 2010.
(ii) Reversal of an Impairment loss and its allocation as per AS-28 at the end of year 2012.
4+4=8

(b) From the following information of Neel Ltd., compute the Economic Value Added(EVA):

Share Capital	**₹ 3,000 lakhs**
Reserves and Surplus	**₹ 5,000 lakhs**
Long Term Debt	**₹ 500 lakhs**
Tax Rate	**40 %**

Risk Free Rate	**8 %**	
Market Rate of Return	**15 %**	
Interest	**₹ 50 lakhs**	
Beta Factor	**1.05**	
Profit before Interest and Tax	**₹ 3,000 lakhs**	**7**

Answer 2.

(a) (i)

ALEENA LTD.
CALCULATION AND ALLOCATION OF IMPAIRMENT
LOSS FOR THE ASSETS AFTER END OF YEAR 2010

Amount in ₹lakh

Particulars	Goodwill	Identifiable Assets	Total
Historical Cost	2500.00	5000.00	7500.00
Accumulated / Amortization for 2007 to 2010	2000.00	1333.00	3333.00
Carrying Amount:	500.00	3667.00	4167.00
Recoverable amount at the End of 2010 = 3400			
Impairment of Loss (4167 – 3400) = 767			
Impairment Loss allocated first to Goodwill and balance to other Assets.			
Carrying Amount after	500.00	267.00	767.00
Impairment loss.	NIL	3400.00	3400.00

(ii)

Reversal of an impairment loss and its allocation
For the assets at the end of year 2012

	Goodwill	Identifiable Assets	Total
Carrying amount	NIL	2782.00 (3400 – 618) (WN – 7)	2782.00
Recoverable Amount			4275.00
Excess of Recoverable amount over in accordance with Para 28.23.1 (Para 106 & 107 of As – 28) The impairment loss to be reversed in 2012 will be as under :-			1493.00
Carrying Amount of Asset in 2012 had no impairment loss in 2010 been recognized (WN – 2) (3667 – 667)			3000.00
Carrying Amount of Asset at the end of 2012 after Recognizing impairment loss in 2010 and depreciation for 2 years			2782.00
ALLEENA Ltd. can increase the amount of the assets by (3000 – 2782)			218.00

Hence Reversal of impairment loss to be reversed in 2012 by Crediting the same to Profit / Loss statement is ₹218 Lakh.

Working Notes:

1) [(3400)/11 years] x 2 years. = ₹618 (lakh)

2) $3667 - \left(\frac{5000}{15} x2\right) = 3667 - 667 =$ ₹3000 Lakh

(b)

NEEL Ltd.
Computation of Economic Value Added

Particulars	₹in Lakh
Net operating – Profit after tax (Refer working note 5):	1,770
Add: Interest on long term fund (Refer working note 2):	30
	1,800
Less: Cost of Capital ₹8,500 lakhs x 14.80%: (Refer working notes 3 & 4)	1,258
Economic Value Added:	542

Working Notes:

1) **Cost of Equity** = Risk free rate + Beta Factor (Market Rate – Risk Rate)
8% + 1.05 (15 – 8) = 8% + 7.35% = 15.35%

2) **Cost of Debts**

Interest :	₹50 lakhs
Less: Tax (40%)	₹20 lakhs
Interest after tax:	₹30 lakhs

Cost of Debt $\frac{30}{500}$ x 100 = 6%

3) **Weighted Average cost of Capital:**

Cost of Equity ₹8,000 lakhs x 15.35% (W.N.-1):	₹1228 lakhs
Cost of Debt ₹500lakhs x 6% (W.N. – 2.):	₹ 30 lakhs
	₹1258 lakhs

WACC = $\frac{1258}{8.500}$ = 14.80%

4) **Capital Employed :**

	₹in lakhs
Share Capital :	3,000
Reserves and Surplus:	5,000
Long Term Debts:	500
	8,500

5) **Net Operating Profit after tax**:

Profit before Interest + Tax:		3,000
Interest:		50
		2,950
Tax 40% on ₹2,950 lakhs :	1,180	
Operating profit after tax:		1,770

3. The following is an abstract of the Balance Sheet as on 31st March, 2013 of H LTD. and its two Subsidiaries (B LTD. and C LTD).

Particulars	H LTD. ₹	B LTD ₹	C LTD ₹

Liabilities:			
Share Capital:			
Authorised and Issued Equity Shares of ₹100 each fully paid	**50,00,000**	**25,00,000**	**10,00,000**
Reserves and Surplus:			
Capital Reserve	**5,00,000**	**1,50,000**	**1,00,000**
Revenue Reserve	**10,00,000**	**7,50,000**	**6,00,000**
Current liabilities & Provisions :			
Creditors	**20,00,000**	**10,00,000**	**3,00,000**
Income Tax	**5,00,000**	**3,50,000**	**3,00,000**
	90,00,000	**47,50,000**	**23,00,000**
Assets:			
Fixed Assets (at cost less depreciation)	**32,00,000**	**16,00,000**	**3,00,000**
Investments :			
Shares in B Ltd. at cost	**45,00,000**		
Shares in C Ltd. at cost	**5,00,000**	**10,00,000**	**---**
Stock	**2,00,000**	**9,00,000**	**7,00,000**
Debtors	**4,00,000**	**10,50,000**	**11,50,000**
Bank Balance	**2,00,000**	**2,00,000**	**1,50,000**
	90,00,000	**47,50,000**	**23,00,000**

Additional Information:

(a) B Ltd. acquired 6000 shares in C Ltd. on 01.4.2011 when the balance on Capital Reserve had been ₹ 1,00,000 and Revenue Reserve ₹ 1,50,000.

(b) H Ltd. purchased 20000 shares in B Ltd. on 01.4.2012 when the latter's balance on Consolidated Revenue Reserve had been ₹ 5,50,000. The Balance of Capital Reserve in B Ltd. at that time was ₹ 1,50,000

(c) H Ltd. also acquired 3000 shares in C Ltd. on 01.4.2012 when the balance on Capital Reserve had been ₹ 1,00,000 and Revenue Reserve ₹ 3,50,000.

Required :

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiaries as on March 31, 2013 together with consolidation schedules. **15**

Answer 3.

(a)

H LTD AND ITS SUBSIDIARIES B LTD. AND C LTD.
CONSOLIDATED BALANCE SHEET
AS ON 31ST MARCH, 2013

Liabilities	₹	Assets	Rs.
Share Capital :		Fixed Assets*	5100000
Authorized, issued	---	(at cost less depreciation)	
Issued, Subscribed and paid up:		Goodwill :	2255000
50,000 Equity Shares of ₹100 each fully paid	5000000	Investments:	---
		Current Assets, Loans* & Advances:	
Reserves & Surplus:			
Capital Reserve:	500000		
Revenue Reserve:	1451000	Stock in trade:	1800000
Secured Loans :	---	Sundry Debtors:	2600000
Unsecured Loans:	---		
		Cash at Bank:	550000
Current Liabilities & Provisions:			
Sundry Creditors*	3300000		

Provisions for Income Tax* Minority Interest	1150000 904000		
	12305000		12305000

Working Notes:

1) Analysis of Profit of C Ltd:

(a) From the view point of H Ltd.:

	Capital Profit Rs.	Revenue Profit Rs.
Capital Reserve as on 01.04.2012:	100000	
Revenue Reserve as on 01.04.2012:	350000	
Increase in Revenue Reserve	-	250000
	450000	250000
Share of H Ltd. (3/10)	135000	75000

(b) Minority Interest in C Ltd.

Capital Reserve 1/10):	10000
Revenue Reserve (1/10):	60000
	70000

(c) From the view point of B Ltd.

	Capital Profit Rs.	Revenue Profit Rs.
Capital Reserve as on 01.04.2011:	100000	
Revenue Reserve as on 01.04.2011:	150000	
Increase in Revenue Reserve	-	450000
	250000	450000
Share of B Ltd. (3/5):	150000	270000

Share of Capital Profit of B in C will be taken to cost of control. However, share of Revenue Profit of B Ltd. in C Ltd. will be divided between Capital and Revenue from the point of view of H Ltd. as follows:

	₹
Increase in Capital Reserves of C Ltd. from 01.04.2011 to 01.04.2012 (₹350000 – 150000):	200000
Increase in Capital / Revenue Reserves of C Ltd. from 01.04.2012 to 31.03.2013 (600000 – 350000):	250000

The derived Revenue profits of ₹270000 of B Ltd. from C Ltd. will therefore be divided between Capital and Revenue in the ratio of 20 : 25 i.e., 4 : 5
Capital Profit : 270000 x 4/9 = ₹120000

Revenue Profit : 270000 x 5/9 ₹150000

2) **Analysis of profit of B Ltd. from the view point of H Ltd.**

Particulars	**Capital Profit Rs.**	**Revenue Profit Rs.**
Consolidated Reserve on 01.04.2012: (including ₹120000 from C Ltd., its own being only ₹430000).	550000	----

Capital Reserve 01.04.2012	150000	
Increase in Revenue Reserved since 01.04.2012 i.e.(750000–430000)		320000
Derived Revenue Profit from C Ltd.:		150000
	700000	470000
Less: Minority Interest (1/5):	140000	94000
H Share of H Ltd.	560000	376000

3) Cost of Control:

Particulars		Rs.
Amount Paid for Shares by H Ltd. In B Ltd.		4500000
Amount Paid for Shares by H Ltd. In C Ltd.		500000
Amount Paid for Shares by B Ltd. In C Ltd.		1000000
		6000000
Less: Paid up Value of Shares 600000 + 2000000 + 300000 :	2900000	
Capital Profit in C Ltd.		
Share of H Ltd.:	135000	
Share of B Ltd.:	150000	
Share of H Ltd. in Capital Profit of B Ltd.:	560000	3745000
Goodwill:		2255000

4)

Consolidated Revenue Reserve

Particulars	Rs.
Revenue Reserve of H Ltd.:	1000000
Share of H Ltd. in C Ltd.:	75000
Share of H Ltd. in B Ltd.:	376000
	1451000

5)

Minority Interest

Particulars	Rs.
Paid up value of Shares	
In B Ltd.	500000
In C Ltd.	100000
Share of Capital Profits	
In B Ltd.	140000
In C Ltd.	10000
Share of Revenue Profits	
In B Ltd.	94000
In C Ltd.	60000
	904000

4. The following are the Balance Sheet of RITO LTD. and ARIMA LTD. as on March 31, 2013.

(Amounts in ₹ lakh)

Liabilities	RITO	ARIMA	Assets	RITO	ARIMA

	LTD.	LTD.		LTD.	LTD.
Share Capital: Equity Shares of ₹ 100 each fully paid up	600	300	Fixed Assets - net of depreciation	810	255
Reserves & Surplus	240	---			
10% Debentures	150	---	Investments (including investment in Arima Ltd.)	210	---
Loans from Banks	75	135			
Bank Overdrafts	---	15	Debtors	120	45
Sundry Creditors	90	90	Cash at Bank	75	---
Proposed Dividends	60	---	Accumulated loss Profit & Loss A/c	---	240
	1215	540		1215	540

It was decided that ARIMA LTD. will acquire the business of RITO LTD. for enjoying the benefit of carry forward of business loss.

The following scheme has been approved for the merger:

(i) ARIMA LTD. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (New Shares).

(ii) Banks agreed to waive the loan of ₹ 18 lakh of Arima Ltd.

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

(iv) Sundry Creditors of Arima Ltd. includes ₹ 30 lakh payable to RITO Ltd.

(v) After merger the proposed dividend of Rito Ltd. will be paid to Shareholders of Rito Ltd.

(vi) RITO Ltd. will cancel 20% holding of Arima Ltd. investment which was held at a cost of ₹ 75 lakh.

(vii) Authorised Capital of ARIMA LTD. will be raised accordingly to carry out the scheme.

Required:

Pass necessary entries in the books of ARIMA LTD. and prepare Balance Sheet (after merger) as on March 31, 2013 **15**

Answer 4.

ARIMA LTD.
CALCULATION PURCHASE CONSIDERATION

RITO Ltd. 600000 Equity Shares will be issued:		600000
One Share (new) for each Share by ARIMA Ltd.		
Less: Already held by Rito Ltd.		
20% of 300000 =	60000	
New converted into New Shares Of 6000 of ₹100 each		6000
Number of Shares to be issued by Arima Ltd. to Rito Ltd.		594000

Total purchase Consideration : ₹594 Lakh

JOURNAL ENTRIES (IN THE BOOKS OF ARIMA LTD.)

(Amount in ₹Lakh)

Particulars		Amount Dr.	Amount Cr.
Equity Share Capital A/c. (₹100) To Equity Share Capital A/c. (₹10) To Reconstruction A/c. (Being reduction in share capital)	Dr.	300	 30 270
Equity Share Capital A/c. (₹10 each)	Dr.	30	

To Equity Share Capital A/c. (₹100) (Being consolidation of share)			30
Loan from Banks To Reconstruction A/c. (Being waiver of loan by Bank)	Dr.	18	18
Reconstruction A/c. (₹100) To Profit and Loss A/c. To Capital Reserve A/c. (Being adjustment for accumulated loan)	Dr.	288	 240 48
Business Purchase A/c. To Liquidator of RITO Ltd.. (Being purchase consideration for RITO Ltd.)	Dr.	594	
Fixed Assets A/c. Other Investments A/c. Sundry Debtors A/c. Cash at Bank A/c. Reserves A/c. To Sundry Creditors A/c. To 10% Debentures A/c. To Loan from Banks A/c. To Proposed Dividend A/c. To Business Purchase A/c. To Reserves A/c. (Being entry on acquiring of Assets/Liabilities of RITO Ltd.)	Dr. Dr. Dr. Dr. Dr.	810 135 120 75 69	 90 150 75 60 594 240
Proposed Dividend A/c. To Bank A/c. (Payment of Proposed dividend to Shareholders of RITO Ltd.)	Dr.	60	 60
Liquidator or RITO Ltd. A/c. To Equity Share Capital A/c. (of Arima Ltd.) Discharge of purchase Consideration in the Form of equity Shares of Arima Ltd.	Dr.	594	 594
Sundry Creditors A/c. To Sundry Debtors A/c. Cancellation of Inter Company ownings.	Dr.	30	 30

BALANCE SHEET OF ARIMA LTD.
As on March 31, 2013
(after merger)

(Amount in ₹Lakh)

Liabilities	Amount	Assets	Amount
Share Capital 624000 Equity Shares of ₹100 each. (30000 + 594000)	624	Fixed Assets – net of Depreciation : Investment:	1065 135

Capital Reserves:	48	Sundry Debtors:	135
General Reserves: (240 – 69)	171	Cash at Bank: (75 – 60)	15
10% Debentures:	150		
Loan from Banks:	192		
Bank Overdrafts:	15		
Sundry Creditors:	150		
	1350		1350

5. (a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS-3: 8

Particulars	₹ in lakhs	₹ in lakhs
Net Profit		**80,000**
Add: Sale of Investments		**60,000**
Depreciation on Assets		**14,000**
Issue of Preference Shares		**10,000**
Loan Raised		**5,000**
Decrease in Stock		**11,000**
		1,80,000
Less: Purchase of Fixed Assets	**50,000**	
Decrease in Creditors	**5,000**	
Increase in Debtors	**10,000**	
Exchange Gain	**10,000**	
Profit on Sale of Investments	**15,000**	
Redemption of Debenture	**6,500**	
Dividend Paid	**2,000**	
Interest Paid	**1,500**	**1,00,000**
		80,000
Add: Opening Cash and Cash Equivalent		**14,450**
Closing Cash and Cash Equivalent		**94,450**

(b) As per requirement of Revised Clause-49 issued by SEBI, the Board shall lay down a Code of Conduct for all Board members and senior management of the company. For this purpose, state the meaning of "senior management". 2

(c) State the powers of Audit Committee. 2

(d) Why internally generated goodwill is not recognized in financial statement? 3

Answer 5.

(a) Cash Flow Statement

₹in Lakh

<u>Cash flow from operating activities:</u>		
Net Profit:		80,000
<u>Less</u>: Exchange gain:		(10,000)
<u>Less</u>: Profit on Sale Investments:		(15,000)
		55,000
<u>Add</u>: Depreciation on assets:		14,000

		69,000
Changes in current assets and current liabilities:		
(-) Increase in debtors	(10,000)	
+ Decrease in Stock :	11,000	
(-) Decrease in creditors:	(5,000)	(4,000)
Net Cash from operating activities:		65,000
Cash flow from investing activities:		
Sale of investments :	60,000	
Purchase of fixed assets:	(50,000)	
		10,000
Net cash from investing activities:		
Cash flows from financing activities:		
Issue of preference shares:	10,000	
Loan raised	5,000	
Redemption of Debentures:	(6,500)	
Interest paid:	(1,500)	
Dividend paid:	(2,000)	
Net Cash from financing activities:		5,000
Net increase in cash & cash equivalents:		80,000
Add: Opening cash and cash equivalents:		14,450
Closing cash and cash equivalents:		94,450

(b) The term 'Senior Management' shall mean, personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

(c) The Audit Committee shall have powers, which should include the following:
(i) To investigate any activity within its term of reference.
(ii) To seek information from any employee.
(iii) To obtain outside legal or other professional advice.

(d) The enterprise while doing business, slowly develops the goodwill. Goodwill generated in the process of doing business is called internally generated goodwill. This type of goodwill may be generated because of number of factors, like good business practice, good and trained employees, advertisement, continuous training to employees, etc. certainly, to generate the goodwill internally involves cost, but this cost cannot be measured reliably. As the cost cannot be measured reliably, the self generated goodwill is not recognized in books / financial statements.

6. (a) Following information is given of two companies for the year ended 31st March, 2013:

Particulars	**Company X ₹**	**Company Y ₹**
Equity Shares of ₹ 100 each	**12,00,000**	**15,00,000**
10% Preference Shares of 100 each	**9,00,000**	**6,00,000**
Profit after Tax	**4,50,000**	**4,50,000**

Assume market expectation is 15% and 80% of the profits are distributed.

(i) What is the rate you would pay to the Equity Shares of each company?

(a) if you are buying a small lot.

(b) if you are buying controlling interest in the company.

(ii) If you plan to invest only in Preference Shares, which company's Preference Shares is

better? 8

(b) 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

(c) How is liability determined in the case of a finance lease? 3

Answer 6.

(a) (i) (a) buying a small lot of equity shares : If the purpose of valuation is to provide data base to aid a decision of buying a mall (non-controlling) position of the equity of the companies, dividend capitalization method is most appropriate. Under this method, value of equity shares will be

Dividend per Share/Market Capitalisation rate x 100

Company X : ₹(24 ÷ 15) x 100 = ₹160.00

Company Y : ₹(20.80 ÷ 15) x 100 = ₹138.67

(b) Buying controlling interest equity shares : If the purpose of valuation is to provide data base to aid a decision of buying controlling interest in the company, EPS Capitalisation method is most appropriate. Under this method, value of equity is given by

Earning per Share / Market capitalization rate x 100

Company – X : ₹(30 ÷ 15) X 100 = ₹200.00

Company – Y : ₹(26 ÷ 15) x 100 = ₹173.00

(ii) Preference dividend coverage ratio of both companies are to be compared to make such decision.

Preference Dividend coverage ratio = Profit after tax / Profit Dividend x 100

Company – X : ₹4,50,000 ÷ 90,000 = 5 times

Company – Y : ₹4,50,000 ÷ 60,000 = 7.5 times

So, if we are planning to invest only in preference shares, we would prefer shares of Y company as there is more coverage for preference dividend.

(b) 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.

(c) In the case of finance lease, the lessee should recognize a liability equal to the fair value of leased asset at the inception of the lease. If the fair value of the leased exceeds the present value of the minimum lease payments for the stand – point of the lessee, the amount recorded as an asset and a liability should be present value of minimum lease payments from the stand point of lessee.

In calculating the present value of the minimum lease payments the discount rate is the rate implicit in the lease, if this is practicable to determine, if not, the lessee's incremental borrowing rate should be used.

7. The following is the Balance Sheet as at 31st March, 2012 of Hopeful Ltd.:

Liabilities	₹	Assets	₹
Share Capital:		**Fixed Assets (including**	
8,500 Equity Shares of ₹ 100 each		**goodwill of ₹ 1,00,000)**	**11,80,000**
fully paid up	**8,50,000**	**Investments**	**40,000**
4,000 Cumulative Preference		**Stock in Trade**	**2,75,000**
Shares of ₹ 100 each fully paid up		**Trade Debtors**	**1,50,000**
Securities Premium	**4,00,000**	**Bank Balances**	**65,000**
General Reserve	**20,000**		
Trade Creditors	**60,000**		
	3,80,000		
	17,10,000		**17,10,000**

Contingent liability:
Preference Dividends in arrears ₹ 60,000.
The Board of Directors of the company decided upon the following scheme of reconstructions, which was duly approved by all concerned and put into effect from 1st April, 2012.

- **(i) The Preference Shares are to be converted into 12% unsecured debentures of ₹ 100 each with regard to 70% of the dues (including arrears of dividends) and for the balance Equity Shares of ₹ 50 paid up would be issued. The authorised Capital of the company permitted the issue of additional shares.**
- **(ii) Equity Shares would be reduced to share of ₹ 50 each paid up.**
- **(iii) Since goodwill has no value, the same is to be written off fully.**
- **(iv) The market value of investments are to be reflected at ₹ 60,000.**
- **(v) Obsolete item in Stock of ₹ 75,000 are to be written off. Bad Debts to the extent of 5% of the total debtors would be provided for. Fixed assets to be written down by ₹ 1,80,000.**

The company carried on trading for six months upto 30th September, 2012, and made a net profit of ₹ 1,00,000 after writing off depreciation at 25% p.a. on the revised value of fixed assets. The half yearly working resulted in an increase of Sundry Debtors by ₹ 80,000, stock by ₹ 70,000 and Cash by ₹ 50,000.
You are required to show the Journal entries for giving effect to the above arrangement and also draw the Balance Sheet of the company as at 30th September, 2012. 15

Answer 7.

Hopeful Ltd.
Balance Sheet as at 30 September, 2012

Liabilities	Rs.	Assets	₹	Rs.
Subscribed Capital		Fixed Assets:	9,00,000	
11,260 Equity Shares of ₹50 each:	5,63,000	Less: Depreciation	1,12,500	7,87,500
Securities Premium:	20,000	Investments:		60,000
Capital Reserve:	22,500	Stock-in-Trade: (275000–75000+70000)		2,70,000
General Reserve:	60,000			
		Trade Debtors:	2,30,000	

Profit and Loss A/c.:	1,00,000	Less: Provision for Doubtful Debt.:	7,500	2,22,500
12% unsecured Debentures:	3,22,000			
Trade Creditors:	3,67,500	Cash & Bank Balance:		1,15,000
	14,55,000			14,55,000

Working Notes:

1) No. of equity shares issued to cumulative preferences Shareholders: 2,760
No. of shares held by Equity Shareholders: 8,500
11,260

2) Calculation of Cash Balance:

Opening cash balance as on 31.03.2012:	65,000
Add: Changes in cash balance (as given in question)	50,000
	1,15,000

3) Calculation of Creditors:

Profit and Loss upto 30.09.2012:	1,00,000
Add: Depreciation (Non-cash item):	1,12,500
Cash from operations (A):	**2,12,500**
Change in Current Assets:	
Debtors:	+ 80,000
Stock:	+ 70,000
Cash:	+ 50,000
Cash out flow (B)	**2,00,000**
Decrease in Creditors:	
Excess of (A) over (B);	- 12,500
Add: Opening balance of Creditor :	3,80,000
Closing creditor (30.09.12):	**3,67,500**

Journal Entries:

In the books of Hopeful Ltd.

Particulars		Dr. Rs.	Cr. Rs.
Cumulative preference share Capital A/c. Capital Reduction A/c. To Cumulative Preference Shareholders A/c. (Being Cumulative preference shares and preference Shareholders A/c.)	Dr. Dr.	4,00,000 60,000	 4,60,000
Cumulative preference Shareholders A/c. To 12% unsecured Debentures A/c. To Equity Share Capital A/c. (Being the issue of 12% unsecured Debentures and 2760 Equity Shares of ₹100 each issued as ₹50 paid up)	Dr.	4,60,000	 3,22,000 1,38,000
Equity Share Capital A/c. To Capital Reduction A/c.	Dr.	4,25,000	 4,25,000

(Being the entry for reducing every share of ₹100 each as ₹50 paid up, 8500 Equity shares @ 50 per share)			
Investments A/c. Capital Reduction A/c. (Balancing figure) To Goodwill A/c. To Stock A/c. To Fixed Assets A/c. To Provision for doubtful debts (Being the change in value of assets)	Dr. Dr.	20,000 3,42,500	 1,00,000 75,000 1,80,000 7,500
Capital Reduction A/c. To Capital Reserve A/c. (Being transfer of Capital Reduction A/c. balance to Capital Reserve)	Dr.	22,500	 22,500

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

(a) Advantages in the preparation of Value Added Statement;
(b) Jaggi and Lau model on valuation of group basis of Human Resources;
(c) Constitution of Public Accounts Committee;
(d) Convergence of Accounting Standards with IFRS.

Answer:

8. (a) The advantages in the preparation of Value Added Statements are as follows. These are:

- Reporting on the aspects of Value Added Statements (VA) can to a great extent improve the attitude of employees towards their relevant companies. This is mainly due to the fact VA reflects a broader view of the company's objectives and responsibilities.
- VA statement duly makes it advantageous for the company to introduce a productivity linked bonus system for the employees based on the VA. The, employees may be given a productivity bonus on the basis of VA/Payroll Ratio.
- VA based ratios (e.g. VA/Payroll, Taxation / VA, VA/Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
- VA provides a very good measure of the size and importance of a company. For using the sales figure on capital employed figures as a basis for company's rankings can cause distortion. This is because adopting the sales figure to get inflated through large bought in expenses or a capital intensive – intensive company with a few employees may appear to be more important than a highly skilled labour – intensive company.
- VA Statement usually links a financial company's financial accounts to a national income of an economy, and its relevant contribution.
- VA Statement is built on the basic conceptual foundations which are currently accepted in Balance Sheets and income Statements. The relevant statements and the concepts like going concern, matching, consistency and substance over form are equally applicable towards preparation of VA Statement.

(b) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals or individuals as a group are taken into consideration. A group usually refers to a homogenous employee whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict. On a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model is designed to calculate the present value of all existing employees in each rank. Such relevant present value is measured with the help of the following steps.

Ascertain the number of employees in each rank.

Estimate the probability that an employee will be in his rank within the within the organisation or being terminated promoted in the next period. This probability will be estimated for a specified group for a significant time period.

Ascertaining the economic value of an employee in a specified rank during each time period.

The present of existing employees in each rank can be obtained by multiplying the above three factors and applying an appropriate discounting rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as a valuation base. But in the process, they ignored the exceptional qualities of some skilled employees.

(c) The Committee consists of not more than 22 members comprising 15 members elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote and not more than 7 members of Rajya Sabha elected by that house in like manner associated with the committee. This system of election ensures that each Party/Group is represented on the committee in proportion to its respective strength in the two Houses.

The Chairman is appointed by the Speaker from amongst its members of Lok Sabha. The Speaker, for the first time, appointed a member of the Opposition as the Chairman of the Committee for 1967 – 68. This practice has been continued since then. A Minister is not eligible to be elected as a member of the committee. If a member after his election to the committee is appointed a Minister, he ceases to be a member of the committee from the date of such appointment.

(d) Convergence means to harmonize the Indian Accounting Standards with IFRS (International Financial Reporting Standards). There are some differences between ASs and IFRS. To Coverage means to sort-out these differences and agreed to one way of accounting treatment which will be more investor friendly and also enhance the comparability of financial statements. The ICAI has published the roadmap of convergence with IFRS. It has also announced that it will converge with IFRS.

The convergence does not mean the adoption of the IFRS. We will not be adopting word by word the IFRS. The local business environment will be considered while converging with IFRS.