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GROUP IV

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GROUP - IV

Paper-16 : ADVANCED FINANCIAL ACCOUNTING & REPORTING

FINAL EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - IV

Paper-16 : ADVANCED FINANCIAL ACCOUNTING & REPORTING

Q1. Write short notes on the Advantages and disadvantages of setting of Accounting Standards.

Answer 1.

The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance. The setting of accounting standards has the following advantages:

(i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

(ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

However, there are some **disadvantages** of setting of accounting standards:

(i) Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

(iii) Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Q2. (a) Briefly indicate the items, which are included in the expression "borrowing cost" as explained in AS 16.

(b) Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3(AS 3) revised.

(c) Write short note on Effect of Uncertainties on Revenue Recognition.

Answer 2.

(a) Borrowing costs: Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

As per para 4 of AS 16 on Borrowing Costs, borrowing costs may include :

(i) Interest and commitment charges on bank borrowings and other short-term and long-term borrowings;

(ii) Amortization of discounts or premiums relating to borrowings ;

(iii) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;

(iv) Finance charges in respect of assets acquired under finance leases or under other similar arrangements; and

(v) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

(b) As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(i) The direct method whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(ii) The indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the enterprise; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:

(i) changes during the period in inventories and operating receivables and payables:

(ii) other non-cash items; and

(iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

(i) changes during the period in inventories and operating receivables and payables;

(ii) non-cash items such as depreciation, provisions, deferred taxes, and unrealized foreign exchange gains and losses; and

(iii) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

(c) **Effect of Uncertainties on Revenue Recognition**

Para 9 of AS 9 on "Revenue Recognition" deals with the effect of uncertainties on Revenue Recognition. The para states:

(i) Recognition of revenue requires that revenue is measurable and at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

(ii) Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc. revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise,

revenue only when it is reasonably certain that the ultimate collection will be made. When there is uncertainty as to ultimate collection, revenue is recognised at the, time of sale or rendering of service even, though payments are made by instalments.

(iii) When the uncertainty relating to collectability arises subsequent to the time of sale or rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

(iv) An essential criterion for the recognition of revenue is that the consideration receiv-able for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits; the recognition of revenue is postponed.

(v) When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

Q3. Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.09. You are required to advise the company on the following items from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards.

(a) An audit stock verification during the year revealed that the opening stock of the year was understated by Rs. 3 lakhs due to wrong counting.

(b) The company purchased on 01.04.08 a special purpose machinery for Rs. 25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.

(c) The company undertook a contract for building a crane for Rs. 10 lakhs. As on 31.03.09 it incurred a cost of Rs. 1.5 lakhs and expects that there will be Rs. 9 lakhs more for completing the crane. It has received so far Rs. 1 lakh as progress payment.

Answer 3.

(a) The wrong counting of opening stock of the current year/closing stock of the previous year must have also resulted in lowering of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year in respect of these errors in the preparation of the financial statements of the prior period and should therefore be treated as prior period adjustments as per AS 5 (Revised). Accordingly, the rectifications relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the current statement of profit and loss together with their nature and amount in a manner that their impact on current profit or loss can be perceived.

(b) AS 12 'Accounting for Government Grants' regards two methods of presentation, of grants related to specific fixed assets, in financial statements as acceptable alternatives. Under the first method, the grant can be shown as a deduction from the gross book value of the machinery in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under the second method, it can be treated as deferred income which should be recog-nised in the profit and loss statement over the useful life of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description e.g., 'Deferred government grants' to be shown after 'Reserves and Surplus' but before 'Secured Loans'.

The following should also be disclosed :

(i) The accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) The nature and extent of government grants recognised in the financial statement.

(c) Para 21 of AS 7 (Revised) 'Construction Contracts' provides that when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively with reference to the stage of completion of the contract activity at the reporting date.

As per para 32 of the standard, during the early stages of a contact it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the contract costs incurred. Therefore, contract revenue is recognized only to the extent of costs incurred that are expected to be recovered. As the outcome of the contract cannot be estimated reliably, no profit is recognised. Para 35 of the standard states that when it is probable that the total contacts costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Thus the forseesable loss of Rs. 50,000 (expected cost Rs. 10.5 lakhs less contract revenue Rs. 10 lakhs) should be recognized as an expense in the year ended 31st March, 2009.

Also, the following disclosures should be given in the financial statements:

(i) The amount of contract revenue recognized as revenue in the period;
(ii) The aggregate amount of costs incurred and loss recognized upto the reporting date;
(iii) Amount of advances received;
(iv) Amount of retentions; and
(v) Gross amount due from/due to customers Amount*

Q4. A firm of contractors obtained a contract for construction of bridges across river Mahanadi. The following details are available in the records kept for the year ended 31st March, 2009.

	(Rs. in lakhs)
Total Contract Price	**1,000**
Work Certified	**500**
Work not Certified	**105**
Estimated further Cost to Completion	**495**
Progress Payment Received	**400**
To be Received	**140**

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

Answer 4.

(a) Amount of foreseeable loss

	(Rs in lakhs)
Total cost of construction (500 + 105 + 495)	1,100
Less: Total contract price	1,000
Total foreseeable loss to be recognized as expense	100

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

(b) Contract work-in-progress i.e. cost incurred to date are Rs. 605 lakhs

	(Rs in lakhs)
Work certified	500
Work not certified	105
	605

This is 55% (605/1,100 × 100) of total costs of construction.

(c) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised). 55% of Rs. 1,000 lakhs = Rs. 550 lakhs.

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

= [605 + Nil – 100 – (400 + 140)] Rs. in lakhs

= [605 – 100 – 540] Rs. in lakhs

Amount due to customers = Rs. 35 lakhs

The amount of Rs. 35 lakhs will be shown in the balance sheet as liability.

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

	Rs. in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognized losses	(100)
Progress billings (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

Q5. In preparing the financial statements of R Ltd. for the year ended 31st March, 2009, you come across the following information. State with reasons, how you would deal with them in the financial statements :

(a) An unquoted long term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 2009 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs. 20,000.

(b) The company invested 100 lakhs in April, 2009 in the acquisition of another company doing similar business, the negotiations for which had started during the financial year.

(c) There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2008-09).

As it is stated in the question that financial statements for the year ended 31st March, 2009 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

Answer5.

(a) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 20,000 in the financial statements for the year ended 31st March, 2009.

(b) Para 3.2 of AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2009. Applying para 15 which clearly states that/disclosure should be made in

the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 100 lakhs in April, 2009 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

(c) Due to major theft of stores in the preceding year (2007-08) which was detected only during the current financial year (2008-09), there was overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived.

Note: Alternatively, it may be assumed that in the preceding year, the value of stock of stores as found out by physical verification of stocks was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2009.

Q6. (a) A Limited Company closed its accounting year on 30.6.09 and the accounts for that period were considered and approved by the board of directors on 20th August, 2009. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2009 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of Rs. 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.09.

(b) X Co. Ltd., has obtained an Institutional Loan of Rs. 680 lakhs for modernisation and renovation of its plant & machinery, Plant & machinery acquired under the modernisation scheme and installation completed on 31.3.09 amounted to Rs. 520 lakhs, 30 lakhs has been advanced to suppliers for additional assets and the balance loan of Rs. 130 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to Rs. 62 lakhs during 2008-09.

You are required to state how the interest on the institutional loan is to be accounted for in the year 2008-09.

(c) Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 2008-2009.

You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

(d) A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.09 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.09 and 31.12.09 respectively. First instalment was paid on 31.12.09. The entire difference in foreign exchange has been capitalized.

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

(e) A Limited Company finds that the stock sheets as on 31.3.08 had included twice an item the cost of which was Rs. 20,000.

You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31.3.09

Answer 6.

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

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

(b) The treatment for total interest amount of Rs. 68 lakhs can be given as follows :

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
		Rs. in lakhs	Rs. in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset*		
Advance to suppliers for additional assets	Qualifying asset*	$\frac{62\times30}{680}=2.74$	
Working Capital	Not a qualifying asset		$\frac{62\times130}{680}=11.85$
		50.15	11.85

(c) As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

(i) **Interest:** on a time proportion basis taking into account the amount outstanding and the rate applicable.

(ii) **Royalties:** on an accrual basis in accordance with the terms of the relevant agreement.

(d) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference :

Foreign currency loan = $\frac{\text{Rs. 3,000 lakhs}}{\text{Rs. 40}}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars ×(42.50 – 40.00)

= Rs. 187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting Rs. 187.50 lakhs should be charged to profit and loss account for the year.

(e) The error in the recording of closing stock of the year ended 31st March, 2008 must have also resulted in overstatement of profits of previous year, brought forward to the current year ended 31st March, 2009. Vide para 4 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, the rectifications as required in the current year are 'Prior Period Items'. Accordingly, Rs. 20,000 should be deducted from opening stock in the profit and loss account. And Rs. 20,000 should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 2009 in accordance with para 15 of AS 5 (Revised) which requires that the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

Q7. (i) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2009.

A claim lodged with the Railways in March, 2006 for loss of goods of Rs. 2,00,000 had been passed for payment in March, 2009 for Rs. 1,50,000. No entry was passed in the books of the Company, when the claim was lodged.

(ii) The notes to accounts of X Ltd. for the year 2008-09 include the following :
"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Fertiliser Project amounting to Rs. 1,80,80,000 has been capitalized during the year, which includes approximately Rs. 1,70,33,465 capitalised in respect of the utilization of loan and debenture money for the said purpose." Is the treatment correct? Briefly comment.

Answer 7.

(i) Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on Revenue Recog-nition states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction cannot be taken as a Prior Period Item.

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

(ii) The treatment done by the company is not in accordance with AS 16 'Borrowing Costs'. As per para 10 of AS 16, to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should

be determined as the actual borrowing costs incurred on that borrowing during the period. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. Rs. 1,70,33,465. Thus, there is an excess capitalisation of Rs. 10,46,535. This has resulted in overstatement of profits by Rs. 10,46,535 and amount of fixed assets has also gone up by this amount.

Q8. State with reference to accounting standard, how will you value the inventories in the following cases :

(i) Raw material was purchased at Rs. 100 per kilo. Price of raw material is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost. 10,000 kgs. of raw material is on stock at the year end. Replacement cost is Rs. 80 per kg.

(ii) In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is Rs. 1,000. The entire quantity of waste is on stock at the year end.

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

Material cost Rs. 100 per kg.

Direct labour cost Rs. 20 per kg.

Direct variable production overhead Rs. 10 per kg.

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

Answer 8.

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

Hence, in the given case, the stock of 10,000 kgs of raw material will be valued at Rs. 80 per kg. The finished goods, if on stock, should be valued at cost or net realisable value whichever is lower.

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

In this case, normal waste is 250 MT and abnormal waste is 50 MT.

The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to Rs. 50,000 (50 MT x Rs. 1,000) will be charged in the profit and loss statement.

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

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

	Rs.
Material cost	100
Direct labour cost	20
Direct variable production overhead	10
Fixed production overhead $\left(\frac{\text{Rs. }10,00,000}{1,00,000}\right)$	10
	140

Thus, the value of 2,000 kgs. of finished goods on stock at the year end will be Rs. 2,80,000 (2,000 kgs. × Rs. 140).

Q. 9. Answer the following questions by quoting the relevant Accounting Standard :

(i) During the year 2008-2009, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 5,00,000. Is a separate disclosure necessary?

(ii) A Limited company has been including interest in the valuation of closing stock. In 2008-2009, the management of the company decided to follow AS 2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by Rs. 3,00,000. Is a disclosure necessary? If so, draft the same.

(iii) A company signed an agreement with the Employees Union on 1.9.2008 for revision of wages with retrospective effect from 30.9.2008. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2008-09 ?

Answer 9.

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS 5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that :

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(ii) As per AS 5 (Revised), change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the instant case, the company has changed its accounting policy in order to conform with the AS 2 (Revised) on Valuation of Inventories. Therefore, a disclosure is necessary in the following lines by way of notes to the annual accounts for the year 2008-2009.

"To be in conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock unlike preceding years. Had the same principle been followed in previous years, profit for the year and its corresponding effect on the year end net assets would have been higher by Rs. 3,00,000."

(iii) It is given that revision of wages took place on 1st September, 2009 with retrospective effect from 30.9.2008. Therefore wages payable for the half year from 1.10.2008 to 31.3.2009 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs. 7,50,000 (for 1½ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Q. 10. Briefly explain, as per relevant Accounting Standard :

(a) TVSM company has taken a Transit Insurance Policy. Suddenly in the year 2008-2009 the percentage of accident has gone up to 7% and the company wants to recognise insurance claim as revenue in 2008-2009 in accordance with relevant Accounting Standards. Do you agree?

(b) SCL Ltd. sells agriculture products to dealers. One of the condition of sale is that interest is payable at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2008-2009 the company wants to recognise the entire interest receivable. Do you agree?

(c) ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months upto 31.3.2008.

The company wants to provide during the year ending 31.3.2009 based on technical evaluation :

Total value of stock	**Rs. 100 lakhs**
Provision required based on 12 months issue	**Rs. 3.5 lakhs**
Provision required based on technical evaluation	**Rs. 2.5 lakhs**

Does this amount to change in Accounting Policy? Can the company change the method of provision?

(d) XYZ is an export oriented unit and was enjoying tax holiday upto 31.3.2008. No provision for deferred tax liability was made in accounts for the year ended 31.3.2008. While finalising the accounts for the year ended 31.3.2009, the Accountant says that the entire deferred tax liability upto 31.3.2008 and current year deferred tax liability should be routed through Profit and Loss Account as the relevant Accounting Standard has already become mandatory from 1.4.2007. Do you agree?

Answer 10.

(a) AS 9 on Revenue Recognition defines revenue as 'gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of the enterprise from the sale of goods, from the rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends'.

To recognise revenue AS 9 requires that revenue arises from ordinary activities and that it is measurable and there should be no uncertainty. As per para 9.2 of the Standard, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

In the given case, TVSM company wants to suddenly recognise Insurance claim because it has increased over the previous year. But, there are uncertainties involved in the settlement of the claim. Also, the claim does not seem to be in the course of ordinary activity of the company.

Hence, TVSM company is not advised to recognise the Insurance claim as revenue.

(b) As per para 9.2 of AS 9 on Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, SCL Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstandings is also an estimate and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

(c) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from Rs.3.5 lakhs to Rs.2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2008-09:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by Rs.1 lakh."

(d) Paragraph 33 of AS 22 on "Accounting For Taxes on Income" relates to the transitional provisions. It says, "On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets.

Further Paragraph 34 lays down, "For the purpose of determining accumulated deferred tax in the period in which this statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences."

Therefore, in the case of XYZ, even though AS 22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves.

Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

Q. 11. PQR Ltd.'s accounting year ends on 31st March. The company made a loss of Rs. 2,00,000 for the year ending 31.3.2007. For the years ending 31.3.2008 and 31.3.2009, it made profits of Rs. 1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2007, the company feels that there will be sufficient

taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 2008 and 2009 for tax purposes. Prepare a statement of Profit and Loss for the years ending 2007, 2008 and 2009.

Answer 11.

Statement of Profit and Loss

	31.3.2007	**31.3.2008**	**31.3.2009**
	Rs.	**Rs.**	**Rs.**
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/ adjusted during the year		(40,000)	(40,000)
Profit (loss) after tax effect	(1,20,000)	60,000	72,000

Q. 12. (a) At the end of the financial year ending on 31st December, 2008, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

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

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

(b) Z Ltd. presents the following information for the year ending 31.03.2008 and 31.03.2009 from which you are required to calculate the Deferred Tax Asset/Liability assuming tax rate of 30% and state how the same should be dealt with as per relevant accounting standard.

	31.03.2008 Rs. (lakhs)	**31.03.2009 Rs. (lakhs)**
Depreciation as per books	**4,010.10**	**4,023.54**
Unabsorbed carry forward business loss and depreciation allowance	**2,016.60**	**4,110.00**
Disallowance under Section 43B of Income tax Act, 1961	**518.35**	**611.45**
Deferred Revenue Expenses	**4.88**	**—**
Provision for Doubtful Debts	**282.51**	**294.35**

Z Ltd. had incurred a loss of Rs. 504 lakhs for the year ending 31.03.2009 before providing for Current Tax of Rs. 26.00 lakhs.

Answer 12.

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

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

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

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

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

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

Expected loss in next ten cases = 30% of Rs. 1,20,000 + 10% of Rs. 2,00,000
= Rs. 36,000 + Rs. 20,000
= Rs. 56,000

Expected loss in remaining five cases = 30% of Rs. 1,00,000 + 20% of Rs. 2,10,000
= Rs. 30,000 + Rs. 42,000
= Rs. 72,000

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

(b)

	Rs. in lakhs 31.3.2008	**Rs. in lakhs 31.3.2009**
Carried Forward Business Loss and Depreciation Allowance	2,016.60	4,110.00
Ad: Disallowance under Section 43 B of Income Tax Act,1961	518.35	611.45
Provision for Doubtful Debts	282.51	294.35
	2,817.46	5,015.80
Less: Depreciation	4,010.10	4,023.54
	(-) 1,192.64	992.26
Less: Deferred Revenue Expenditure*	4.88	—
Timing Differences	(-) 1,197.52	992.26
Deferred Tax Liability	359.26	
Deferred Tax Asset		297.68

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported

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

Q. 13. Briefly explain as per relevant Guidance Notes:

(a) HSL Ltd. is manufacturing goods for local sale and exports. As on 31st March, 2009, it has the following finished stocks in the factory warehouse:

(i) Goods meant for local sale Rs. 100 lakhs (cost Rs. 75 lakhs).

(ii) Goods meant for exports Rs. 50 lakhs (cost Rs. 20 lakhs).

Excise duty is payable at the rate of 16%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence is not a cost. Please advise HSL using guidance note, if any issued on this, including valuation of stock.

(b) SFL Ltd. is a mutual fund. The fund values the investment on "mark to market basis". The Accountant argues since investment are valued on the above basis there is no necessity to disclose depreciation separately in the financial statements. Do you agree?

(c) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2008-2009 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

Answer 13.

(a) Guidance Note on Accounting Treatment for Excise Duty says that excise duty is a duty on manufacture or production of excisable goods in India.

According to Central Excise Rules, 2002, excise duty should be collected at the time of removal of goods from factory premises or factory warehouse. The levy of excise duty is upon the manufacture or production, the collection part of it is shifted to the stage of removal.

Further, paragraph 23(i) of the Guidance Note makes it clear that excise duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation.

Therefore, in the given case of HSL Ltd., the Managing Director's contention that "excise duty is payable only on clearance of goods and hence is not a cost is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 16% on the selling price, that is, Rs. 100 lakhs for valuation of stock.

Excise duty on goods meant for exports, should be provided for, since the liability for excise duty arises when the manufacture of the goods is completed. However, if it is assumed that all the conditions specified in Rule 19 of the Central Excise Rules, 2002 regarding export of excisable goods without payment of duty are fulfilled by HSL Ltd., excise duty may not be provided for.

(b) The Guidance Note on Accounting for Investments in the Financial statements of Mutual Funds provides that the investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. Clause 2(i) of the Eleventh Schedule provides that "where the financial statements are prepared on a mark to market basis, there need not be a separate provision for depreciation."

However keeping in view, 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the guidance note recommends that the gross value of depreciation on investments should be reflected in the Revenue Account rather than the same being netted off with the appreciation in the value of other investments. In other words, depreciation/appreciation on investments should be worked out on an individual investment basis or by category of investment basis, but not on an overall basis or by category of investment.

In the given case of SFL Ltd., depreciation should be separately disclosed in the financial statements.

(c) The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.

Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

Q. 14. The summarized Balance Sheets of B Ltd. and X Ltd. for the year ending on 31.3.2010 are as under :

	B Ltd. Rs.	X Ltd. Rs.		B Ltd. Rs.	X Ltd. Rs.
Equity Share capital (in shares of Rs. 10 each)	24,00,000	12,00,000	Fixed assets	55,00,000	27,00,000
8% Preference Share capital (in share of Rs. 10 each)	8,00,000	—	Current assets	25,00,000	23,00,000
10% Preference Share capital (in shares of Rs. 10 each)	—	4,00,000			
Reserves	30,00,000	24,00,000			
Current liabilities	18,00,000	10,00,000			
	80,00,000	**50,00,000**		**80,00,000**	**50,00,000**

1. The following information is provided :

	X Ltd. Rs.	B Ltd. Rs.
(a) Profit before tax	10,64,000	4,80,000
(b) Taxation	4,00,000	2,00,000
(c) Preference dividend	64,000	40,000
(d) Equity dividend	2,88,000	1,92,000

2. The Equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.
3. B Ltd. proposes to absorb X Ltd. as on 31.3.2010. The terms of absorption are as under :
   a. Prefernce shareholders of X Ltd. will receive 8% preference shares of B Ltd. sufficient to increase the income of preference shareholders of X Ltd. by 10%
   b. The equity shareholders of X Ltd. will receive equity shares of B Ltd. on the following basis :
      (i) The equity shars of X Ltd. will be valued by applying to the earnings per share of X Ltd. 75% of pric earnings ratio of B Ltd. based on the results of 2009-2010 of both the companies.
      (ii) The market price of equity shares of B Ltd. is Rs. 40 per share.
      (iii) The number of shares to be issued to the equity shareholders of X Ltd. will be based on the above market value.

(iv) In addition to equity shares, 8% preference share of B Ltd. will be issued to the equity shareholders of X Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2009-2010.

4. The assets and liabilities of X Ltd. as on 31.3.2010 are revalued by professional valuer as under :

	Increased by Rs.	Decreased by Rs.
Fixed assets	1,00,000	—
Current assets	—	2,00,000
Current liabilities		40,000

5. For the next two years, no increase in the rate of equity dividend is expected.

You are required to :

i) Set out in detail the purchase consideration.

ii) Give the Balance Sheet as on 31.3.2010 after absorption.

Note : Journal entires are not required.

Answer 14.

I. Purchase Consideration

A. Preference Shareholders

8% preference shars of B Ltd. sufficient to increase income by 10%.

Particulars	Rs.
Current income from Preference shares of X Ltd. (Rs. 4,00,000 × 10%)	40,000
Add : 10% increase	4,000
Income from Preference Shares of B Ltd.	44,000
Value of 8% Preference Shares of B Ltd. to be issued [44,000×100/8]	**5,50,000**

B. Equtity Shareholders

i. Consideration by way of Equity shares

Valuation of shares of X Ltd.
(12,000 shares × Rs. 24 [WN # 3]
Rs. 28,80,000

Share Capital
[72,000 shares* ×Rs. 10]
Rs. 7,20,000

Share Premium
[72,000 shares* × Rs. 30]
Rs. 21,60,000

* No. of shares to be issued = Rs. 28,80,000 ÷ Rs. 40
= 72,000 Shares

ii. Consideration by way of Preference Shares

Particulars	Rs.
i. Current equity dividend from X Ltd.	1,92,000
ii. Expected Equity dividend from B Ltd.	86,400
iii. Loss in income	1,05,600
iv. Number of 8% Preference Shares to be issued (1,05,600 ÷ 8%)	**13,20,000**

C. Total Purchase Consideration

[5,50,000 + 28,80,000 + 13,20,000] Rs. 47,50,000

WN # 1 : *Computation of EPS*

Rs.

	Particulars	X Ltd.	B Ltd.
a.	Profit before tax	10,64,000	4,80,000
b.	Less : Tax (given)	(4,00,000)	(2,00,000)
c.	Profit after tax	6,64,000	2,80,000
d.	Less : Preference dividend	(64,000)	(40,000)
e.	Profit available to equity shareholders	6,00,000	2,40,000
f.	Earnings per share (Profit for Equity Shareholders ÷ No of Shares)	25	20

WN # 2 : *P/E ratio of B Ltd.*

$$\text{P/E ratio} = \frac{\text{Market Price}}{\text{EPS}} = \frac{40}{2.5} = \text{Rs. } 16$$

75% of P/E ratio = (16×0.75) = Rs. 12

WN # 3 : *Value per share of X Ltd.*

= EPS × P/E ratio
= Rs. 2 × Rs. 12
= Rs. 240

WN # 4 : *Adjustment with Reserves*

Total Purchase Consideration paid to B Ltd.	47,50,000
Less : Share Capital of B Ltd. (Equity + Preference)	16,00,000
To be adjusted with Reserves	31,50,000

∴ Reserves = 30,00,000 + 24,00,00 – 31,50,000 = 22,50,000

X Ltd.
Balance Sheet as at on 31.03.2010 (after absorption)

Liabilities	*Amount Rs.*	*Amount Rs.*	*Assets*	*Amount Rs.*	*Amount Rs.*
Equity Share Capital (@Rs. 100 each) (24,000+7,200 Eq. share)		31,20,000	Fixed Assets	55,00,000	
			(+) B Ltd. (27,00,000+1,60,000)	28,60,000	83,60,000
8% Preference Shares of Rs. 100 each (8,000+5,500+13,200) = 26,700 shares)			Current Assets	25,00,000	
			(+) B Ltd. (23,00,000 – 2,00,000)	21,00,000	46,00,000
Reserves (WN # 4)		22,50,000			
Securities Premium		21,60,000			
Current Liabilities (18,00,000+10,00,000 – 40,000)		27,60,000			
		1,29,60,000			**1,29,60,000**

Q.15. M Ltd. and N Ltd. were amalgamation on and from 1st April, 2010. A new company A Ltd. was formed to take over the business of the existing companies. The balance sheet of M Ltd and N Ltd as on 31st March, 2010 are given below :

(Rs. in lakhs)

Liabilities	M Ltd.	N Ltd.	Assets	M Ltd.	N Ltd.
Share capital :			Fixed assets :		
Equity Shares of Rs. 100/- each	850	725	Land and Building	460	275
			Plant and Machinery	325	210
14% Preference Share of			Investments	75	50
Rs. 100 each	320	175	Current Asset and		
Reserves and surplus :			Loans and Advances :		
Revaluation reserve	125	80	Stock	325	269
General reserve	240	160	Sundry Debtors	305	270
Investment Allowance	50	30	Bills receivable	25	—
Reserve			Cash and Bank	385	251
Profit and Loss Account	75	52			
Secured Loans :					
13% Debentures (Rs.100 each)	50	28			
Unsecured Loan :					
Public Deposits	25	—			
Current liabilities and Provision :					
Sundry creditors	145	75			
Bills Payable	20	—			
	1,900	**1,325**		**1,900**	**1,325**

Other Information :

i. 13% debentures of M Ltd and N Ltd are discharged by A Ltd. by issuing such number of its 15% debentures of Rs. 100 each so as to maintain the same amount of interest.

ii. Preference shareholders of the two companies are issued equivalent number of 15% preference shares of A Ltd. at a price of Rs. 125 per share (face value Rs. 100)

iii. A Ltd. will issue 4 equity shars for each equity share of M Ltd. and 3 equity shares for each equity share of N Ltd. The shares are to be issued@ Rs. 35 each, having a face value of Rs. 10 per share.

iv. Investment allowance reserve is to be maintained for two more years.

Prepare the balance sheet of A Ltd. as on 1st April, 2010 after the amalgamation has been caried out.

Answer 15.

Method 1 : Amalgamation in the Nature of Merger

WN # 1 : ***Calculation of Purchase Consideration***

	Particulars	***M Ltd.***	***N Ltd.***
a.	Equity Shares :		
	i. No. of Shares outstanding	8.50	7.25
	ii. Exchange Ratio	4:1	3:1
	iii. No. of Shares to be issued	34	21.75
	iv. Issue price per share (Rs.)	35	35
	v. Purchase Consideration	1190	761.25
	• Share capital	340	217.50
	• Share Premium	850	543.75
b.	Preference Shares :		
	i. No. of Shares outstanding	3.2	1.75
	ii. Exchange Ratio	1:1	1:1
	iii. No. of Shares to be issued	3.2	1.75
	iv. Issue price per share (Rs.)	125	125
	v. Purchase Consideration	400	218.75
	• Share capital	320	175.00
	• Share Premium	80	43.75
c.	Total Considertion {a(iv) + b(iv)}	1590	980.00
		Rs. 2,570 Lakhs	

WN # 2 : ***Computation of Debenture to be issued***

Particulars	***M Ltd.***	***N Ltd.***
a. Value of 13% Debentures taken over	50,00,000	28,00,000
b. 13% Interest on above value	6,50,000	3,64,000
c. 15% Debentures to be issued to earn same amount of interest	43,43,333.33 $\left[6,50,000 \times \frac{100}{15}\right]$	24,26,666.66 $\left[3,64,000 \times \frac{100}{15}\right]$
d. Total amont of debenture issued [43,43,333+24,26,667]		Rs. 67,60,000

Note : Normally fractions of Debentures is settled in Cash.

Balance Sheet of A Ltd. as at 31st March 2010

(Rs. in Lakhs)

Liabilities	*Amount*	*Assets*	*Amount*
Share Capital :		**Fixed Assets :**	
Equity Share capital :		Land and Building	
Authorized, issued and		(460 + 275)	735.00
Subscribed		Plant and Machinery	
Capital (340 Lakhs + 217.50	557.50	(325 + 210)	535.00
Lakhs) of Rs. 10 each -		Investment (75+50)	125.00
[out of the above all the		Current Asset and	
shares were issued for		Loans and Advances :	
consideration other than cash]		Stock (325+269)	594.00
15% Preference Share capital		Debtors (305+270)	575.00
or Rs. 100 each (320000+175000)	495.00	Bills Receivable (25+ –)	25.00
[of the above all the shares were		Cash and Bank	636.00
issued for consideration other		(385+251)	
than cash]			
(Reserves and surplus) :			
Share Premium	1,517.50		
[850+543.75+80+43.75]			
Profit and Loss A/c (WN # 3)	37.40		
Revaluation Reserve	205.00		
Investment allowance reserve	80.00		
Secured Loans :			
15% Debentures	67.60		
(Rs. 100 each) (WN # 2)			
Unsecured Liabilities :			
Public deposits	25.00		
Current liabilities and Provisions :			
Sundry Creditors (145+75)	220.00		
Bills Payable	20.00		
	3,225.00		**3,225.00**

WN # 3 : ***Calculation of reserves to be incorporated in Balance Sheet.***

	Particulars	*M Ltd.*	*N Ltd.*
a.	Aggregate Purchase Consideration		2,570
b.	Aggregate paid-up capial		
	i. Equity Share capital	1,575	
	ii. Preference Share capital	495	2,070
c.	Excess		500
d.	The above excess to be adjusted against :		
	i. General reserves	400	
	ii. P and L Account	100	500
e.	Balance of Reserves available		
	i. Profit and Loss A/c	27	
	ii. Investment allowance reserve	80	
	iii. Revaluation reserve	205	312
f.	Settlement to debenture holders		
	i. Debenure capital of transferee companies	78.00	
	ii. Less : Amount of A Ltd.'s debenture issued	(67.60)	
	iii. Profit to be credited to Profit and Loss A/c		10.40
g.	Balance of reserves to be incorporated		
	i. P & L Account		37.40
	ii. Investment allowance reserve		80.00
	iii. Revaluation reserve		205.00

Method 2 : Amalgamation in Nature of Purchase

Balance Sheet of M/s A Ltd. as on 31.03.10

Liabilities	*Amount*	*Assets*	*Amount*
Share capital :		Fixed assets : (WN1)	
Equity Share capital of Rs. 10 each (of the above all he shares were issued for consideration other than cash)	557.50	Land and Building	735.00
		Plant and Machinery	535.00
		Investments	125.00
15% Preference Share capital of Rs. 100 each (of the above all the share were issued for consideration other than for cash)	495.00	Current assets and Loans and Advances	
		Stock	594.00
Reserves and surplus :		Debtors	575.00
Security Premium (WN#1)	1517.50	Bills Receivable	25.00
Capital reserve (312+10.40)	322.40	Cash and Bank	636.00
Intestment allowance	80.00	Misc. Exp. to be extent not written off	
Secured Loans			
15% Debentures of Rs. 100 each	67.60	Amalgamation Adjustment amount	80.00
Unsecured Liabilities			
Public deposits	25.00		
Current liabilities and Provisions :			
Creditors	220.00		
Bills Payable	20.00		
	3,305.00		**3,305.00**

Q. 16. Given below Balance Sheets of Sure Ltd and Flop Ltd. as on 31.3.2009. Flop Ltd. was merged with Sure Ltd with effect from 01.04.2009.

Balance Sheets as on 31.3.2010

(Rs.)

Liabilities	Sure Ltd.	Flop Ltd.	Assets	Sure Ltd.	Flop Ltd.
Share Capital :			Sundry Fixed Assets	9,50,000	4,00,000
Equity Shares of			Investments (Non-	2,00,000	50,000
Rs. 10 each	7,00,000	2,50,000	trade)		
General Reserve	3,50,000	1,20,000	Stock	1,20,000	50,000
Profit and Loss A/c	2,10,000	65,000	Debtors	75,000	80,000
Export Profit Reserve	70,000	40,000	Advance Tax	80,000	20,000
12% Debentures	1,00,000	1,00,000	Cash and Bank	2,75,000	1,30,000
Sundry Creditors	40,000	45,000	balances		
Provision for Taxation	1,00,000	60,000	Preliminary Expenses	10,000	—
Proposed Dividend	1,40,000	50,000			
	17,10,000	**7,30,000**		**17,10,000**	**7,30,000**

Sure Ltd. would issue 12% Debentures to discharge the claims of the debenture holders of Flop Ltd. at par. Non-trade investments of Sure Ltd. fetched @ 25% while those of Flop Ltd. fetched @ 18%. Profit (pre-tax) by Sure Ltd and Flop Ltd. during 2007-08, 2008-09 and 2009-10 and were as follows :

Year	Sure Ltd. Rs.	Flop Ltd. Rs.
2007-08	5,00,000	1,50,000
2008-09	6,50,000	2,10,000
2009-10	5,75,000	1,80,000

Goodwill may be calculated on the basis of capitalisation method taking 20% as the pretax normal rate of return. Purchase consideration is discharged by Sure Ltd. on the basis of intrinsic value per share. Both companies decided to cancel the proposed dividend.

Required Balance Sheet of Sure Ltd. after merger.

Answer 16.

WN # 1: Purchase Consideration :

(i)	Shares outstanding in Flop Ltd. Intrinsic	25,000
(ii)	Value per Share of Flop Ltd. [WN # 2]	Rs. 36.20
(iii)	Value of Shares (a×b)	Rs. 9,05,000
(iv)	Intrinsic value per share of Sure Ltd. [WN # 2]	Rs. 40.40
(v)	No. of shares to be issued by Sure Ltd.	

Rs. 905000 / Rs. 40.40 = 22400.99

Shares	Cash for fractions
22400	0.99 × 40.40 = 40

(iv) Purchase consideration

(a) 22400 shares @ 40.40

Capital [Rs.10 / Share]	2,24,000		
Premium [Rs. 30.40 / Share]	6,80,960	=	9,04,960
(b) Cash for fraction		=	40
(c) Total purchase consideration payable		=	9,05,000

WH # 2 : *Intrinsic Value per share :*

(Rs.)

			Sure Ltd.		**Flop Ltd.**	
(i)	**Assets**					
	(a)	Goodwill	13,65,000		3,80,000	
	(b)	Sundry Fixed assets	9,50,000		4,00,000	
	(c)	Investments	2,00,000		50,000	
	(d)	Stock	1,20,000		50,000	
	(e)	Debtors	75,000		80,000	
	(f)	Advance Tax	80,000		20,000	
	(g)	Cash and Bank Balance	2,75,000	30,65,000	1.30.000	11,10,000
(ii)	**Liabilities**					
	(a)	12% Debentures	1,00,000		1,00,000	
	(b)	Sundry creditors	40,000		45,000	
	(c)	Provision for tax	1.00.000	(2,40.000)	60.000	(2,05.000)
(iii)	Net Assets (i-ii)			28,25,000		9,05,000
(iv)	No. of Outstanding Shares			70,000		25,000
(v)	Intrinsic Value per share (iii)/(iv)			**40.40**		**36.20**

W # 3 : *Valuation of Goodwill*

A. Capital Employed

	Sure Ltd.		***Flop Ltd.***	
(i) Assets :				
(a) Sundry Fixed assets	9,50,000		4,00,000	
(b) Investment (Non-trade	—		—	
(c) Stock	1,20,000		50,000	
(d) Debtors	75,000		80,000	
(e) Advance tax	80,000		20,000	
(f) Cash and Bank balance	2,75,000	15,00,000	1.30.000	6,80,000
(ii) Liabilities :				
(a) 12% Debentures	1,00,000		1,00,000	
(b) Sundry creditors	40,000		45,000	
(c) Provision for tax	1,00,000	2,40,000	60,000	2,05,000
(iii) Capital Employed : (i) - (ii)		**12,60,000**		**4,75,000**

B. Average Pre-tax Profit :

	Particulars	*Sure Ltd.*	*Flop Ltd.*
(i)	2006-07	5,00,000	1,50,000
(ii)	2000-08	6,50,000	2,10,000
(iii)	20008-09	5,75,000	1,80,000
(iv)	Total (a+b+c)	17,25,000	5,40,000
(v)	Simple Average [(iv)/3]	5,75,000	1,80,000
(vi)	Less: Non-trading income	(50,000)	(9,000)
(vii)	**Average pre-tax profit**	**5,25,000**	**1,71,000**

C. Computation of Goodwill :

	Particulars	*Sure Ltd. Rs.*	*Flop Ltd. Rs.*
a.	Capitalised value of average profits $\left[\frac{5,25,000}{0.20}; \frac{1,71,000}{0.20}\right]$	26,25,000	8,55,000
b.	Capital Employed	12,60,000	4,75,000
c.	**Goodwill (a-b)**	**13,65,000**	**3,80,000**

Journal Entries - Books of Ravi Ltd.

- Nature of Amalgamation – PURCHASE
- Method of Accounting – PURCHASE METHOD

	Particulars		*Debit*	*Credit*
a.	For Business Purchase :			
	Business Purchase A/c	Dr.	9,05,000	
	To Liquidator of Flop Ltd. A/c			9,05,000
b.	Assets and Liabilities taken over			
	Goodwill A/c	Dr.	3,80,000	
	Fixed Assets A/c	Dr.	4,00,000	
	Investments A/c	Dr.	50,000	
	Stock A/c	Dr.	50,000	
	Debtors A/c	Dr.	80,000	
	Advance tax A/c	Dr.	20,000	
	Cash and Bank A/c	Dr.	1,30,000	
	To 12% Debenture holders A/c			1,00,000
	To Creditors A/c			45,000
	To Provision for Taxation A/c			60,000
	To Business Purchase A/c			9,05,000
c.	Liquidator of Flop Ltd.	Dr.	9,05,000	
	To Equity Share capital A/c			2,24,000
	To Share premium A/c			6,80,000
	To Cash A/c			40
d.	Contra Entry			
	Amalgamation Adjustment A/c	Dr.	40,000	
	To Export Profit Reserve A/c			40,000

Balance Sheet Sure Ltd (after Merger) as at 31.3.10

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital :		Fixed assets :	
Issued, Subscribed Paid up	9,24,000	Goodwill (WN # 3C)	3,80,000
Share capital		Sundry Fixed assets	13,50,000
92,400 Equity Shares of Rs. 10 each.		(9,50,000 + 4,00,000)	
(Of which 22,400 shares were		Investment	2,50,000
issued for consideration other		Current assets, Loans	
than cash)		and Advances :	
Reserves and surplus		Stock (1,20,000 + 50,000)	1,70,000
Share Premium	6,80,960	Debtors (75,000 + 80,000)	1,55,000
General Reserve	3,50,000	Advance tax (80,000 + 20,000)	1,00,000
Profit and Loss A/c 2,10,000		Cash and Bank Balances	
Add: Proposed		(2,75,000 + 1,30,000 - 40)	4,04,960
Dividend cancelled 1,40,000	3,50,000	Miscellaneous Expenses :	
Export Profit Reserve	1,10,000	Preliminary Expenses	10,000
(70,000 + 40,000)		Amalgamation	
Secured Loans		Adjustment A/c	40,000
12% Debenture	2,00,000		
(1,00,000 + 1,00,000)			
Current liabilities and			
provisions:			
Sundry creditors			
(40,000 + 45,000)	85,000		
Provision for tax			
(1,00,000 + 60,000)	1,60,000		
	28,59,960		**28,59,960**

Q. 18. The Balance Sheets of Big Ltd. and Small Ltd. as on 31.03.10 were as follows :

Balance Sheet as on 31.03.10

Liabilities (Rs.)	*Big Ltd. (Rs.)*	*Small Ltd.*	*Assets (Rs.)*	*Big Ltd. (Rs.)*	*Small Ltd.*
Equity Share	8,00,000	3,00,000	Building	2,00,000	1,00,000
capital (Rs. 10)			Machinery	5,00,000	3,00,000
10% Preference	—	2,00,000	Furniture	1,00,000	60,000
Share capital (Rs. 100)			Investment :		
			6,000 shares of Small Ltd.	60,000	—
General Reserve	3,00,000	1,00,000	Stock	1,50,000	1,90,000
Profit and Loss A/c	2,00,000	1,00,000	Debtors	3,50,000	2,50,000
Creditors	2,00,000	3,00,000	Cash and Bank	90,000	70,000
			Preliminary Expenses	50,000	30,000
	15,00,000	**10,00,000**		**15,00,000**	**10,00,000**

Big Ltd. has taken over the entire undertaking of Small Ltd. on 30.09.10, on which date, the position of Current assets except cash and bank balances and Current liabilities were as follows :

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

Profits earned for the half year ended on 30.09.10 after charging depreciation as 5% on building, 15% on machinery and 10% on furniture, are :

Big Ltd. Rs. 1,02,500

Small Ltd. Rs. 54,000

On 30.08.10 both companies have declared 15% dividend for 2009-10.

Goodwill of Small Ltd. has been valued at Rs. 50,000 and other Fixed assets at 10% above their book values on 31.03.10. Preference shares of Small Ltd. are to be allotted 10%. Preference Shares of Big Ltd. and Equity shareholders of Small Ltd. are to receive requisite number of equity shares of Big Ltd. valued at Rs. 15 per share on satisfaction of their claims.

Show the Balance Sheet of Big Ltd. as of 30.09.10 assuming absorption is through by that date.

Answer 18.

Part. I

Balance Sheet *of Big Ltd. Small Ltd. Companies as* on *30* September, 2010

Liabilities	*Big Ltd. Rs.*	*Small Ltd. Rs.*	*Assets*	*Big Ltd. Rs.*	*Small Ltd. Rs.*
Equity Share capital Rs. 10 each	8,00,000	3,00,000	**Fixed Assets :**		
			Building	1,90,000	95,000
			Machinery	4,25,000	2,55,000
10% Preference Share capital	—	2,00,000	Furniture	90,000	54,000
			Investment	60,000	—
Reserves and surplus			Current assets Loans and **Advances :**		
General Reserve	3,00,000	1,00,000			
Profit and Loss A/c	1,91,500*	1,09,000*			
Current liabilities and Provisions			Stock	1,20,000	1,50,000
			Debtors	3,80,000	2,50,000
Creditors	1,80,000	2,10,000	Cash (bal. fig)	1,56,500	85,000
			Miscellaneous Expense not written off: Preliminary Expenses	50,000	30,000
	14,71,500	**9,19,000**		**14,71,500**	**9,19,000**

Calculation of Profit & Loss Account Balances

	Particulars	*Big Ltd.*	*Small Ltd.*
i.	Opening balance	2,00,000	1,00,000
ii.	Profit for half year	1,02,500	54,000
iii.	Less: Equity dividend	(1,20,000)	(45,000)
iv.	Add: Dividend income on 6000 Equity Shares	9,000	–
	Total	**1,91,500**	**1,09,000**

Assumptions :

(a) Preference dividend has already been paid

(b) Half year profit given is "Trading Profit" and does not include dividend income.

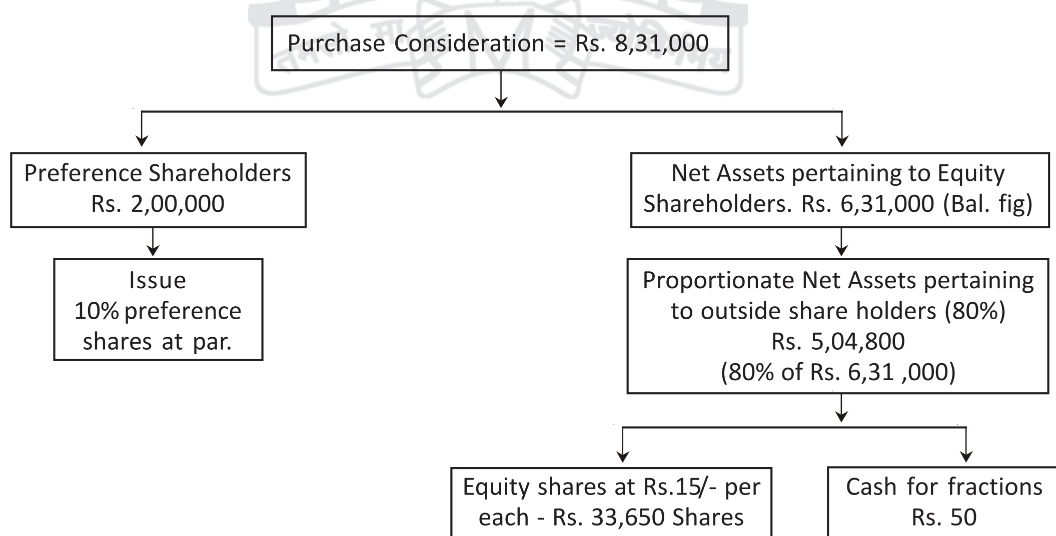
(c) The entire dividend income is post-acquisition (ie. investment has been acquired prior to 1.4.08)

Part II

Purchase Consideration - Net Assets Method

Particulars	*Amount Rs.*	*Amount Rs.*
Goodwill	50,000	
Building	1,10,000	
Machinery	3,30,000	
Furniture	66,000	
Stock	1,50,000	
Debtors	2,50,000	
Cash	851000	10,41,000
Less: Creditors		(2,10,000)
Purchase Consideration		8,31,000

Analysis of Purchase Consideration :



Total consideration summary **:**

Particulars	*Amount Rs.*
i) Preference Share capital at par	2,00,000
ii) 33,650 Equity shares @ Rs. 15/- per share	5,04,750
iii) Cash	50
Total	**7,04,800**

Part - III ***In*** **the** ***books of Big Ltd.***

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

Journal Entries **(Rs.)**

Particulars		*Debit*	*Credit*
1. For Purchase Consideration Due :			
Business Purchase A/c	Dr.	7,04,800	
To Liquidator of Small Ltd.			7,04,800
(Being purchase consideration due)			
2. For Assets of Libilties taken over :			
Building A/c	Dr.	1,10,000	
Machinery A/c	Dr.	3,30,000	
Furniture A/c	Dr.	66,000	
Stock A/c	Dr.	1,50,000	
Debtors A/c	Dr.	2,50,000	
Cash A/c	Dr.	85,000	
To Creditors A/c			2,10,000
To Business Purchase A/c			7,04,800
To Investment in Small Ltd. A/c			60,000
To Capital Reserve A/c			16,200
(Being assets and liabilities taken over)			
3. Discharge of Purchase Consideration			
Liquidator of Small Ltd. A/c	Dr.	7,04,800	
To 10% Preference Share capital A/c			2,00,000
To Equity Share capital A/c			3,36,500
To Securities Premium A/c			1,68,250
To Bank/Cash A/c			50
(Being purchase consideration discharged)			

Amalgamated Balance Sheet of Big Ltd. as on 30.09.2010

Liabilities	***Amount Rs.***	***Assets***	***Amount Rs.***	***Amount Rs.***
Share Capital :	11,36,500	**Fixed Assets :**		
113650 Equity Shares of		Building	2,00,000	
Rs.10 each		Less: Depreciation	10,000	
(Out of which 33650 share are			1,90,000	
allotted for consideration		Add: Taken over	1,10,000	3,00,000
other than cash)				
10% Preference Share	2,00,000	Machinery	5,00,000	
capital of Rs. 100 each		Less: Depreciation	75,000	
(The above shares are		Add: Taken Over	3,30,000	7,55,000
alloted for consideration				
other than cash)		Furniture	1,00,000	
Reserves and surplus		Less: Depreciation	10,000	
Capital reserve	16,200	Add: Taken over	66,000	1,56,000
Securities Premium	1,68,250	Current assets,		
General Reserve	3,00,000	Loans and Advances:		
Profit and Loss A/c	1,91,500	Stock		2,70,000
Current liabilities and		Sundry Debtors		6,30,000
Provisions		Cash and Bank		2,41,450
Sundry creditors	3,90,000	Miscellaneous Exp...		
		Preliminary Exp.		50,000
	24,02,450			**24,02,450**

Q. 19. Following are the Balance sheets of two companies, B Ltd. and D Ltd. as at August 31, 2010.

Liabilities	***B Ltd. Rs.***	***D Ltd. Rs.***	***Assets***	***B Ltd. Rs.***	***D Ltd. Rs.***
Sahare capital :			Sundry assets	7,50,000	3,50,000
(Shares of Rs. 10 each)	5,00,000	30,00,000	10,000 Shares in		
Reserve	1,00,000	55,000	B Ltd.	—	1,00,000
Creditors	1,50,000	95,000			
Total	**7,50,000**	**4,50,000**	**Total**	**7,50,000**	**4,50,000**

B Ltd. was to absorb D Ltd. on the basis of intrinsic value of the shares, the purchase consideration was to be discharged in the form of fully paid shares, entries to be made at par value only. A sum of Rs. 20,000 is owed by B Ltd. to D Ltd. Also included in the stocks of B Ltd. Rs. 30,000 goods supplied by D Ltd. cost plus 20%. Give Journal entires in the books of both the Companies.

Answer 19.

Part I **In the Books of D Ltd.**

	Particulars		***Debit Rs.***	***Credit Rs.***
1.	Realisation A/c	Dr.	3,50,000	
	To Sundry Assets			3,50,000
	[Being the assets taken over by B Ltd. transferred to Realisation A/c]			
2.	Creditors A/c	Dr.	95,000	
	To Realisation A/c			95,000
	[Being Creditors taken over by B Ltd. transferred Realisation A/c]			
3.	B Ltd. A/c	Dr.	2,12,500	
	To Realisation			2,12,500
	[Being purchase consideration (WN # 2) receivable]			
4.	Shares in B Ltd. A/c	Dr.	2,12,500	
	To B Ltd. A/c			2,12,500
	[Being discharge of purchase consideration]			
5.	Shareholders A/c	Dr.	42,500	
	To Realisation A/c			42,500
	[Being realisation loss transferred to Shareholder A/c]			
6.	Share Capital A/c	Dr.	3,00,000	
	Reserves A/c	Dr.	55,000	
	To Shareholders A/c			3,55,000
	[Being Share capital and Reserves transferred to Shareholders A/c]			
7.	Shareholders A/c	Dr.	3,12,500	
	To Shares in B Ltd.			3,12,000
	[Being the settlement to shareholders for the amount due]			

Calculation of Purchase consideration - Net Assets Method

WN # 1 : ***Intrinsic value of share***

	Particulars	***B Ltd (Rs.)***	***D Ltd. (Rs.)***
a)	Sundry Assets	7,50,000	3,50,000
b)	Investments in B Ltd. 1,000 shares @ Rs. 12 each	—	1,20,000
c)	Creditors	(1,50,000)	(95,000)
d)	Net Assets	6,00,000	3,75,000
e)	No. of shares outstanding	50,000	30,000
f)	Intrinsic Value of shares [d ÷ e]	12	12.5

WN # 2 : ***Purchase Consideration***

	Particulars	***Amount Rs.***
a)	No. of shares of D Ltd.	30,000
b)	Value of shares @ Rs. 12.50	3,75,000
c)	No. of shares issuable based on intrinsic value of Rs. 12 (3,75,000 ÷ 12)	31,250
d)	No. of shares held by D Ltd.	(10,000)
e)	Net shares to be issued	21,250
f)	Total consideration at par	2,12,500

Part - II : ***In the books of D Ltd.***

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest

Particulars			***Debit Rs.***	***Credit Rs.***
1. For Purchase Consideration Due :				
Business Purchase A/c		Dr.	2,12,500	
To Liquidator of D Ltd.				2,12,500
2. a. For of assets and liabilities taken over				
i. Aggregate consideration to share holders of Selling Company				
* Shares already held by D Ltd.	1,00,000			
* Shares now issued	2,12,000			
	3,12,500			
ii. Paid up capital of D Ltd.	(3,00,000)			
iii. Excess	12,500			
iv. Above excess to be adjusted against reserves of D Ltd.	12,500			
v. Balance of reserves to be incorporated (55,000 - 12,500)	42,500			
b. Asset A/c		Dr.	3,50,000	
To Creditors				95,000
To Reserve				42,500
To Business Purchase				2,12,500
3. Discharge of Purchase consideration				
Liquidator of D Ltd.		Dr.	2,12,500	
To Equity Share Capital				2,12,500
4. Others				
a. Cancellation of Inter company owings				
Creditors A/c		Dr.	20,000	
To Sundry assets				20,000
b. Adjusted of Stock Reserve				
Reserve A/c		Dr.	5,000	
To Stock Reserve				5,000

Balance Sheet of B Ltd. as on 31.08.2010 (after Amalgamation)

Liabilities	***Amount* (Rs.)**	***Assets***	***Amount* (Rs.)**
Share Capital (of the above, 21,250 shares issued for consideration other than cash)	7,12,500	Sundry Asset (7,50,000+3,50,000– 20,000 – 5,000)	10,75,000
Reserves and Surplus			
Reserve (1,00,000+42,500 – 5,000)	1,37,500		
Creditors	2,25,000		
	10,75,000		**10,75,000**

Q. 20. The following are the Balance Sheets of Signed Ltd. and Unsigned Ltd. as on 31st August, 2010.

Liabilties	**Signed *Ltd.* *Rs.***	**Unsigned *Ltd.* *Rs.***	***Assets***	**Signed *Ltd.* *Rs.***	**Unsigned *Ltd.* *Rs.***
Share capital			**Fixed Assets**	7,00,000	2,50,000
Equity shares of	6,00,000	3,00,000	**Investment :**		
Rs. 10 each			6,000 shares of Us Ltd.	80,000	—
10% Preference shares of Rs. 10 each	2,00,000	1,00,000	5,000 shares of S Ltd.	—	80,000
Reserves and surplus	3,00,000	2,00,000	**Current Assets :**		
Secured loans :			Stock	2,40,000	3,20,000
12% Debentures	2,00,000	1,50,000	Debtors	3,60,000	1,90,000
Current liabilities			Bills receivable	60,000	20,000
Sundry creditors	2,20,000	1,25,000	Cash at bank	1,10,000	40,000
Bills payable	30,000	25,000			
	15,50,000	**9,00,000**		**15,50,000**	**9,00,000**

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

After the above transactions are given effect to, Signed Ltd. will absorb Unsigned Ltd. on the following terms.

(i) **8 Equity shares of Rs. 10 each will be issued by Signed Ltd. at par against 6 shares of Unsigned Ltd.**

(ii) **10% Preference Shareholders of Unsigned Ltd. will be paid at 10% discount by issue of 10% Preference Shares of Rs. 100 each at par in Signed Ltd.**

(iii) **12% Debentureholders of Unsigned Ltd. are to be paid at 8% premium by 12% Debentues in Signed Ltd. issued at a discount of 10%.**

(iv) **Rs. 30,000 is to be paid by Signed Ltd. to Unsigned Ltd. for Liquidation expenses. Sundry creditors of Unsigned Ltd. include Rs. 10,000 due to Signed Ltd.**

***Prepare* :**

(a) **Absorption entries in the books of Signed Ltd.**

(b) **Statement of consideration payable by Unsigned Ltd.**

Answer 20.

Part - I *Purchase consideration payable by Signed Ltd.*

A.	*Equity share holders* :	
	No of equity shares of Unsigned Ltd.	30,000
	Less : Held by Signed Ltd.	6,000
	No. of equity shares held by outsiders	24,000
	Exchange ratio	8:6
	No. of equity shares to be issued by Signed Ltd. (24,000 × 8/6)	32,000
	Less : Already held by Unsigned Ltd. in Signed Ltd.	(5,000)
	No. of equity shares to be issued now	27,000
	Value of shares to be issued 27,000 × 10 =	Rs. 2,70,000
B.	*Preference share holders:*	
	Preference Share capital of Unsigned Ltd.	1,00,000
	Payable at discount of 10% [100,000 – (10% of 100,000)]	90,000
	10% Preference shares to be issued at par by Signed Ltd. to Unsigned Ltd.	Rs. 90,000
C.	*Purchase consideration* (*Signed+Unsigned*)	Rs. 3,60,000

Part II* - *Absorption entries* in *the books of Signed Ltd.

***A. Pre - Amalagamation Events* :**

(Rs.)

	Particulars		*Debit*	*Credit*
1.	Revaluation of Fixed assets			
	Fixed Assets A/c	Dr.	1,05,000	
	To Revaluation Reserve A/c			
	(Being fixed assets revalued)			1,05,000
2.	Dividend received from B Ltd. on 600 shares			
	Bank A/c	Dr.	6,000	
	To Reserves and surplus A/c			
	(Being dividend received)			6,000
3.	Dividend on equity Share capital @ 10%			
	i. Due entry			
	Reserves and Surplus A/c	Dr.	60,000	
	To Proposed dividend A/c			60,000
	(Being adjustment for dividend proposed)			
	ii. Payment entry			
	Proposed Dividend A/c	Dr.	60,000	
	To Bank A/c			60,000
	(Being proposed dividend paid)			

B. Amalgamation Events

Nature of Amalgamation - Purchase

Method of Accounting - Purchase

Journals (without Narration) **(Rs.)**

	Particulars		***Debit***	***Credit***
1.	Due entry			
	Business purchase A/c	Dr.	3,60,000	
	To Liquidator of Unsigned Ltd.			3,60,000
2.	Incorporation of assets and liabilities taken over			
	Fixed assets (115% of 2,50,000)	Dr.	2,87,500	
	Stock A/c (95% of 3,20,000)	Dr.	3,04,000	
	Debtors A/c [95% of 200,000] - (5% of 190,000)	Dr.	1,80,500	
	Bills Receivable A/c	Dr.	20,000	
	Bank A/c (W1)	Dr.	15,000	
	To 12% Debentures of Unsigned Ltd A/c (W1)			1,62,000
	To Sundry creditors A/c			1,25,000
	To Bills payable A/c			25,000
	To Business purchase A/c			3,60,000
	To Investment in Unsigned Ltd. A/c			80,000
	To Capital Reserve A/c (Balancing Figure)			55,000
3.	Discharge of Purchase consideration			
	Liquidator of Unsigned Ltd A/c	Dr.	3,60,000	
	To Equity Share capital A/c			2,70,000
	To 10% Preference Share capital A/c			90,000
4.	Liquidation expenses incurred by Unsigned Ltd, later reimbursed by Signed Ltd.			
	Capital Reserve A/c	Dr.	30,000	
	To Bank A/c			30,000
5.	Discharge to debenture holders of Unsigned Ltd.			
	12% Debenture Holders A/c	Dr.	1,62,000	
	Discount on Issue of debentures A/c	Dr.	18,000	
	To 12% Debentures A/c.			1,80,000
6.	Cancellation of inter company owings			
	Sundry Creditors A/c	Dr.	10,000	
	To Sundry Debtors A/c			10,000

W1 Bank : [Bank Balance of Unsigned Ltd.]

Balance as per Balance Sheet	40,000
Add : Dividend received from Signed Ltd (10% on 50,000)	5,000
Less : Dividend paid on Share capital (10% on 3,00,000)	[30,000]
	15,000

W2 12% Debentures of Unsigned Ltd. 1,50,000

Payable at 8% premium 1,50,000 × 108%

= 1,62,000

Q. 21. The following are the balance sheets of AB Ltd. and XY Ltd. as on 30.06.2010.

Liabilities Rs.	*AB Ltd. Rs.*	*XY Ltd.*	*Assets Rs.*	*AB Ltd. Rs.*	*XY Ltd.*
Share capital :			Fixed Assets		
Equity Shares of Rs.100	2,000	1,000	(net of depreciation)	2,700	850
each fully paid up			Investments	700	–
Reserves and Surplus	800	–	Sundry Debtors	400	150
10% debentures	500	–	Cash and Bank	250	–
Loan from Financial			Profit and Loss A/c	–	800
Institutions	250	400			
Bank Overdraft	–	100			
Sundry Creditors	300	300			
Proposed Dividend	200	–			
Total	**4,050**	**1,800**	**Total**	**4,050**	**1,800**

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

- **i. XY Ltd. will reduce its shares to Rs. 10 and then consolidate 10 such shares into one share of Rs. 100 each (New Share).**
- **ii. Financial institutions agreed to waive 15% of the loan of XY Ltd.**
- **iii. Shareholders of AB Ltd. will be given one new share of XY Ltd. in exchange of every share held in AB Ltd.**
- **iv. AB Ltd. will cancel 20% holdings of XY Ltd. Investments were held at Rs. 250 thousands.**
- **v. After merger, the proposed dividend of AB Ltd. will be paid to the shareholders of AB Ltd.**
- **vi. Authorised Capital of XY Ltd. will be raised accordingly to carry out the scheme. vii. Sundry creditors of XY Ltd. includes payables to AB Ltd. Rs. 1,00,000.**

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

Answer 21.

Part - I Purchase consideration

WN # 1 : ***Shareholding of AB Ltd. in XY Ltd.***

	Particulars	*Amount (Rs.)*
a.	Original Share capital of XY Ltd. [10,000 equity shares of Rs. 100/- each]	10,00,000
b.	Share capital of XY Ltd. after reduction [10,000 equity shares of Rs. 10/- each]	1,00,000
c.	Share capital of XY Ltd. after reconsolidation [1000 equity shares of Rs. 100/- each]	1,00,000
d.	Holding of AB Ltd in XY Ltd.	20%
e.	Value of holding of AB Ltd in XY Ltd. [200 equity shares of Rs. 100/- each]	20,000

WN # 2 : ***Purchose consideration***

	Particulars	
a.	No. of equity shares of AB Ltd. (20,00,000 ÷ 100)	20,000
b.	Exchange ratio	1:1
c.	No. of equity shares to be given by XY Ltd. to AB Ltd.	20,000
d.	Less : No. of Equity shares held by AB Ltd. in XY Ltd.	200
e.	No. of shares now to be given	19,800
f.	Purchase consideration (19,800 equity shares of Rs. 100/- each) (Rs.)	19,80,000

Part* - II :** ***Journal entries in the books of AB Ltd.

(Without Narration) Rs. '000

Particulars		Debit	Credit
1. a. Transfer to realisation account of all Assets taken over except investment held by selling company in purchasing company			
Realisation A/c	Dr.	3,800	
To Fixed Assets A/c			2,700
To Investments [700 - 250] A/c			450
To Sundry Debtors A/c			400
To Cash and Bank A/c			250
b. Transfer to realisation account of all liabilities taken over			
10% Debentures A/c	Dr.	500	
Loan from financial institations A/c	Dr.	250	
Sundry Creditors A/c	Dr.	300	
Proposed Dividend A/c	Dr.	200	
To Realisation A/c			1250
2. Purchase consideration			
a. Due entry			
XY Ltd. A/c	Dr.	1,980	
To Realisation A/c			1,980
b. Receipt			
Shares in XY Ltd. A/c	Dr.	1,980	
To XY Ltd. A/c			1,980
3. Transfer of realisation loss to share holders			
Equity shareholders A/ c	Dr.	570	
To Realisation A/c			570
4. Transfer of Share capital and Reserves and surplus to equity share holders			
Share capital A/c	Dr.	2,000	
Reserves and surplus A/c	Dr.	800	
To Equity shareholders			2,800
5. Settlement to share holders by transfer of purchase consideration now received and shares already held by AB Ltd. in XY Ltd.			
Equity shareholders A/c	Dr.	2,230	
To Equity shares of XY Ltd.			2,230

Part.* III.** ***Journal entries in the books of XY Ltd. (Without Narration)

(Rs. '000)

Particulars		***Debit***	***Credit***
1. Reduction of Share capital			
Equity Share capital (Rs. 100) A/c	Dr.	1,000	
To Equity Share capital (Rs. 10) A/c			100
To Reconstruction A/c			900
2. Consolidation of equity shares of Rs.10/- to Rs. 100/-			
Equity Share capital (Rs. 10/-) A/c	Dr.	100	
To Equity Share capital (Rs. 100) A/c			100
3. Waiver of loan by financial institution			
Loan from financial institution A/c	Dr.	60	
To Reconstruction A/c			60
4. Write off the debit balance of Profit and Loss A/c by utilising Reconstruction A/c and balance of Reconstruction A/c transferred to Capital reserve			
Reconstruction A/c	Dr.	960	
To Profit and Loss A/c			800
To Capital Reserve A/c			160

Entries relating to Amalgamation :

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest Method

Journal Entries in the Books of XY Ltd. (Rs. '000)

Particulars			***Debit***	***Credit***
1. For Purchase Consideration Due				
Business Purchase A/c		Dr.	1,980	
To Liquidator of AB Ltd. A/c				1,980
2. Incorporation of assets and liabilities taken over				
Purchase consideration now paid	1,980			
Shares already held by AB Ltd.	250			
Total consideration	2,230			
Less: Paid-up Share capital of AB Ltd.	2,000			
Excess Purchase Consideration Paid	230			
This excess is to be adjusted against reserves of AB Ltd.				
Reserves of AB Ltd.	800			
Less: Excess as above	230			
Balance to be incorporated	570			
Fixed Assets (net of depreciation) A/c		Dr.	2,700	
Investment A/c		Dr.	450	
Sundry Debtors A/c		Dr.	400	

	Particulars		***Debit***	***Credit***
	Cash and Bank A/c	Dr.	250	
	To Reserves and Surplus A/c			570
	To Debentures A/c			500
	To Loan from financial institutions A/c			250
	To Sundry Creditors A/c			300
	To Proposed Dividend A/c			200
	To Business Purchase A/c			1,980
3.	Discharge of purchase consideration			
	Liquidator of AB Ltd. A/c	Dr.	1,980	
	To Equity Share capital of XY Ltd. A/c			1,980
4.	Payment of proposed divided to shareholders of AB Ltd.			
	Proposed Dividend A/c	Dr.	200	
	To Bank A/c			200
5.	Cancellation of inter company owings			
	Sundry Creditors A/c	Dr.	100	
	To Sundry Debtors A/c			100

***Balance sheet of Z Ltd. as* on 30.06.2010**
(After Acquisition)

Liabilities	***Amount* Rs. '000**	***Assets***	***Amount* Rs. '000**
Share capital		Fixed assets net of depreciation	3,550
20,800 equity shares @		[2,700 + 850]	
Rs.100/- each [1980+20+80]	2,080		
Reserves and Surplus		Investments [700-250]	450
Capital Reserves	160	Sundry Debtors [400+ 150-100]	450
General Reserves	570		
Secured loan :			
10% Debentures	500		
Loan from Finanacial			
Institution (340 + 250)	590		
Bank over draft			
[200+100-250]	50		
Current liabilities and provisions			
Creditors [600-100]	500		
	4,450		**4,450**

Q. 22. The business of Prospect Ltd. was being carried on continuously at losses. The following are the extracts from the Balance Sheet of the Company as on 31st March, 2010.

Balance Sheet as on 31st March, 2010

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*
Authorised, issed and		Goodwill	50,000
Subscribed Capital :		Plant	3,00,000
30,000 Equity Shares of Rs. 10		Loose Tools	10,000
each fully paid	3,00,000	Debtors	2,50,000
2,000 8% Cumulative Pref.		Stock	1,50,000
Shares of Rs. 1 00 each fully paid	2,00,000	Cash	10,000
Share Premium	90,000	Bank	35,000
Unsecured Loan(From Director)	50,000	Preliminary Expenses	5,000
Sundry creditors	3,00,000	Profit and Loss Account	2,00,000
Outstanding Expenses	70,000		
(including Directors'			
remuneration 20,000)			
	10,10,000		**10,10,000**

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

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

1. **Equity shares to be converted into 1,50,000 shares of Rs. 2 each.**
2. **Equity shareholders to surrender to the Company 90 per cent of their holding.**
3. **Preference shareholders agree to forego their right to arrears to dividends inconsideration of which 8 percent Preference Shares are to be converted into 9 per cent Preference Shares.**
4. **Sundry creditors agree to reduce their claim by one fifth in consideration of their getting shares of Rs. 35,000 out of the surrendered equity shares.**
5. **Directors agree to forego the amounts due on account of unsecured loan and Director's remuneration.**
6. **Surrendered shares not otherwise utilised to be cancelled.**
7. **Assets to be reduced as under :**

Goodwill by	**Rs. 50,000**
Plant to	**Rs. 2,60,000**
Tools by	**Rs. 8,000**
Sundry Debtors by	**Rs. 15,000**
Stock by	**Rs. 20,000**

8. **Any surplus after meeting the losses should be utilised in writing down the value of the plant further.**
9. **Expenses of reconstruction amounted to Rs. 10,000.**
10. **Further 50,000 Equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid-up.**

A member holding 100 equity shares opposed the scheme and his shares were taken over by the Director on payment of Rs. 1,000 as fixed by the Court.

You are required to pass the journal entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.

Answer 22. **Journal (Without Narration)**

	Particulars		*Debit* Rs.	*Credit* Rs.
a.	Sub Division of Shares			
	Equity Share Capital (Rs. 10 each) A/c	Dr.	3,00,000	
	To Equity Share Capital (Rs. 2 each) A/c			3,00,000
b.	Surrender of Shares			
	Equity Share Capital (Rs. 2) A/c	Dr.	2,70,000	
	To Shares Surrendered A/c			2,70,000
c.	Conversion of Preference Share capital			
	8% Cumulative Preference Share capital A/c	Dr.	2,00,000	
	To 9% Cumulative Preference Share Capital A/c			2,00,000
d.	Surrendered shares issued to creditors under reconstruction scheme			
	Shares Surrendered A/c	Dr.	35,000	
	To Equity Share Capital A/c			35,000
e.	Expenses Paid			
	Expenses A/c	Dr.	10,000	
	To Bank A/c			10,000
f.	Cancellation of unissued surrendered shares			
	Shares Surrendered A/c	Dr.	2,35,000	
	To Capital Reduction A/c			2,35,000
g.	Amount sacrificed by directors creditors			
	Unsecured Loan A/c	Dr.	50,000	
	Sundry Creditors A/c	Dr.	60,000	
	Outstanding Expenses A/c	Dr.	20,000	
	To Capital Reduction A/c			1,30,000
h.	Assets Written off			
	Capital Reduction A/c	Dr.	3,65,000	
	To Goodwill A/c			50,000
	To Loose tools A/c			8,000
	To Sundry debtors A/c			15,000
	To Stock - in - trade A/c			20,000
	To Profit and Loss A/c			2,00,000
	To Preliminary expenses A/c			5,000
	To Expenses A/c			10,000
	To Plant A/c			57,000
i.	Issue of Shares			
	Applications received			
	Bank A/c	Dr.	1,00,000	
	To Share Application A/c			1,00,000
	Allotment of Shares			
	Share Application A/c	Dr.	1,00,000	
	To Share Capital A/c			1,00,000
	(Being 50000 equity shares of Rs. 2 each issued as fully paid as per Board's Resolution dated...)			

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

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

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

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

Balance Sheet of P Ltd (And Reduced) as on 31st March 2010.

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*	*Amount Rs.*
Share capital		Fixed assets		
Authorised		Goodwill	50,000	
1,50,000 Equity shares of	3,00,000	Less : Amount written off		
Rs. 2 each		under the scheme of		
		reconstruction	50,000	Nil
2000 9% Preference shares		Plant	3,00,000	
of Rs.100 each	2,00,000	Less : Amount written		
		off under the scheme of		
		reconstruction	57,000	2,43,000
Issued, subscribed and		Current assets, Loans		
paid up		Advances		
82500 Equity Shares of Rs. 10		Loose tools.		
each fully paid		Stock-in-trade		2,000
(Of the above 17500		Sundry Debtors		1,30,000
shares have been issued for		Cash at Bank		2,35,000
consideration other than cash		Cash in Hand		1,25,000
under the scheme of	1,65,000			10,000
reconstruction)				
20000 9% Cumulative preference				
shares of Rs. 100 each fully paid	2,00,000			
Reserves and surplus:				
Share Premium	90,000			
Secured Loans	Nil			
Unsecured Loans	Nil			
Current liabilities and				
provisions :				
Sundry creditors	2,40,000			
Outstanding expenses	50,000			
	7,45,000			**7,45,000**

Q. 23. Yum Ltd. and Thung Ltd. are two companies. On 31st March, 2010 their Balance Sheets were as under :

(Rs. in crores)

	Yum Ltd.		Thung Ltd.	
Sources of funds				
Share capital				
Authroised :		500		500
Issued : Equity shares of Rs. 10				
each fully paid up		300		200
Reserves and surplus.				
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	10	750	5	450
Owners' funds		1,050		650
Loan funds		250		350
Total		**1,300**		**1,000**
Funds' employed in :				
Fixed assets :				
Cost	1,000		700	
Less : Depreciation	(400)	600	(300)	400
Net Current assets :				
Current assets	2,000		1,500	
Less : Current liabilities	(1,300)	700	(900)	600
		1,300		**1,000**

Yum Ltd. has 2 divisions - very profitable division A and loss making division B. Thung Ltd. similarly has 2 divisions-very profitable division B and loss making division A.

The two companies decided to reorganise. Necessary approval's from creditors and members and sanction by High Court have been obtained to the following scheme.

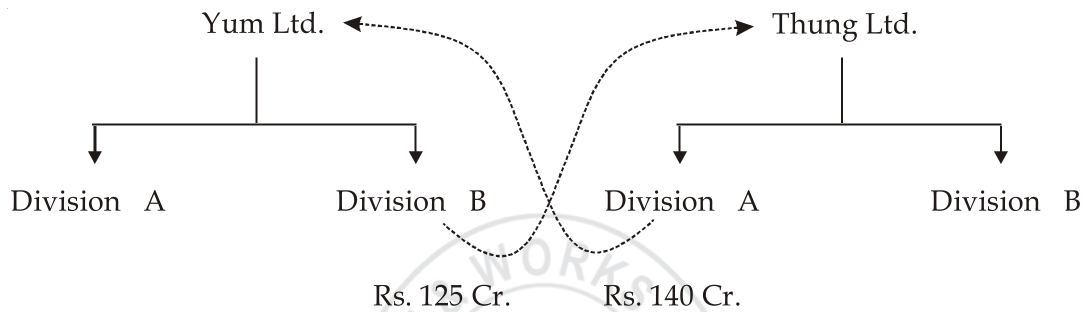
1. **Division B of Yum Ltd. which has Fixed assets costing Rs. 400 crores (written down value Rs. 160 crores). Current assets Rs. 900 crores Current liabilities Rs. 750 crores and loan funds of Rs. 200 crores is to be transferred at Rs. 125 crores to Thung Ltd.**
2. **Division A of Thung Ltd. which has Fixed assets costing Rs. 500 crores (depreciation Rs. 200 crores), Current assets Rs. 800 crores Current liabilities Rs. 700 crores and loan funds Rs. 250 cres is to be transferred at Rs. 140 crores to Yum Ltd.**
3. **The difference in the two consideration is to be treated as loan carrying interest at 15% per annum.**
4. **The directors of each of the companies revalued the Fixed assets taken over as follows :**
   - **i. Division A of Thung Ltd. taken over : Rs. 325 crores.**
   - **ii. Division B of Yum Ltd. taken over : Rs. 200 crores.**

All the other assets and liabilities are recorded at the balance sheet values.

a. **The directors of both the companies ask you to prepare the balance sheets after reconstruction (showing the corresponding figures before reconstruction).**

b. Mr. Poor, who owns 50,000 equity shares of Yum Ltd. and 30,000 equity shares of Thung Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above recognisation.

Answer 23.



Books of Yum Ltd.
A. Transfer of Division B

(Rs. in Crores)

	Particulars		***Debit***	***Credit***
i.	Due Entry :			
	Yaa Ltd A/c	Dr.	125	
	Current liabilities A/c	Dr.	750	
	Loan Funds A/c	Dr.	200	
	Provision for Dep A/c	Dr.	240	
	To Fixed assets A/c			400
	To Current assets A/c			900
	To Capital reserve A/c			15
ii.	Receipt of consideration - Not Applicable			

B. Take over of division A of Thung Ltd.

	Particulars		***Debit***	***Credit***
i.	Due Entry :			
	Business Purchase A/c	Dr.	140	
	To Liquidator of Thung Ltd. A/c			140
ii.	Incorporation of Assets and Liabilities taken over :			
	Fixed Assets A/c	Dr.	325	
	Current Assets A/c	Dr.	800	
	To Current liabilities A/c			700
	To Loan Funds A/c			250
	To Business Purchase A/c			140
	To Capital Reserve A/c			35
iii.	Discharge of consideration - Not Applicable			

Balance Sheet of Yum Ltd. on 31.03.09

Rs. in Crores

Liabilities	*Amount*		*Assets*	*Amount*	
	@	*		@	*
Share capital	300	300	Fixed assets		
Reserves and surplus			Cost (600 + 375)	925	1,000
Capital reserve [40+15+35]	90	40	Less : Depreciation	(160)	(400)
Revenue reserves	700	700	Net Block	765	600
Surplus	10	10	Current assets	1,900	2,000
Loan funds [250+250–200]	300	250			
15% Loan - Yaa	15	-			
Current liabilities	1,250	1,300			
	2,655	**2,600**		**2,665**	**2,600**

@ Before Reconstruction * After Reconstruction

Part - II Books of Thung Ltd.

A. Transfer of Division A to Yum Ltd.

(Rs. in Crores)

Particulars		*Debit*	*Credit*
i. Due Entry :			
Yum Ltd. A/c	Dr.	140	
Current liabilities A/c	Dr.	700	
Loan Funds A/c	Dr.	250	
Provision for depreciation A/c	Dr.	200	
Capital reserve A/c [balancing figure]	Dr.	10	
To Fixed assets A/c			500
To Current assets A/c			800
ii. Receipt of consideration - Not applicable			

B. Take over of* division *B of Ksha Ltd.

(Rs. in Crores)

Particulars		*Debit*	*Credit*
i. Due Entry :			
Business purchase A/c	Dr.	125	
To Yum Ltd. A/c			125
ii. Incorporation of assets and liabilities taken over :			
Fixed assets A/c	Dr.	200	
Currnt assets A/c	Dr.	900	
To Current liabilities A/c			750
To Loan funds A/c			200
To Business purchase A/c			125
To Capital reserve A/c			25
iii. Discharge of consideration - Not Applicable			

***Balance Sheet of Yum Ltd. as* on *31st March,* 2010**

Rs. in Crores

Liabilities	***Amount***		***Assets***	***Amount***	
	@	*		@	*
Share capital	200	200	Fixed assets :		
Reserves and surplus			Cost	400	700
Capital reserve	35	20	Less : Depreciation	(100)	(300)
Revenue reserves	425	425	Net Block	300	400
Surplus	5	5	Current assets	1,600	1,500
Loan funds	300	350	15% Loan	15	—
Current liabilities	950	900			
	1,915	**1,900**		**1,915**	**1,900**

@ Before Reconstruction * After Reconstruction

Evaluation of Mr. Poor's Investment

Rs. in Crores

		Yum Ltd.		*Thung Ltd.*	
		Before Reconstruction	After Reconstruction	Before Reconstruction	After Reconstruction
a.	Total assets	1300	1415	1000	965
b.	Outside liabilities	250	315	350	300
c.	Net Assets	1050	1100	650	665
d.	Number of shares Outstanding	3	3	2	2
e.	Intrinsic Value (Rs.)	350	367	325	332.50
f.	Number of shares held	5,000	5,000	3,000	3,000
g.	Value of shares held	17.5 Lakhs	18.35 Lakhs	9.75 Lakhs	9.975 Lakhs
h.	Increase in value	85,000		22,500	
i.	**Total increase in value due to demerger**	**Rs. 1,07,500**			

Q. 24. The following is the balance sheet of Recourse Ltd. having an authorised capital of Rs. 2,000 Cr. as on 31st March, 2010 :

(Rs. in crores)

	Rs.	*Rs.*
Sources of funds :		
Shareholders' funds		
Share capital		
Equity shares of Rs. 20 each fully paid in cash	500	
Reserves and surplus (Revenue)	1,500	2,000
Loan funds		
Secured against : (a) Fixed assets Rs. 600 Cr.		
(b) Working capital Rs. 200 Cr.	800	
Unsecured	1,200	2,000
		4,000
Employment of funds		
Fixed assets		
Gross block	1,600	
Less: Depreciation	400	1,200
Investment at cost (Market value Rs. 2,000 Cr.)		800
Net Current assets :		
Current assets	6,000	
Less: Current liabilities	(4,000)	2,000
		4,000

Capital commitments : Rs. 1,400 crores.

The company consists of 2 divisions.

i. **Established division whose gross block was Rs. 400 crores and net block was Rs. 60 crores; Current assets were Rs. 3,000 crores and working capital was Rs. 2,400 crores; the entire amount being financed by shareholders' funds.**

ii. **New project division to which the remaining Fixed assets, Current assets and Current liabilities related.**

The following scheme of reconstruction was agreed upon.

a. **Two new companies Sun Ltd. and Moon Ltd. are to be formed. The authorised capital of Sun Ltd. is to be Rs. 2,000 crores. The authorised capital of Moon Ltd. is to be Rs. 1,000 crores.**

b. **Moon Ltd. is to take over investments at Rs. 1,600 crores and unsecured loans at balance sheet value. It is to allot equity share of Rs. 20 each at par to the members of Diverse Ltd. in satisfaction of the amount due under the arrangement.**

c. **Sun Ltd. is to take over the Fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which Recourse Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of Rs. 20 each as consideration to Recourse Ltd. Sun Ltd. made an issue of unsecured convertible debentures of Rs. 1,000 crores carrying interest at 15% per annum and having a right to convert into equity shares of Rs. 10 each at par on 31.3.2010. This issue was made to the members of Sun Ltd. as a right who grabbed the opportunity and subscribed in full.**

d. **Recourse Ltd. is to guarantee all liabilities transferred to the 2 companies.**

e. **Recourse Ltd. is to make a bonus issued of equity shares in the ratio of one equity share for every equity share held by making use of the Revenue reserves.**

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

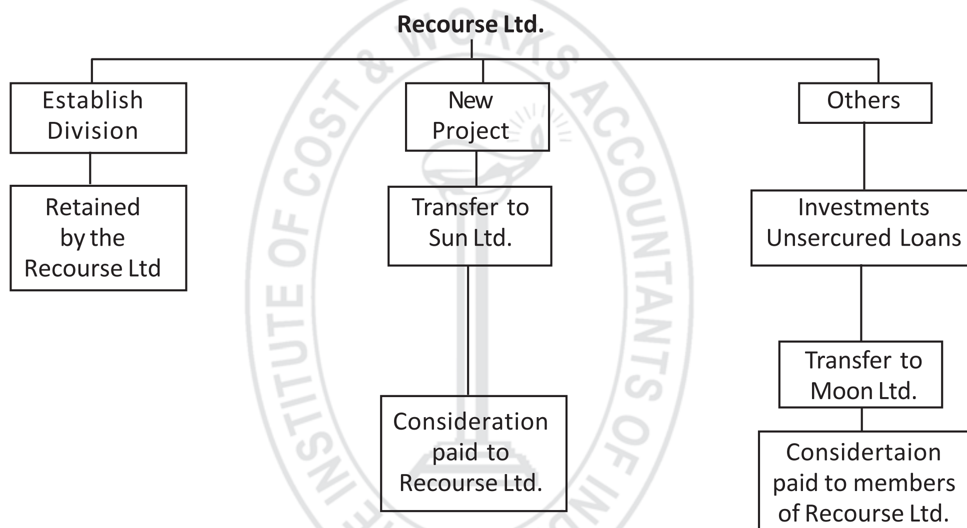
***You are asked to* :**

i. **Pass journal entries in the books of Recourse Ltd., and**

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

Answer 24.

WN # 1 : *Scheme of Reorganisation*



WN # 2 : *Assets and Liabilities - Division Wise*

(Rs. in crores)

	Particulars	*Established Division*	*New Project Division*	*Others*
a.	Fixed assets :			
	i) Gross Block	400	1,200	-
	ii) Accumulated depreciation	(340)	(60)	-
	iii) Net block	60	1,140	-
b.	Investments	-	-	800
c.	Net Current assets			
	i) Current assets	3,000	3,000	-
	ii) Current liabilities	(600)	(3400)	-
	iii) Net Current assets	2,400	(400)	-
d.	Secured loans	-	800	-
e.	Unsecured loans	-	-	1,200

WN # 3 : *Purcahse considerations.*

A. For transfer to Moon Ltd. - Net Assets Method.

(Rs. in crores)

	Particulars	Amount
i)	Investments	1,600
ii)	Unsecured loans	(1,200)
iii)	Net assets	400

Share of Moon Ltd. issued to members of Recourse Ltd.

B. For transfer to Sun Ltd. - Payment Method — 20 Crores

1 crores shares of Rs. 20 each — Issued to Recourse Ltd.

Part -II

Books of Moon Ltd.

(Rs. in crores)

Particulars		Debit	Credit
i. Due Entry			
Business purchase A/c	Dr.	400	
To Members of Recourse Ltd.			400
ii. Incorporation of Assets and Liabiltiies taken over			
Investment A/c	Dr.	1,600	
To Unsecured loans			1,200
To Business purchase			400
iii. Dischange of purchase consideration			
Members of Recourse Ltd. A/c	Dr.	400	
To Equity Share capital A/c			400

Balance Sheet of Khajana Ltd. as on 01.04.2009

(Rs. in crores)

Liabilities	***Rs.***	***Assets***	***Rs.***
Authorised Share capital Issued, subscribed and paid up Equity capital of Rs. 20 each fully paid (The above shares are issued for consideration other than cash)	1,000 400	Investments at cost (Quoted investments with Market Value of Rs. 2000 Crores)	1,600
Unsecurd Loans (Guaranteed by Diverse Ltd.)	1,200		
	1,600		**1,600**

Part III : ***Books of Sun Ltd.***

(Rs. in crores)

Particulars			***Debit***	***Credit***
II.	Due Entry			
	Business purchase A/ c	Dr.	20	
	To Recourse Ltd.			20
b.	Incorporation of assets and Liabilities taken over			
	Good will A/c (Balancing Figure)	Dr.	80	
	Fixed asset A/ c	Dr.	1,140	
	Current assets A/c	Dr.	3,000	
	To Current liabilities A/c			3,400
	To Business purchase A/c			20
	To Secured loan A/c			800
c.	Discharge of purchase consideration			
	Recourse Ltd. A/c	Dr.	20	
	To Equity Share capital			20
d.	Issue of unsecured convertible debentures			
	i. Bank A/c	Dr.	1,000	
	To Debenture application money A/c			1,000
	ii. Debenture application money A/c	Dr.	1,000	
	To 15% Debenture A/c			1,000

Balance sheet of Sun Ltd. as **on** ***1st April, 2010***

(Rs. in crores)

Liabilities	***Rs.***	***Assets***	***Rs.***
Authorised Share capital	2,000	Fixed assets :	
Issued, subscribed and Paid-up		- Goodwill	80
capital		- Other Fixed assets	1,140
Equity Shares of Rs. 20	20		
each fully paid-up		Current assets :	
(The above shares are issued for		- Bank	
consideration other than cash. The		- Other Current assets	1,000
entire capital is held by Diverse Ltd)			3,000
Debentures	1,000		
Secured Loan	800		
Current liabilities and Provisions	3,400		
	5,220		**5,220**

Note : 1. Capital commitments: Rs. 700 crores.
2. Secured Loans and Current liabilities guaranteed by M/s. Recourse Ltd.

Part - IV ***Books of Recourse Ltd.***

(Rs. in crores)

Particulars		***Debit***	***Credit***
1. Transfer to Khajana Ltd.			
i. Due Entry			
Moon Ltd. A/c	Dr.	400	
Unsecured Loans A/c	Dr.	1,200	
To Investments A/c			800
To Capital reserve A/c			800
ii. Cancellation of balance in Moon Ltd. not receivable, since consideration is paid directly to members :			
Capital Reserve A/c	Dr.	400	
To Moon Ltd.			400
2. Transfer to Sun Ltd :			
i. Due Entry			
Sunrise Ltd A/c	Dr.	20	
Current liabilities A/c	Dr.	3,400	
Secured Loan A/c	Dr.	800	
Provision for depreciation A/c	Dr.	60	
To Fixed Asset A/c			1,200
To Current Assets A/c			3,000
To Capital Reserve A/c			80

Particulars		Debit	Credit
ii. Receipt of consideration			
Equity shares of Sun Ltd.	Dr.	20	
To Sun Ltd.			20
iii. Others			
a. Subscripiton to unsecured convertible debenture of Sun Ltd.			
Investments in Debenture of Sun Ltd. A/c	Dr.	1,000	
To Bank			1,000
b. Bonus issue			
i. Revenue reserves A/c	Dr.	500	
To Bonus to shareholders A/c			500
ii. Bonus to Share holders A/c	Dr.	500	
To Equity Share capital A/c			500

Balance Sheet of Recourse Ltd.

Liabilities		Rs.	Assets		Rs.
Authorised, issued, subscribed and fully paid equity shares of Rs. 10 each (out of which 25 crores Equity shares are issued for consideration other than cash)		500	Fixed assets		
			Gross Block		200
			Less: Depreciation		
			Net Block		
			Investment (Un quoated)		
			- Shares of Sunrise	10	
Reserve Surplus :			- Debentures of Sunrise	<u>500</u>	
					510
Capital reserve		240	Current assets Loans and Advances		1,000
Revenue reserve	750				
Less: Bonus Issue	<u>(250)</u>	500			
Current liabilities and Provisions		300			
		1,540			**1,540**

Capital committment by Sunrise Ltd. Rs. 700 Crores, Guarantees given in respect of liabilities transferred to Sunrise Ltd, and Khajana Ltd. amounting to Rs. 2100 Crores and Rs. 600 Crores respectively.

Q. 25. AB Ltd has 2 divisions - A and B. The Balance Sheet as at 30th June, 2010 was as under :

(in Crores)

		A		B		Total
Fixed assets						
Cost		**600**		**300**		**900**
Depreciation		**500**		**100**		**600**
W.D.V.		**100**		**200**		**300**
Net Current assets						
Current assets	**400**		**300**		**700**	
Less : Current Liabilities	**100**	**300**	**100**	**200**	**200**	**500**
Total		**400**		**400**		**800**
Financed by :						
Loans funds		**—**		**100**		**100**
(Secured by a charge on Fixed assets)		**—**		**100**		**100**
Own funds :						
Equity capital						**50**
(Fully paid up Rs. 10 shares)						**650**
Reserves and surplus						**700**
Total		**400**		**400**		**800**

It is decided to form a new comapny B Ltd., to take over the assets and liabilities of B division.

According B. Ltd. was incorporated to take over at balance sheet figures, the assets and liabilities of that division. B Ltd. is to allot 5 crores equity shars of Rs. 10 each in the company to the members of AB Ltd., in full settlement of the consideration. The members of AB Ltd. are therefore to become members of B Ltd. as well without having to make any further investment.

- **a. You are asked to pass journal entries in relation to the above in the books of AB Ltd. and B. Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st August, 2010, showing corresponding previous year's figures.**
- **b. The directors of the 2 companies, ask you to find out the net asset value of equity shares pre and post demerger.**
- **c. Comment on the impact of demerger on "shareholders welth".**

Answer 25.

Part I : In the Books of M/s. AB Ltd.

Rs. in crores

Particulars		*Debit*	*Credit*
i. Transfer of assets and liabilities of Division B to B Ltd.			
(a) Due Entry			
A Ltd. A/c	Dr.	50	
Loan funds A/c	Dr.	100	
Curent liabilities A/c	Dr.	100	

		Debit	Credit
Provision for Depreciation A/c	Dr.	100	
Profit and Loss A/c (balancing figure)	Dr.	250	
To Fixed assets A/c			300
To Current assets A/c			300
ii. Cancellation of balance in A Ltd. not receivable since consideration is paid to members of AB Ltd. in full			
Reserves A/c	Dr.	50	
To A Ltd.			50

Part II : In the Books of B Ltd.

Particulars		*Debit Rs.*	*Credit Rs.*
i. Due entry			
Business purchase A/c	Dr.	50	
To shareholders of AB Ltd.			
ii. Assets and liabilities taken over			
Fixed assets A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Loan funds A/c			100
To Current liabilities A/c			100
To Capital reserve (balancing figure)			250
To Business Purchase A/c			50
iii. Discharge of purchase consideration			
Shareholders of AB Ltd.	Dr.	50	
To Equity Share capital A/c			50

Part III : Balance Sheet of two companies after reorganisation.

Balance Sheet of Z Ltd. as on 01.08.2010

(Rs. in crores)

	Before AB	*Before AB*	*Before B Ltd.*
Sources of Funds			
i. Share capital	50	50	50
ii. Reserves and surplus			
a. Capital reserve	Nil	Nil	250
b. Revenue reserve	650	*350	Nil
iii. Loan Funds	100	Nil	100
	800	**400**	**400**

Application of Funds :			
i. Fixed Asset			
Gross Block	900	600	300
Less : Depreciation	600	500	100
Net Block	300	100	200
ii. Current assets (Net)	500	300	200
	800	**400**	**400**

* Revenue reserve :

Opening balance-	- 650
Less : Transfer to B Ltd.	- (250)
Less : Cancel due from B Ltd.	- (50)
Closing balance	- 350

Net assets before and after reorganisation

(Rs. in crores)

		A	*B*	*AB*
a.	Value of total assets	800	400	400
b.	Less : Loan funds	(100)	—	(100)
c.	Net assets	700	400	300
d.	Net assets belonging to Equity share holders after December		700	

Conclusion :

The impact on share holders wealth after reorganisation is Nil.

Q. 26. K Ltd. furnishes you with the following Balance Sheet as at 31st March, 2010 :

(Rs. in Crores)

Sources of Funds		
Share capital :		
Authorised		**100**
Issued :		
12% redeemable preference shares of Rs. 100 each fully paid	**75**	
Equity shares of Rs. 10 each fully paid	**25**	**100**
Reserves and surplus		
Capital reserve	**15**	
Share Premium	**25**	
Revenue reserves	**260**	**300**
		400
Funds employed in :		
Fixed assets : cost	**100**	
Less: Provision for depreciation	**100**	**nil**
Investments at cost (Market value Rs. 400 Cr.)		**100**
Current assets	**340**	
Less : Current liabilities	**40**	**300**
		400

The company redeemed preference shares on 1 st April 2010. It also bought back 50 lakh equity shares of Rs. 10 each at Rs. 50 share. The payments for the above were made out of the huge bank balances, which appeared as a part of Current assets.

You are asked to :

i. Pass journal entries to record the above

ii. Prepare balance sheet

iii. Value equity share on net asset basis.

Answer 26.

Part I - Journal entries in the books of K Ltd.

Rs. in crores

Particulars		*Debit*	*Credit*
a. Redemption of Preference Shares on 1st April 2010			
i. Due Entry			
12% Preference Share capital A/c	Dr.	75	
To Preference Share Hodlers A/c			75
ii. Payment Entry			
Preference Shareholders A/c	Dr.	75	
To Bank A/c			75
b. Shares bought back			
i. On buy back			
Shares bought back A/c	Dr.	25	
To Bank A/c			25
(50 lakhs shares × Rs. 50 per share)			
ii. On Cancellation			
Equity Share capital A/c (50 Lakhs × Rs. 10)	Dr.	5	
Security premium A/c (50 Lakhs × Rs. 40)	Dr.	20	
To Shares bought back A/c			25
iii. Transfer to Capital Redemption Reserve			
Revenue reserve A/c	Dr.	80	
To Capital Redemption Reserve A/c			80
(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

Part-II : Balance Sheet of MI s. K Ltd after reconstruction :

Balance Sheet of M/s. K Ltd as at 1.4.2010

Liabilities	***Rs.***	***Rs.***	***Assets***	***Rs.***	***Rs.***
Share capital			Fixed assets		
Authorised		100	Cost :		
Issued, subscribed and paid up			Less : Provision for		
equity shares of 200 lakhs of			Depreciation	(100)	Nil
Rs. 10 each		20	Investment at Cost		
12% Redeemable preference			(Market Value of		
shares were redeemed at par.			Investments=Rs. 400 Crores)		100
Reserves and surplus			Current assets as on 31.3.2004	340	
Capital reserve	15		Less : Bank payment for		
Capital Redemption Reserve	80		redemption and buy back	(100)	240
Share Premium (25-20)	5				
Revenue reserve (260-80)	180	280			
Current liabilities		40			
		340			**340**

Part - III - Net Asset Value of Equity Shares

(Rs. in crores)

		Particulars	***Amount***	***Amount***
a.	i.	Fixed assets	Nil	
	ii.	Investments (at market value)	4,00	
	iii.	Current assets	2,40	6,40
b.		Less : Current liabilities		(40)
		Net assets available for equity share holders		6,00
c.		No. of equity shares outstanding		2
d.		Value per equity share of Rs. 10 each = (600÷2)		Rs. 300

Q. 27. X Co. Ltd. was incorporated on 1st July, 2009 to take over the business of Mr. A as and from 1st April, 2009, Mr. A's Balance Sheet, as at that date, was as under :

Liabilities	***Rs.***	***Assets***	***Rs.***
Trade creditors	**36,000**	**Building**	**80,000**
Capital	**1,94,000**	**Furniture and Fittings**	**10,000**
		Debtors	**90,000**
		Stcok	**30,000**
		Bank	**20,000**
	2,30,000		**2,30,000**

Debtors and Bank balance are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue A with 10,000 equity shares of Rs. 10 each, Rs. 8 per share paid up and cash of Rs. 5,000.

The company issued to the public for cash 20,000 equity shares of Rs. 10 each on which by 31 st March, 2010, Rs.8 per share was called and paid up except in the case of 1,000 shares on which the 3rd call of Rs. 2 per share had not been reatised. In the case of 2,000 shares, the entire face value of the shares has been realised. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following balances were shown by the books of account of X Co. Ltd. on 31st March, 2010.

	Rs.
Discount (including Rs. 1,000 allowed on vendor's debtors)	6,000
Preliminary Expenses	10,000
Director's Fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2010 was Rs. 52,000. Depreciation at 10% on Furniture and Fittings and at 5% on building is to be provided. Collections from debtors belonging to the vendor were Rs. 60,000 in the period.

Prepare the Trading and Profit and Loss account for the period ended 31 st March, 2010 of X Co. Ltd. and its balance sheet as at that date.

Answer 27.

Part I : Calculation of purchase consideration.

	Particulars	Rs.
a.	Consideration paid in the form of cash	56,000
b.	Consideration paid in the form of equity shares of X Ltd Co.	80,000
	10,000 Shares of Rs. 10 each, Rs.8 paid up	
c.	Total consideration	1,36,000

Part II : ***In the Books of Mr. A.***

Realisation Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Building	80,000	By X Co. Ltd Purchase consideration	1,36,000
To Furniture	10,000		
To Stock	30,000		
To Profit on Realisation	16,000		
	1,36,000		**1,36,000**

Journal Entries

	Particulars		Debit Rs.	Credit Rs.
a.	Due entry			
	X Co. Ltd. A/c	Dr.	1,36,000	
	To Realisation A/c			1,36,000
b.	Receipt entry			
	Equity shares in X Ltd. A/c	Dr.	80,000	
	Cash I Bank A/c	Dr.	56,000	
	To X Co. Ltd. A/c			1,36,000
c.	Other receipts from X Ltd - Debtors collection			
	i. Recovery of debtors.			
	X Co. Ltd. (Vendor Drs)	Dr.	90,000	
	To Debtors A/c			90,000
	ii. Receipt of cash and commission paid.			
	Discount on debtors A/c	Dr.	1,000	
	Commission to X Co. Ltd A/c	Dr.	3,000	
	Cash/Bank A/c	Dr.	57,000	
	To X Co. Ltd			61,000
	[Since the debtors are held by Mr. A, the discount given to debtors are to be borne by Mr. A.			
	Commission = Cash collected × 5% = 60,000 × 5%= 3,000			
	∴ Balance in vendor debtors A/c (90,000–61,000=29,000)			
d.	Settlement to creditors			
	Creditors A/c	Dr.	36,000	
	To Bank			36,000
	[Since creditors are also held by Mr. A. and not taken over by X Co. Ltd.]			

Cash / Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To balance b/d	20,000	By Creditors	36,000
To X. Co. (Purchase Consideration)	56,000	By balance c/d	97,000
To X Co. (Debtors Collection)	57,000		
	1,33,000		1,33,000
To bal b/d	97,000		

Balance sheet of Mr. A as at 1 st April 2009

Particulars		Rs.	Particulars	Rs.
Capital		1,94,000	Investment in equity shares of X	
Add :	Realisation Profit	16,000	Co. Ltd (Rs. 8 paid)	80,000
Less :	Discount to debtors	(1,000)	Vendor Debtors (X Ltd.)	29,000
Less :	Commission Paid	(3,000)	Cash /Bank	97,000
		2,06,000		**2,06,000**

Part III - In the books of X Co. Ltd.

	Particulars		*Debit* Rs.	*Credit* Rs.
a.	Take over business of Mr. A			
i.	Due Entry			
	Business purchase A/c	Dr.	1,36,000	
	To Mr. A			1,36,000
ii.	Incorporation of Assets taken over			
	Goodwill A/c (balancing figure)	Dr.	16,000	
	Building A/c	Dr.	80,000	
	Furniture and fixture A/c	Dr.	10,000	
	Stock A/c	Dr.	30,000	
	To Business purchase A/c			1,36,000
iii.	Discharge of Purchase Consideration			
	Mr. A A/c	Dr.	1,36,000	
	To Equity Share capital A/c			80,000
	To Bank / Cash A/c			56,000
b.	Public Issue of shares			
i.	Bank A/c	Dr.	1,36,000	
	To Equity shares capital A/c			1,36,000
	[Being Rs. 8/- per share received on 17,000 shares (20,000 - 1,000 - 2,000)]			
ii.	Bank A/c	Dr.	6,000	
	Calls in Arrears A/c	Dr.	2,000	
	To Equity Share capital A/c			8,000
	[Being receipt of Rs. 61 - on 1000 shares. Rs.2/- on 3rd call had not been realised]			
iii.	Bank A/c	Dr.	20,000	
	To Equity Share capital A/c			16,000
	To Calls in advance A/c			4,000
	[Being on 2,000 shares, the entire amount of Share capital received. Rs. 2/- per share not called up transferred to calls in advance A/c)			

Underwriting commission A/c To equity Share capital A/c [Being 2% on the face value of the public issue paid as underwriting commission. Commission discharged as fully paid equity shares. 20,000 shares × Rs. 10 each = 2,00,000 2% × 2,00,000 = 4,000]	Dr.	4,000	 4,000

Debtors Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Sales (Assuming fully credit)	 40,60,000	By Discount (6,000 - 1,000) By Cash received (balancing figure) By Balance cld (1,60,000 - 29,000)*	5,000 3,24,000 1,31,000
	4,60,000		**4,60,000**

• Vendor Debtors Taken over :

	Particulars	Rs.
i.	Particulars Debtors taken over from Mr. A	90,000
ii.	Less : Discount given	(1,000)
iii.	Less : Cash collected	(60,000)
iv.	Balance in vendor debtors	29,000

Creditors Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Cash (Balancing figure) To Balance c/d	2,72,000 48,0000	By Purchases (assuming fully on credit)	3,20,000
	3,20,000		**3,20,000**

Cash / Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Realisation from debtors.	3,24,000	By Purchase consideration to Mr.A	56,000
To Receiptfrom vendor debtors	60,000	By Remittance of vendor Debtors collection (60000 – 3000)	57,000
To equity Share capital (1,36,000 + 6,000 + 20,000)	1,62,00	By Payment to creditors	2,72,000
		By Preliminary expenses	10,000
		By Directors fees	12,000
		By Salaries	48,000
		By Balance c/d (balancing figure)	91,000
	5,46,000		**5,46,000**

Computation of Goodwill on acquisition

Particulars	Rs.	Rs.
Purchase Consideration		
- in shares of Rs. 10 each	80,000	
- in cash	56,000	1,36,000
Less : Assets taken over :		
- Building	80,000	
- Furniture and Fittings	10,000	
- Stock	30,000	1,20,000
Goodwill		16,000

Trading Account of M/s. X Company Ltd. tor the year ending 31st March, 2010

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	30,000	By Sales	4,60,000
To Purchase	3,20,000	By Closing Stock	52,000
To Gross profit c/d	1,62,000		
	5,12,000		**5,12,000**

Profit and Loss Account of M/s. X Company Ltd. for the Pre and Post Incorporation periods

Dr. Cr.

Particulars	1.4.09 to 30.06.09	1.7.09 to 31.3.10	Particulars	1.4.09 to 30.6.09	1.7.09 to 31.3.10
To Discount	–	5,000	By Gross profit	40,500	1,21,500
To Directors fees	–	12,000	By Commission	–	3,000
To Salaries	–	48,000	Received		
To Depreciation	1,250	3,750			
To Capital reserve	39,250	–			
To P and L	–	55,750			
	40,500	**1,24,500**		**40,500**	**1,24,500**

Note :

a. Entire salary and discount pertains to post incorporation period.

b. Depreciation :

i. Pre-incorporation:

Building : $80,000 \times 5\% \times \frac{3}{12}$ = 1,000

Furniture : $10,000 \times 10\% \times \frac{3}{12}$ = 250 1,250

ii. Post-incorporation :

Building: 80,000 × 5% × 9/12 = 3,000

Furniture: 10,000 × 10% × 9/12 = 750 3,750

* Profit during 1.4.09 to 30.6.09 reduces the cost of Acquisition and hence transferred to Capital reserve.

Balance sheet of X. Co. Ltd. As at 31.03.2010

Particulars	*Rs.*	*Rs.*	*Particulars*	*Rs.*	*Rs.*
Share capital			Building	80,000	
Authorised		3,00,000	Less : Depreciation		
Share capital			@ 5%	4,000	76,000
Issued and			Furniture	10,000	
subscribed capital		3,00,000	Less : Depreciation		
30,000 shares of Rs. 10			@ 10%	1,000	9,000
each Rs. 8			Current assets,		
Called up Capital			Loans and Advances		
30,000 shares of			i) Stock	52,000	
Rs. 8 each	2,40,000		ii) Debtors	1,31,000	
Less : Calls in arrears	2,000		iii) Cash	91,000	2,74,000
1000 x Rs.2/-	2,38,000		Miscellaneous		
[Out of the above			Expenses		
shares 10,000 shares			i) Preliminary		
were issued to Mr. A			Expenses	10,000	
for consideration other			ii) Underwriting		
than cash]			Commission	4,000	14,000
400 shares of Rs. 10					
each fully paid (to be					
issued to underwriter					
for consideration other					
than cash)	4,000	2,42,000			
Reserves and sl:lrplus					
Capital reserve*	23,250				
Profit and Loss A/c	55,750	79,000			
Current liabilities and					
Provision :					
Creditors	48,000				
Calls in Advance	4,000	52,000			
		3,73,000			**3,73,000**

* **Note :** Since both Capital reserve and goodwill arise out of the business acquisition, they can be written off against each other.

Therefore, Capital reserve is Rs. 23,250.

Pre incorporation profits	:	39,250
Less : Goodwill on business purchase	:	(16,000)
Balance of Capital reserve	:	23,250

Q. 28. Balance Sheet of P Ltd. and Q Ltd. as at 30.06.2010 is given below (Rs. in 000's)

Liabilities	P	Q	Liabilities	P	Q
Equity Share Capital (Rs.10)	5,000	2,400	Goodwill	300	200
Securities Premium	200	140	Buildings	1,000	1,000
General Reserve	1,000	1,600	Machinery	4,000	2,440
Profit & Loss Account	900	600	Investment in Shares:		
8% Debentures	2,000	1,000	-1,92,000 Shares of Q Ltd.	1,500	
Trade Creditors	800	400	Investments in Debentures:		
Outstanding Expenses	300	150	- In Q Ltd. (Face Value Rs.4,00,000)	450	
			- In P Ltd. (Face Value Rs.2,00,000)		220
			Sundry Debtors	1,500	1,000
			Stock	1,000	1,000
			Cash and Bank	200	100
			Preliminary Expenses	100	50
			Outstanding Income	150	280
Total	**10,200**	**6,290**	**Total**	**10,200**	**6,290**

1. When the Shares were acquired, Q Ltd. had Rs.2.2 Lakhs in General Reserve and Rs.1,00,000 in Securities Premium, Rs. 3,00,000 (Dr.) in Profit and Loss Account.
2. Two years after the date of acquisition Bonus Shares at 1 to 1 were issued out of General Reserve.
3. One year after the Bonus issue, Rights Shares were issued at 10% Premium at 1 for 5 held and P Ltd. purchased all the shares offered to it.
4. P Ltd. received Rs.1,92,000 dividend for the last year and Rs.96,000 interim dividend in the current year, i.e. 3 years after the Rights Issue.
5. For the current year 15% dividend (including Interim Dividend) has been proposed by Q Ltd., 10% by P Ltd., but no effect has yet been given in the accounts.
6. On the same day referred to in (5) above, Bonus Dividend has been declared at 1 to 2, but no effect has yet been given.
7. 50% of the shares originally purchased in Q Ltd. were paid for to the shareholders of Q Ltd. by 50,000 shares of P Ltd. issued at 10% premium.
8. Debenture Interest of both the Companies falls due on 30th June, but payments are made 2 or 3 days after.

Prepare Consolidated Balance Sheet as at 30.06.2010.

Answer 28.

1. Basic Information

Compan Status		Dates	Holding Status	
Holding Company	= P	Consolidation : 30.06.2010	Holding Company	= 80%
Subsidiary	= Q		Minority Interest	= 20%

Note : DOA = Date of Acquisition.

	Shares held as on 30.06.2010	1,92,000
Add :	Second Bonus Issue (1,92,000 × 1/2)	96,000
	Actual Shareholding	2,88,000

DOA - 1 (Original Acquisition)	First Bonus Issue (1:1 as at DOA-1)	DOA-2 Rights Issue	Second Bonus Issue (1:2 as at DOA-2)
80,000	80,000	32,000	96,000
(balancing figure)	[(1,92,000–32,000) ÷ 2]	[1,92,000 ×1 ÷ (5+1)]	

DOA-1 split:

40,000	40,000
For Cash	For Shares of P Ltd.

2. Analysis of Reserves & Surplus of Q Ltd.

(a) Securities Premium

Balance on 30.06.2010 Rs. 1,40,000

DOA-1	Proceeds from Rights Issue
Rs. 1,00,00	**Rs. 40,000**
Capital Profit	**Capital**

(b) General Reserve

	Shares held as on 30.06.2010	16,00,00
Add :	Second Bonus Issue (24,00,000 × 1/2)	12,000
	Actual Balance	40,00,000

	DOA-1	Rs. 22,00,000	Additions upto Consolidation
Less :	First Bonus	(Rs. 10,00,000) (80,000 Shares/80% ×Rs. 10)	(balancing figure) **Rs. 4,00,000**
	Capital Profit	**Rs. Nil**	**Revenue Reserve**

Note : In the absence of information in this regard, it is presumed that the second bonus issue has been made out of reserves as on the date of controlling acquisition.

(c) Profit & Loss Account

	Balance as on 31.12.2008	6,00,000
Less :	Debenture Interest (10,00,000×8%)	(80,000)
Add :	Debenture Interest from P (2,00,000×8%)	**16,000**
Less :	Proposed Dividend (24,00,000×15% – Interim 1,20,000	(2,40,000) (See Note)
		2,96,000

DOA-1	Additions to P&L A/c
(Rs. 3,00,000) Debit balance given	**Rs. 5,96,000**
Capital Profit	**Revenue Profit**

Note : Interim Dividend received by Holding Company = Rs. 96,000 for 80% holding. Hence, Total Interim Dividend paid by Subsidiary = Rs. 96,000 ÷ 80% = Rs. 1,20,000

3. Analysis of Net Worth of Q Ltd.

Particulars	Total 100%	P 80%	Minority 20%
(a) Equity Share Capital : (including Bonus Rs. 12,00,00)	**36,00,000**	28,80,000	7,20,000
(b) Capital Profits: Securities Premium Account	1,00,000		
General Reserve	Nil		
Profit & Loss Account	(3,00,000)		
Preliminary Expenses	(50,000)		
	(2,50,000)	(2,00,000)	(50,000)
(c) Securities Premium (after acquisition date)	**40,000**	32,000	8,000
(d) Revenue Reserves: General Reserve	**4,00,000**	3,20,000	80,000
(e) Revenue Profits: Profit & Loss A/c	**5,96,000**	4,76,800	1,19,200
(f) Proposed Equity Dividend	**2,40,000**	1,92,00	48,000
Minority Interest			**9,25,200**

4. Cost of Control

	Particulars	Rs.	Rs.
	Cost of Intestment	15,00,000	
Less:	(1) Nominal Value of Equity Capital	28,80,000	
	(2) Share in Capital Profit of Q Ltd.	(2,00,000)	(26,80,000)
Capital Resrve on Consolidation			**(11,80,000)**

5. Gain/Loss on Consolidation of Debenturs

	Particulars	Rs.	Rs.
	Cost of Investment in Debentures :		
	Lavanya Ltd. in P Ltd.	2,20,000	
	Karunya Ltd. in Q Ltd.	4,50,00	6,70,000
Less:	Face Value of Debentures (Rs. 20,000 + Rs. 40,000)		(6,00,000)
Loss on Consolidation of Debentures (Adjusted against Group Reserves)			**70,000**

6. Consolidation of Reserves & Surplus

	Particulars		Securities Premium	General Reserve	P&L A/c
	Balance as per Balance Sheet of P Ltd.		2,00,000	10,00,000	9,00,000
Less:	Proposed Dividend (Rs. 50,00,000×10%)			–	(5,00,000)
Less:	Debenture Interest Due (Rs. 20,00,000×8%)		–	–	(1,60,000)
Add:	Share of Dividend from Q Ltd.	(Rs. 2,40,000×80%)	–	–	1,92,000
Add:	Share of Debenture Int from Q	(Rs. 4,00,000×8%)	–	–	32,000
	Adjusted Balance		**2,00,000**	**10,00,000**	**4,64,000**
Add:	Share of Reserves of Q Ltd.		32,000	32,000	4,76,800
Less:	Loss of Elimination of Debentures on Consolidation				(70,000)
	Consolidated Balance		**2,32,000**	**13,20,000**	**8,70,800**

7. Consolidated Balance Sheet of P Ltd. and its Subsidiary Q Ltd. as at 31.12.2009

Liability	Rs.	Assets		Rs.
Share Capital: Equioty Share Capital	50,00,000	**Fixed Assets:**		
Reserves and Surplus:		Goodwill	(3,00,000+2,00,000)	5,00,000
Securities Premium	23,200	Building	(10,00,000+10,00,000)	20,00,000
General Reserve	13,20,000	Machinery	(40,00,000+24,40,00)	64,40,000
Profit & Loss Account	8,70,000			
Capital Reserve	11,80,000	**Current Assets:**		
Secured Loans		Sundry Debtors	(15,00,000+10,00,000)	25,00,000
8% Debenture (20,00,000+10,00,000-		Stock in Trade	(10,00,000+10,00,000)	20,00,000
2,00,000 (held by Q) - 4,00,000	24,00,000	Cash in Hand	(2,00,000+1,00,000)	3,00,000
(held by P)		Outstanding	(1,50,000+2,80,000)	4,30,000
Debenture Interest accrued	1,92,000	Income		
Minority Interest:	9,25,200	**Misc. Expenditure (to the extent not w/off)**		
Current Liabilities:		Preliminary Expenses		1,00,000
Sundry Creditors [8,00,000+4,00,000]	12,00,000			
Outstanding Exp [3,00,000+1,50,000]	4,50,000			
Proposed Dividend (P Ltd.)	5,00,000			
Total	**1,42,70,000**	**Total**		**1,42,70,000**

Notes :

- It is presumed that the Companies have not accounted for the inter company owings in respect of Debenture interest and proposed dividends.
- Interest due on Debenture has been shown under Secured Loans together with Debentures in accordance with Schedule VI to the Companies Act, 1956.

Q. 29. Bonus Issue, Asset Revaluation, Interest not recorded

X Ltd. acquired 80,000 Shares of Rs.100 each in Y Ltd. on 30.09.2008. The summarized two Companies as 31.03.2009 were as follows -

Liabilities	X Ltd.	Y Ltd.	Assets	X Ltd.	Y Ltd.
Share Capital (Rs.100)	3,00,00,000	1,00,00,000	**Fixed Assets**	1,50,00,000	1,44,70,000
Capital Reserve	—	55,00,000	Investments in Y Ltd.	1,70,00,000	—
General Reserve	30,00,000	5,00,000	Stock in Hand	40,00,000	20,00,000
Profit & Loss Account	38,20,000	18,00,000	Loan to X Ltd.	—	2,00,000
Loan from Y Ltd.	2,10,000		Debtors	25,00,000	1,08,00,000
Creditors	17,90,000		Bank	2,00,000	2,00,000
Bills Payable (including Rs.50,000 to X Ltd.)	—	7,00,000 1,70,000	Bills Receivable (including Rs.5,000 from Y Ltd.)	1,20,000	—
Total	**3,88,20,000**	**18,67,00,000**	**Total**	**3,88,20,000**	**18,67,00,000**

Contingent Liability (X Ltd.): Bills discounted of Rs. 60,000.

***Additional information* :**

1. **Y Ltd. made a bonus issue on 31 .03.2009 of one share for every two shares held, reducing the Capital Reserve equivalentlly, but the accounting effect to this has not been given in the above Balance Sheet.**
2. **Interest receivable tbr the year (Rs. 10,000) m respect of the Loan due by X Ltd. to Y Ltd. has not been credited in the accounts of Y Ltd.**
3. **The credit balance in Profit & Loss Account of Y Ltd. on 01.04.2008 was Rs. 2,10,000.**
4. **The Directors decided on the date of the acquisition that the Fixed Assets of Y Ltd. were overvalued and should be written down by Rs. 5,00,000. Consequential adjustments on depreciation are to be ignored.**

Prepare the Consolidated Balance Sheet as at 31.03.2009, showing your workings.

Answer 29.

1. Basic Information

Company Status		Dates		Holding Status	
Holding Company	= X Ltd.	Acquisition:	30.09.2008	Holding Company	= 80%
Subsidiary	= Y Ltd.	Consolidation:	31.03.2009	Minority Interest	= 20%

2. Analysis of Reserves and Surplus of V Ltd.

(a) General Reserve

Balance as per B/s Rs. 5,00,000

As on 01.04.2008 (Date of previous B/s) **Rs. 5,00,000**
Assumed that entire balance is available on this date
Capital Profit

01.04.2008 to 31.03.2009 cupto Consolidation)
Rs. NIL (balancing figure)
Revenue Reserve

(b) Profit and Loss Account

	Balance as on date of Consolidation	Rs. 18,00,000
Add:	Interest on Loan to X (Given)	Rs. 10,000
	Corrected Balance	Rs. 18,10,000

Balance on 01.04.2008 (Date of previous B/s) — Rs. 2,10,000 Capital Profit

Profit for 2008-09 (balang figure) **Rs. 16,00,000**

- Upto date of acquisition 01.04.2004 to 30.09.2008 Rs. 16,00,000 × 6/12 — **Capital Profit Rs. 8,00,000**
- Acquisition to Consolidation 30.09.2008 to 31.03.2009 Rs. 16,00,000 × 6/12 — **Revenue Profits: Rs. 8,00,000**

Total Capital Profits: 2,10,000 + 8,00,000 = Rs. 10,10,000; Total Revenue Profit Rs.8,00,000

(c) Capital Reserve

			Remarks
	Balance as on date of Consolidation	Rs. 55,00,000	The entire balance is
Less:	Bonus Issue (Rs. 1,00,000 ×1/2)	Rs. 50,00,000	considered **Capital Profits.**
	Adjusted Balance	Rs. 5,00,000	

(d) Revaluation of Assets: Loss (Rs. 5,00,000) = **Capital Profit**

3. Analysis of Net Worth of Y Ltd.

	Particulars	Total	X Ltd.	Minority
	Shareholding Pattern	**100%**	**80%**	**20%**
(a)	**Share Capital**	1,00,00,000		
Add:	Bonus Issue [1/2 × 1,00,00,000]	50,00,000		
(b)	**Capital Profits:**	**1,50,00,000**	**1,20,00,000**	**30,00,000**
	General Reserve	5,00,000		
	Profit & Loss Account	10,10,000		
	Capital Reserve	5,00,000		
	Loss on Revaluation of Assets	(5,00,000)		
(c)	**Revenue Reserve:**	**15,10,000**	**12,08,000**	**3,02,000**
(d)	**Revenue Profits:**	Nil		
	Pofit & Loss A/c	**8,00,000**	**6,40,000**	**1,60,000**
	Minority Interest			**34,62,000**

4. Cost of Control

	Particulars		Rs.
	Cost of Investment as per B/Sheet		
Less:	(1) Nominal Value of Equity Capital	1,20,00,000	1,70,00,000
	(2) Share in Capital Profit as calculated above	12,08,000	1,32,08,000
	Goodwill on Consolidation		**37,92,000**

5. Consolidation of Reserves & Surplus

Particulars	Gen. Res.	P&L A/c
Balance as per Balance Sheet of X Ltd.	30,00,000	38,20,000
Add: Share of Revenue Reserve / Profit from Y Ltd.	Nil	6,40,000
Consolidated Balance	**30,00,000**	**44,60,000**

6. Consolidation Balance Sheet of X Ltd. and its Subsidiary Y Ltd. as at 31.03.2009

Liabilities	Rs.	Assets	Rs.
Share Capital: Equity Share Capital	3,00,00,000	**Fixed Assets:**	
Reserves & Surplus		Goodwill on Consolidation	37,92,000
General Reserves	30,00,000	Other Fixed Assets	2,89,70,000
Profit and Loss Account	44,60,000	[1,50,00,000+1,44,70,000–5,00,000	
Minority Interest	34,62,000	(Revaluation Loss)]	
Current Liabilities		**Current Assets**	
Sundry Creditors		Sundry Debtors [25,0,000+18,00,000]	43,00,000
[17,90,000 + 7,00,000]	24,90,000	Stock in Trade [40,00,00+20,00,000]	60,00,000
B/P [1,70,000-50,000 (Mutual	1,20,000	Cash at Bank [2,00,000+2,00,000]	4,00,000
Owings)]		B/R [1,20,00 – 50,000 (Mutual	70,000
		Owings)]	
Total	**4,35,32,000**	**Total**	**4,35,32,000**

Contingent Liability for Bills Discounted Rs. 60,000

Note : Fixed Assets have been revalued for the purpose of Consolidation and the depreciation on the revaluation loss has been ignored as its specifically stated in the problem.

Q. 30. The following are the Balance Sheets of L Ltd. and M Ltd. as at 31 .03.2009.

Liabilities	*L Ltd.*	*M Ltd.*	*Assets*	*L Ltd.*	*M Ltd.*
Equity Share Capital (Rs. 10)	**80,000**	**1,00,000**	**Shares in Monu Ltd**	**98,000**	**—**
Profit & Loss Account Sundry	**22,000**	**30,000**	**Cash**	**7,000**	**4,000**
Creditors	**3,000**	**8,000**	**Other Assets**	**—**	**1,34,000**
Total	**1,05,000**	**1,38,000**	**Total**	**1,05,000**	**1,38,000**

1. **Net Profit during 2008-09 included above were: L Ltd. Rs.18,000; M Ltd. Rs. 12,000.**
2. **During 2008-09, M Ltd. credited Rs. 3,000 to its P & L Account in settlement of a claim of loss of stock (costing Rs. 5,400 - included in opening stock) by fire on 30.06.2008.**
3. **Rs. 250 p.m. expenses incurred by L Ltd. on behalf of M Ltd. has been debited to the Profit & Loss Account of L Ltd. and left unrecorded for in the books of M Ltd.**
4. **Both the Companies have proposed a dividend of 10% which is yet to be recorded.**
5. **On 01.04.2008, L Ltd., was formed and on the same day it acquired 4,000 Shares of M Ltd. at Rs. 55,000.**

6. On 31.07.2008, 10% dividend was received from M Ltd. and also Bonus Share at 1:4 was received. The dividend was credited to Profit & Loss Account.
7. On 31.8.2008, L Ltd. purchased another 3,000 Shares of M Ltd. at Rs. 43,000. Draft a Consolidated Balance Sheet for the above Group.

Answer 30.

1. Basic Information

Company Status		Date of Acquisition		Holding Status	
Holding Company	= L Ltd.	Lot 1 4,000 Shares	= 01.04.2008	Holding Company	= 80%
Subsidiary	= M Ltd.	Bonus 1,000 Shares	= 31 .07.2008	Minority Interest	= 20%
		Lot 2 = 3,000 Shares	= 31.08.2008		

Date of Consolidation =31.03.2009

Notes :

- As per M's B/Sheet, number of Shares = 10,000, which is after Bonus Issue of 1:4. Hence, Number of Shares prior to Bonus Issue = 10,000 Less l/5th = 8,000 Shares.
- Lot 14,000 Shares do not constitute controlling acquisition. Hence, Date of Control = 31.08.2008. Shares held by Lalu Ltd. = 8,000 Shares out of 10,000 = 80% Holding.

2. Analysis of Profit & Loss Account of M Ltd.

Note :

1. Normal Operating Profit of M for 2008-09 = 12,000 (given) + 2,400 (abnormal loss item) = Rs. 14,400.
2. Presuming this to be earned uniformly, the Revenue Profits after date of controlling acquisition i.e. the period from 31 .08.2008 to 31 .03.2009 (i.e. 7 months) = Rs. 14,400 x 7/12 = Rs.8,400. Hence, amount relatable to pre-acquisition period = Rs. 14,400 - Rs.8,400 = Rs.6,000.

P & L balance on 31 .03.2009 Rs. 30,000

Bal. in P&L last year	Rs. **46,000**		Profit from 31.08.2008 to 31.03.2009	8,400
Less: Bonus Issue	20,000	(Rs.80,000 × 1 /4)	(See Note 2 above)	
Less: Dividend	8,000	(Rs.80,000 × 10%)	**Less:** Expenses by L Ltd. (Rs.250 × 7)	(1,750)
Less: Stock Loss	2,400		**Less:** 2008-09 Dividend (1,00,000×10%)	(10,000)
	15,600	(30,000 – 14,400)		**(Rs.3,350)**
2008-09 Pft (**Note 2**)	6,000	(Rs. 14,400 × 5/12)	**Revenue Profit**	
Less: Exp. by L Ltd.	(1,250)	(Rs. 250 × 5)		
	20,350	**Capital Profit**		

Note :

- The Opening Balance in P&L A/c Rs. 46,000 is derived by reverse working. From this balance, M Ltd. should have declared bonus shares, paid dividend and written off the stock losses.
- The net balance of Capital and Revenue Profit = Rs. 20,350 – Rs. 3,350 = **Rs. 17,000**. This is confirmed with the corrected balance of M's P&L Account i.e. Balance as given = Rs. 30,000 **Less** Expenses incurred by L Ltd., now recorded = Rs. 3,000 **Less** Dividend for 2008-09 = Rs. 10,000; Net Balance = Rs. 17,000.

3. Analysis of Net Worth of Y Ltd.

	Particulars	Total	L Ltd.	Minority
		100%	**(80%)**	**20%**
(a)	**Equity Share Capital**	1,00,000	80,000	20,000
(b)	**Capital Profits:** Profit & Loss Account	20,350	16,280	4,070
(c)	**Revenue Profits:** Profit & Loss Account	(3,350)	(2,680)	(670)
(d)	**Proposed Dividend**	10,000	8,000	2,000
	Minority Interest			**25,400**

4. Computation of Pre-acquisition Dividend of L Ltd.

Particulars	Total	1st Lot	2nd Lot
% of Holding on 31.03.2009	80%	50%	30%
Share of dividend	Rs. 8,000	Rs. 5,000	Rs. 3,000
Period of holding during 2008-09	—	12 Months	7 Months
To be Credited to P&L A/c	Rs. 6,750	Rs. 5,000	Rs. 1,750 (3,000×7/12)
To be Credited to Investment A/c (Pre-acquisition Dividend)	Rs. 1,250	Nil	Rs. 1,250 (3,000×5/12)

5. Cost of Control

	Particulars		Rs.
	Cost of Investment in M Ltd.		98,000
Less:	Dividend out of Pre-acquisition Profits (2007-08) of M Ltd. (Rs. 8,000×50%)		(4,000)
Less:	Dividend out of Pre-acquisition Profits (2008-09) Working Note-4 above		(1,250)
	Adjusted Cost of Investment		**92,750**
Less:	Nominal Value of Equity Capital	80,000	
	Share in Capital Profit of M Ltd.	16,280	96,280
	Capital Reserve on Consolidation		**(3,530)**

6. Consolidation of Profit & Loss Account

	Particulars		Rs.
	Balance as per Balance Sheet		22,000
Less:	Proposed Dividend	(Rs. 80,000 × 10%)	(8,000)
Add:	Expenses incurred on behalf of M Ltd. by L Ltd.	(Rs. 250 ×12 months)	3,000
Less:	Dividend out of Pre-acquisition Profits (2007-08)	(Rs. 8,000 × 50%)	(4,000)
Add:	Share of Proposed Dividend for FY 2008-09	(WN4)	6,750
	Adjusted Balance		**19,750**
Less:	Share of Revenue Loss of M Ltd.		(2,680)
	Consolidated Balance		**17,070**

7. Consolidation Balance Sheet of L Ltd. and its Subsidiary M Ltd. as at 31.03.2009

Liabilities	Rs.	Assets	Rs.
Share Capital: Equity Share Capital	80,000	**Other Assets**	1,34,000
Reserves & Surplus		**Current Assets:**	
Profit and Loss Account	17,070	Cash [7,000+4,000]	11,000
Capital Reserve on Consolidation	3,530		
Minority Interest	25,400		
Current Liabilities:			
Sundry Creditors [3,000+8,000]	11,000		
Proposed Dividend [shareholders of L Ltd.]	8,000		
Total	**1,45,000**	**Total**	**1,45,000**

Q. 31. Following are the Balance Sheets of M Ltd. and N Ltd. as at 31.03.2009 -

Liabilities	*M Ltd.*	*N Ltd.*	*Assets*	*M Ltd.*	*N Ltd.*
Equity Share Capital of Rs.100 each fully paid	**6,00,000**	**1,00,000**	**Land & Building**	**2,00,000**	**1,00,000**
			Machinery	**2,80,000**	**50,000**
General Reserve	**50,000**	**30,000**	**7000 Shares in N**	**1,00,000**	**-**
Prof it & Loss Account	**80,000**	**40,000**	**Stock in Trade**	**70,000**	**40,000**
Sundry Creditors	**1,00,000**	**40,000**	**Debtors**	**1,50,000**	**20,000**
Bills Payable	**10,000**	**15,000**	**Bills Receivable**	**10,000**	**-**
			Cash at Bank	**30,000**	**15,000**
Total	**8,40,000**	**2,25,000**	**Total**	**8,40,000**	**2,25,000**

Prepare Consolidated Balance Sheet as at 31st March, 2009 from the following additional Information -

1. **All the Bills Receivable of M Ltd. including those discounted were accepted by N Ltd.**
2. **When M Ltd. had acquired 600 Shares in N Ltd., the latter had Rs. 20,000 in General Reserve and Rs. 5,000 Credit Balance in Profit and Loss Account.**
3. **At the time of acquisition of further 100 Shares by N Ltd., the latter had Rs. 25,000 General Reserve and Rs. 28,000 Credit Balance in Profit and Loss Account, from which 20% dividend was paid by N Ltd.**
4. **The dividends received by M Ltd. on these shares were credited to Profit & Loss Account.**
5. **Stock of N Ltd. includes goods valued at Rs.20,000 purchased from M Ltd. which has made 25% profit on cost.**
6. **For the financial year ending 31.03.2009, M Ltd. had proposed a dividend of 10% and N Ltd. has proposed a dividend of 15%, but no effect has yet been given in the above Balance Sheets.**

Answer 31.

1. Basic Information

Company Status		Date of Acquisition		Holding Status	
Holding Company	= M Ltd.	Lot 1 = 600 Sheares	= DOA - 1	Holding Company	= 70%
Subsidiary	= N Ltd.	Lot 2 = 100 Sheares	= DOA - 2	Minority Interest	= 30%

Date of Consolidation =31.03.2009

2. Analysis of Reserves & Surplus of Kaurava Ltd.

(a) General Reserve as per B/s = Rs. 30,000

As on DOA-1	For the period DOA-1 to DOA-2 (Lot 2 date)	From DOA-2 to B/s Date
(Lot 1 date)	Rs. 25,000 - Rs. 20,000 = Rs. 5,000	(upto Consolidation)
Rs. 20,000	For 600 Shares (Lot 1): **Revenue**	**Rs. 5,0000)** (bal. figure)
Capital	For 100 Shares (Lot 2): **Capital**	**Revenue**

Total Capital Profits = Rs.20,000; Total Revenue Reserves = Rs. 10,000 **(See Note)**

Note: Addition to Reserves of Rs.5,000 between DOA-1 and DOA-2 have been considered as Revenue Reserves in full, only for the purpose of determining the share of Minority Interest. After allocating for Minority Interest, the revenue portion of Rs.500 (i.e. 10% Shares x Rs.5,000) will be added to Capital Profits.

(b) Profit & Loss Account

	P & L A/c Balance as per B/s	= Rs. 40,000
Less:	Proposed Dividend = 1,00,000 x 15%	= Rs. 15,000
	Adjusted Balance of N Ltd.'s Profits	= Rs. 25,000

As on DOA-1	For the period DOA-1 to DOA-2 (Lot 2 date)	From DOA-2 to B/s Date
(Lot 1 date)	Rs.28,000 - Rs.5,000 = Rs.23,000	(upto Consolidation)
Rs. 5,000	**Less:** Dividend out of this = Rs.20.000	Rs.17,000 (bal. figure)
	Net Balance = **Rs. 3,000**	
Capital	For 600 Shares (Lot 1) : **Revenue**	**Revenue**
	For 100 Shares (Lot 2) : **Capital**	

Total Capital Profits = Rs.5,000; Total Revenue Reserves = Rs.5,000 (See Note)

Note : Addition to P&L A/c Rs.3,000 between DOA-1 and DOA-2 have been fully considered as Revenue only for the purpose of determining the share of Minority Interest. After allocating for minority Interest, the revenue portion of Rs.300 (i.e. 10% Shares x Rs.3,000) will be added to Capital Profits.

3. Analysis of Net Worth of N Ltd.

	Particulars	Total	M Ltd.	Minority
	% of share Holding on Consolidation Date	**100%**	**70%**	**30%**
(a)	**Equity Share Capital**	**1,00,000**	70,000	30,000
(b)	Capital Profits: General Reserve	20,000		
	Profit & Loss Account	5,000		
		25,000	17,500	7,500
Add:	Capital Items [Res Rs.5000 + P&L A/c Rs.3,000] × 10%		800	
	Net Share in Capital Profit		18,300	
(c)	Revenue Reserves: General Reserve	**10,000**	7,000	3,000
Less:	Capital Item included in Revenue [Rs.5,000 x 10%]		(500)	
	Net Share in Revenue Reserves	**20,000**	6,500	
(d)	**Revenue Profits: Profit & Loss A/c**		14,000	6,000
Less:	Capital Item included in Revenue [Rs. 3,000 x 10%]		(300)	
	Net Share in Revenue Profit	**15,000**	13,700	
(e)	**Proposed Dividend**	13,700		
			10,500	4,500
	Total Minority Interest			**51,000**

4. Cost of Control

	Particulars		Rs.
	Cost of Investment in Equity Shares of N Ltd.		1,00,000
Less:	Dividend out of Pre-acquisition Profits of N Ltd.		2,000
	(Only for Lot 2 - 1000 Shares) – (Rs. 10,000 × 20%)		
	Adjusted Cost of Investment		98,000
Less:	(1) Nominal Value of Equity Capital	70,000	
	(2) Share in Capital Profit of N Ltd.	18,300	88,300
	Goodwill on Consolidation		**9,700**

5. Consolidation of Reserves & Surplus

	Particulars		Gen. Res.	P&L A/c
	Balance as per Balance Sheet of M Ltd.		50,000	80,000
Less:	Dividend out of Pre-acquisition Profits	(Rs. 20,000×10%)	–	(2,000)
Less:	Proposed Dividend	(Rs. 6,00,000×10%)	–	(60,000)
Add:	Share of Dividend from N Ltd.	(Rs. 15,000×70%)	–	10,500
	Adjusted Balance		**50,000**	**28,500**
Add:	Share of Revenue Profits/Reserves of N Ltd.		6,500	13,700
	Consolidated Balance		**56,500**	42,200
Less:	Unrealised Profits on Closing Stock Rs. 20,000×25/125		–	(4,000)
	Adjusted Consolidated Balance		**56,500**	**38,200**

6. Consolidation Balance Sheet of M Ltd. and its Subsidiary N Ltd. as at 31.03.2009

Liabilities	Rs.	Assets	Rs.
Share Capital: Equity Share Capital	6,00,000	**Fixed Assets**	
Reserves & Surplus		Goodwill on Consolidation	9,700
General Reserves	56,500	Land & Building (2,00,000+1,00,000)	3,00,000
Profit & Loss Account	38,200	Plant & Machinery (2,80,000+50,000)	3,30,000
Minority Interest	51,000	**Current Assets**	
Current Liabilities		Stock in Trade [70,000+40,000-4,000	1,06,000
B/P [10,000+15,000 - 10,000 (Mutual)]	15,000	(Stock Reserve)]	
Trade Creditors [1,00,000 + 40,000]	1,40,000	Trade Debtors [1,50,000+20,000]	1,70,000
Proposed Dividend (M Ltd.)	60,000	B/R [10,000 - 10,000 (Mutual Owings)]	Nil
		Cash at Bank [30,000+15,000]	45,000
Total	**9,60,700**	**Total**	**9,60,700**

Notes :

- Balance Sheet items have been consolidated on line-by-line addition basis.
- Stock Reserve i.e. unrealized profits on Closing Stock have been eliminated in full Group reserves as it relates to downstream transaction (i.e. Holding to Subsidiary).
- Inter-Company Owins have been eliminated in full.

Q. 32. Z Ltd. acquired 60% of shares of P Ltd. as on 30th June, 2005. As on 31st December, 2007, Balance Sheet of P Ltd. shows a blance in General Reserves Rs. 2,00,000 and in Profit and Loss Account Rs. 20,000. Subsequently Hema Ltd. purchased another 10% shares of P Ltd. on 30th September, 2008. Finally Z Ltd. purchased another 20% Shares as on 30th November, 2008. Given below the Balance Sheets of Z Ltd. and P Ltd. as on 31st December, 2008 —

Liabilities	*Z Ltd.*	*PLtd.*	*Assets*	*Z Ltd.*	*P Ltd.*
Share Capital	**10,00,000**	**6,00,000**	**Fixed Assets**	**16,00,000**	**10,00,000**
General Reserve	**4,00,000**	**1,00,000**	**(-) Accumulated Depreciation**	**4,00,000**	**2,00,000**
P & L Account	**2,00,000**	**1,00,000**	**Net Block**	**12,00,000**	**8,00,000**
Loans	**3,00,000**	**4,00,000**	**Investments**	**6,00,000**	**2,00,000**
Sundry Creditors	**4,00,000**	**2,00,000**	**Current Assets**		
Provision for Tax	**1,00,000**	**80,000**	**Stock**	**4,00,000**	**3,00,000**
Proposed Dividend	**2,00,000**	**1,20,000**	**Debtors**	**3,00,000**	**2,00,000**
			Cash & Bank	**1,00,000**	**1,00,000**
Total	**26,00,000**	**16,00,000**	**Total**	**26,00,000**	**16,00,000**

Other Information's :

1. **The initial of investment in P Ltd. was made by 2 Ltd. for Rs.3,00,000. The second phase of Investment was Ltd. for Rs. 80,000 and the last phase of investment was made for Rs.1,50,000.**
2. **P Ltd. declared and paid Bonus Shares at one for every two Shares held. For this purpose the book closure date was 15th July to 31st July, 2008.**
3. **Z Ltd. sold a machinery costing Rs.4,00,000 to P Ltd. on 15th September, 2008 on which the former made a profit of Rs. 1,00,000. P Ltd. charged depreciation at 20% on the plant on time proportion basis.**

Prepare a Consolidated Balance Sheet for Z Ltd. and its subsidiary P Ltd. as on 31.12.2008.

Answer 32.

1. Basic Information Date of Ac uisition

Company Status	Date of Acquisition	Holdin Status
Holding Company = Z Ltd. Subsidiary = P Ltd.	Lot 1 = 60% Shares = 30.06.2008 Lot 2 = 10% Shares = 30.09.2008 Lot 3 = 20% Shares = 30.11.2008	Holding Company = 90% Minority Interest = 10

Date of Consolidation = 31.12.2008

2. Analysis of Reserves & Surplus of P Ltd.

(a) General Reserve

Balance on 31.12.2008 Rs. 1,00,000

Balance on 1.1.2008	2,00,000	Transfer during 2008	**Rs. 1,00,000**
Less : Bonus Issue	2,00,000	(balancing figure)	
	Nil		

	Upto 30.6.08 **6 Months**	**1.7.08 to 30.9.08** **3 Months**	**1.10.05 to 30.11.08** **2 Months**	**1.12.08 to 31.12.08** **1 Month**
	100000 × 6/12 = Rs. 50,000	100000 × 3/12 = Rs. 25,000	100000 × 2/12 = Rs. 16,667	00000 × 1/12 = Rs. 8,333
		30%	20%	—
Capital Profit for	90%	60%	70%	90%
Revenue Reserve for				
TotalHoldings by Z Ltd.		90%	90%	90%

Total Capital Profits : **Rs. 50,000**; Total Revenue Profits : **Rs. 50,000**

Note : Additions to General Reserve Account are fully considered as revenue only for the purpose of determining Minority allocating the Minority Interest the respective Capital Portion will be transferred to Capital Profits.

(b) General Reserve

Balance on 31.12.2008 Rs. 1,00,000

Balance on 1.1.2008	**20,000**	Profit earned during 2008 (b/f)	**Rs. 80,000**
	Capital Profit	**Add :** Depreciation on Machinery	Rs. 29,167
		(Rs. 5 Lakhs × 3.5 Months / 12×20%)	**Rs. 1,09,167**

	Upto 30.6.08	**1.7.08 to 30.9.08**	**1.10.08 to 30.11.08**	**1.12.08 to 31.12.08**
	6 Months	3 Months	2 Months	1 Month
	109167 × 6/12 =	109167 × 3/12 =	109167 × 2/12 =	109167 × 1/12 =
	Rs. 54,584	**Rs. 27,292**	**Rs. 18,195**	**Rs. 9,096**
Less : Depreciation	—	Rs. 4,167	Rs. 16,667	Rs. 8,333
	—	(29167×0.5 / 3.5)	(29167×2.0 / 3.5)	(29167×1.0 / 3.5)
Capital Profit for	90%	30%	20%	—
Revenue Profit for	—	60%	70%	90%
Total Holdings by Z Ltd.		90%	90%	90%

Total Capital Profits : Rs. 54,584 + Rs. 20,000 = **Rs. 74,584**; **Total Revenue Profits : Rs. 25,416**

Note :

- Profits are assumed to have been evenly spread out throughout the year.
- Additions to the P & L A/c after 30.06.2008 are fully considered as revenue only for purpose of determining Minority Interst. After allocating the Minority Interest the respective Capital Portion will be transferred to Capital Profits.

3. Computation of amount to be transferred from Revenue Profits to Capital Profits

Period	% of holding considered as Capital	P & L A/c	General Reserve
30.6.2008-30.9.2008	30%	23,125 × 30% = Rs. 6,938	25,000 × 30% = Rs. 7,500
30.9.2008-30.11.2008	20%	1,528 × 20% = Rs. 306	16,667 × 20% = Rs. 3,333
		Rs. 7,244	Rs. 10,833

4. Analysis of Net Worth of S Ltd.

Particulars			Total 100%	Z Ltd. 90%	Minority 10%
(a) Equity Share Capital			**6,00,000**	5,40,000	60,000
(b) Capital Profits :		General Reserve	50,000		
		Profit & Loss Account	74,584		
			1,24,584	1,12,126	12,458
	Add :	Capital Items (7,244 + 10,833)		18,077	
				1,30,203	
			50,000	45,000	
(c) **Revenue Reserve :**		General Reserve		(10,833)	5,000
	Less :	Capital Item included in Revenue		34,167	
(d) **Revenue Profits :**		Profit & Loss Account	**25,416**	22,874	2,542
	Less :	Capital Item include in Revenue		15,630	
(e) **Proposed Dividend**			**1,20,000**	1,08,000	12,000
		Minority Interest			**92,000**

5. Consolidation of Reserves & Surplus

	Particulars		Rs.
	Cost of Investment in Equity Shares of P Ltd.		5,30,000
Less :	Pre-acquisition Dividend		(65,000)
	Adjusted Cost of Investment		
Less :	(1) Nominal Value of Equity Capital	5,40,000	4,65,000
	(2) Share in Capital Profit of P Ltd.	1,30,203	6,70,203
	Capital Reserve on Consolidation		**(2,05,203)**

6. Computation of Pre-acquisition Dividend

Particulars	Pre-Acquisition Dividend	Post Acquisition Dividend
Lot 1 - 60% - Acqd. on 30.6.2008	1,20,000 × 6/12 × 60% = Rs. 36,000	1,20,000 × 6 / 12 × 60% = Rs. 36,000
Lot 2 - 80% - 01.07.08 to 30.09.08	1,20,000 × 3/12 × 80% = Rs. 24,000	1,20,000 × 3 / 12 × 20% = Rs. 6,000
Lot 3 - 90% - 30.09.08 to 30.11.08	1,20,000 × 2/12 × 90% = Rs. 18,000	1,20,000 × 1 / 12 × 10% = Rs. 1,000
Total	**Rs. 65,000**	**Rs. 43,000**

7. Consolidation of Reserves and Surplus

	Particulars		P&L A/c	Gen. Res.
	Balance as per Balance Sheet of Z Ltd.		2,00,000	4,00,000
Add :	Proposed Dividend from P Ltd.		43,000	—
Add :	Share of Revenue Profits / Reserves of P Ltd.		15,630	34,167
Less :	Unrealized Profit on Machinery sold Profit on Sale of Machinery	1,00,000		
Less :	Depreciation on Profit (1,00,000 × 20% × 3.5 / 12)		**1,64,463**	**4,34,167**

8. Consolidated Balance Sheet of Z Ltd. and its subsidiary P Ltd. as at 31.12.2008

Liabilities	Rs.	Assets	Rs.
Share Capital : Equity Share Capital	10,00,000	**Fixed Assets :** (12,00,000+8,00,000 - Unrealised Profits 94,167)	19,05,833
Reserves and Surplus		**Investments**	
– General Reserve	4,34,167	(6,00,000 – 5,30,000 – 2,00,000)	2,70,000
– Profit & Loss Account	1,64,463	**Current Assets**	
– Capital Reserve on Consolidation	2,05,203	Sundry Debtors (3,00,000 – 2,00,000)	5,00,000
Minority Interest :	92,000	Stock in Trade (4,00,00 + 3,00,000)	7,00,000
Loan Funds : (3,00,000 + 4,00,000)	7,00,000	Cash at Bank (1,00,000 + 1,00,000)	2,00,000
Current Liabilities :			
Sundry Creditors (4,00,000 + 2,00,000)	6,00,000		
Provision for tax (1,00,000 + 80,000)	1,80,000		
Proposed Dividend (Hema Ltd.)	2,00,000		
Total	**35,75,833**	**Total**	**35,75,833**

Note : Unrealised Profit on Sale of Machinery has been eliminated fully Group Reserves as it relates to Downstream Activity (i.e. Holding to Subsidiary).

Q. 33. From the following Profit and Loss Account of Kalyani Ltd., prepare a Gross Value Added Statement. Show also the reconciliation between Gross Value Added and Profit before Taxation.

Profit and Loss Account for the year ended 31st March, 2009

Income

	Notes	Amount	
		(Rs. in lakhs)	**(Rs.in lakhs)**
Sales			**206.42**
Other Income			**10.20**
			216.62
Expenditure			
Production and Operational Expenses	**1**	**166.57**	
Administration Expenses	**2**	**6.12**	
Interest and Other Charges	**3**	**8.00**	
Depreciation		**5.69**	**186.38**
Profit before Taxes			**30.24**
Provision for taxes			**3.00**
			27.24
Investment Allowance Reserve Written Back			**0.46**
Balance as per Last Balance Sheet			**1.35**
			29.05
Transferred to:			
General Reserve		**24.30**	
Proposed Dividend		**3.00**	**27.30**
Surplus Carried to Balance Sheet		**1.75**	
		29.05	

Notes:

(1) Production and Operational Expenses

		(Rs.in lakhs)
Increase in Stock		**30.50**
Consumption of Raw Materials		**80.57**
Consumption of Stores+		**5.30**
Salaries, Wages, Bonus and Other Benefits	**12.80**	
Cess and Local Taxes		**3.20**
Other Manufacturing Expenses		**34.20**
		166.57

(2) Administration expenses include inter-alia Audit fees of Rs. 1 lakh, Salaries and commission to directors Rs. 2.20 lakhs and Provision for doubtful debts Rs. 2.50 lakhs.

(3) Interest and Other Charges:

	(Rs.in lakhs)
On Fixed Loans from Financial Institutions	**3.90**
Debentures	**1.80**
On Working Capital Loans from Bank	**2.30**
	8.00

Answer 33.

Kalyani Ltd.

Value Added Statement for the year ended 31st March, 2009

	Rs. in lakhs	Rs. in lakhs	%
Sales		206.42	
Less: Cost of bought in material and services:			
Production and operational expenses	150.57		
Administration expenses	3.92		
Interest on working capital loans	2.30	156.79	
Value Added by manufacturing and trading activities		49.63	
Add: Other income		10.20	
Total Value Added		59.83	

Application of Value Added :

To Pay Employees:			
Salaries, Wages, Bonus and other benefits		12.80	21.39
To Pay Directors:			
Salaries and Commission		2.20	3.68
To Pay Government:			
Cess and Local Taxes	3.20		
Income Tax	3.00	6.20	10.36
To Pay Providers of Capital:			
Interest on Debentures	1.80		
Interest on Fixed Loans	3.90		
Dividend	3.00		
		8.70	14.54
To Provide for maintenance and Expansion of the company:			
Depreciation	5.69		
General Reserve (24.30 – 0.46)	23.84		
Retained profit (1.75 – 1.35)	0.40	29.93	50.03
		59.83	100.00

Reconciliation between Total Value Added and Profit Before Taxation:

		(Rs. in lakhs)	(Rs. in lakhs)
Profit before tax			30.24
Add back:			
Depreciation		5.69	
Salaries, Wages, Bonus and other benefits		12.80	
Directors' Remuneration	2.20		
Cess and Local Taxes	3.20		
Interest on Debentures	1.80		
Interest on Fixed Loans	3.90		29.59
Total Value Added			59.83

Q. 34. From the following Profit and Loss Account of X Limited, prepare Gross Value Added Statement and show the reconciliation between Gross Value Added and Profit before taxation: Profit and Loss Account for the year ended 31st March, 2009

Income	(Rs. in lakhs)	(Rs. in lakhs)
Sales		800
Other Income		50
		850
Expenditure		
Production and Operational Expenses	600	
Administrative Expenses	30	
Interest and Other Charges	30	
Depreciation	20	680
Profit before taxes		170
Provision for taxes		30
		140
Balance as per last Balance Sheet		10
		150
Transferred to:		
General Reserve		80
Proposed Dividend		20
Surplus carried to Balance Sheet		50
		150

Break-up of some of the Expenditure is as follows:

Production and Operational Expenses:	
Consumption of Raw Materials and Stores	320
Salaries, Wages and Bonus	60
Cess and Local Taxes	20
Other Manufacturing Expenses	200
	600
Administrative Expenses:	
Audit Fee	6
Salaries and Commission to Directors	8
Provision for Doubtful Debts	6
Other Expenses	10
	30
Interest and other Charges:	
On Working Capital Loans from Bank	10
On Fixed Loans from ICICI	15
On Debentures	5
	30

Answer 34.

X Limited

Gross Value Added Statement for the year ended 31st March, 2009

			Rs. in lakhs	Rs. in lakhs
Sales				
Less: Cost of bought in material or services:				800
Production and Operational Expenses (320 + 200)			520	
Administrative Expenses (6 + 6 +10)			22	
Interest on working capital loans			10	552
Value added by manufacturing and trading activities				248
Add: Other Income				50
Total Value Added				298
Application of Value Added:				
To	Pay Employees:			%
	Salaries, Wages and Bonus		60	20.14
To	Pay Directors:			
	Salaries and Commission		8	2.68
To	Pay Government:			
	Cess and Local taxes	20		
	Income Tax	30	50	16.78
To	Pay Providers of Capital:			
	Interest on Debentures	5		
	Interest on Fixed Loans	15		
	Dividend	20	40	13.42
To	Provide for Maintenance and Expansion			
	of the Company: Depreciation	20		
	General Reserve	80		
	Retained Profit (50 – 10)	40	140	46.98
			298	100.00

Reconciliation between Gross Value Added and Profit before Taxation

	Rs. in lakhs	Rs. in lakhs
Profit before tax		170
Add back:		
Depreciation	20	
Salaries, Wages and Bonus	60	
Directors' Remuneration	8	
Cess and Local Taxes	20	

Interest on Debentures	5	
Interest on Fixed Loans	15	128
Total Value Added		298

Q. 35. What are the advantages of preparation of Value Added (VA) statements?

Answer 35.

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

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. 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.
4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour–intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

Q. 36. (a) Explain the concept of 'Economic value added' (EVA for short) and its uses.

(b) What is economic value added and how is it calculated? Discuss.

Answer 36.

(a) Economic Value Added (EVA) for short, is primarily a benchmark to measure earnings efficiency. Though the term "Economic Profit" was very much there since the inception of "Economics", Stern Stewart & Co., of USA has got a registered Trade Mark for this by the name "EVA", an acronym for Economic Value Added.

EVA as a residual income measure of financial performance, is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

In addition, EVA is a management tool to focus managers on the impact of their decisions in increasing shareholders' wealth. These include both strategic decisions such as what investments to make, which businesses to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholder wealth is to integrate the EVA framework in four key areas; to measure business performance; to guide managerial decision making; to align managerial incentives with shareholders' interests; and to improve the financial and business literacy throughout the organisation.

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

(b) 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, equity as well as debt, used in the business.

Mathematically EVA= OPBT - Tax - (TCE × COC)

Where :

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

To better align managers interests with shareholders' - the EVA framework needs to be holistically applied in an integrated approach - simply measuring EVA is not enough; it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

However, EVA as a strategic tool has the following limitations:

1. Not easy to use; too complicated for small businesses.
2. Recommends inexpensive debts in order to reduce the cost of capital.
3. A passive tool, measures past performance.

Q. 37. The following information is available of a concern; calculate E.V.A :

Debt capital 12%	Rs. 2,000 crores
Equity capital	Rs. 500 crores
Reserve and surplus	Rs. 7,500 crores
Capital employed	Rs. 10,000 crores
Risk-free rate	9%
Beta factor	1.05
Market rate of return	19%
Equity (market) risk premium	10%
Operating profit after tax	Rs.2,100 crores
Tax rate	30%

Answer 37.

E.V.A. = NOPAT – COCE
NOPAT = Net Operating Profit after Tax
COCE = Cost of Capital Employed
COCE = Weighted Average Cost Of Capital ´ Average Capital Employed
= WACC ´ Capital Employed

Debt Capital		Rs.2,000 crores
Equity capital 500 + 7,500	=	Rs.8,000 crores
Capital employed	=	2,000+8,000 = Rs.10,000 crores
Debt to capital employed	=	$\frac{2,000}{10,000} = 0.20$
Equity to Capital employed	=	$\frac{8,000}{10,000} = 0.80$

Debt cost before Tax		12%
Less:	Tax (30% of 12%)	3.6%
Debt cost after Tax		8.4%

According to Capital Asset Pricing Model (CAPM)

Cost of Equity Capital = Risk Free Rate + Beta ´ Equity Risk Premium
Or
= Risk Free Rate + Beta (Market Rate – Risk Free Rate)
= 9 + 1.05 × (19-9)
= 9 + 1.05 × 10 = 19.5%

WACC = Equity to CE x Cost of Equity capital + Debt to CE x Cost of debt
= 0.8×19.5% + 0.20× 8.40%
= 15.60% + 1.68% = 17.28%

COCE = WACC × Capital employed
= 17.28% × 10,000 crores = 1728 crores

E.V.A. = NOPAT – COCE
= Rs. 2,100 – Rs. 1,728 = Rs. 372 crores

Q. 38. (a) "The content of corporate social report is essentially based on social objectives." Discuss.

(b) Enumerate the major heads identified for corporate social reporting purposes.

(c) Write short note on Corporate Social Reporting.

Answer 38.

(a) The content of Corporate Social Report is essentially based on the social objectives. Brummet identified five areas wherein social objectives can be traced out, namely, Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

In view of the social objectives, the importance of earning objective is not understated, rather attainment of social objectives is dependent on earning objective. A sick business entity becomes liability to the society and sustains social costs instead of generating social benefits.

Human Resource Contribution is the indicator of the impact of organisational activities (viz. pay and allowances, perks and incentives, recruitment, training and development, placement, promotion and transfer, welfare measure, etc.) on people of the organisation. Public Contribution is the indicator of general philanthropy in the cultural and social welfare programmes and contribution to national exchequer by way of tax and duties.

Industrial activity is supposed to consume irreplaceable resources and produces solid wastes. By this process it pollutes air and water, causes noise and spoils the environment. These are termed as negative social effects. The corporate social objective is the abatement of such negative effect. It is covered by environmental contribution.

Lastly, the Product or Service Contribution covers the qualitative aspects of the organisation's product or service. It includes quality guarantee, redressal of customers' grievances, honest exposure in advertisement etc.

Although Brummet covered wide range of objectives, still these are not essentially exhaustive. Social objectives are determined by socio-economic conditions of a country. It is difficult to set universal list of social objectives to be pursued by the corporate sector. For example, in India, regional imbalance, unemployment, reservation for weaker sections of the population, scarcity of foreign exchange, energy deficit, population pressure and illiteracy are some of the widely accepted socio-economic problems. And obviously the general expectation is that the corporate sector will positively contribute to such socio-economic problems. Since the socio-economic problems of a country change over time or the priority attached to a problem shifts. Brummet's over simplified set of contributions should be suitably moulded to fit in the perspective of socio-economic problems of a country.

(b) Considering the major socio-economic problems of the country, eight major heads may be identified for Social Reporting purposes:

I. Employment Opportunities.
II. Foreign Exchange Transactions
III. Energy Conservation.
IV. Research and Development.
V. Contribution to Government Exchequer.
VI. Social Projects
VII. Environmental Control.
VIII. Consumerism.

I. Creation of employment opportunities during the year may be classified into opportunities in India and opportunities abroad. In India employment may be created either by expansion/ diversification in backward or other areas. However, employment protection by absorption of sick units may also be treated as employment opportunities. Moreover, the corporate enterprise may create new openings abroad by adopting foreign projects. In all such cases, quantitative information needs to be disclosed giving break-up of SC/ST persons, physically handicapped persons, women and other workers appointed during the year. Tax advantage or subsidy received for establishing industrial units in backward areas or absorption of sick units should be disclosed properly. If the corporate enterprise follows human resource accounting system, it may show human assets created during the year and costs incurred for such purpose.

II. In view of the scanty foreign exchange reserve, it is desirable to disclose foreign exchange transactions in details. Foreign exchange inflows occur by exports or earnings from foreign

projects. Also saving in foreign exchange is equivalent to foreign exchange inflows. An enterprise can save foreign exchange by import substitution and replacement of foreign technology/ technician. Foreign exchange outflows are caused by purchase of' raw materials/spares, plant and machinery capital repayment, payment of dividend and interest. It is desirable to report inflows and outflows for each currency separately and a summary statement in Indian currency. Any tax advantage/export subsidy received for foreign exchange earnings should be disclosed as an item of social cost.

III. Energy purchased/generated and energy consumed per unit of standard product are to be reported along with consumption norm of the industry. Energy Audit Reports prepared by BICP may be followed for industry norms wherever applicable. Positive/negative variation in energy consumption should be reported along with reasons therefor.

IV. Recurring/non-recurring cost incurred for research and development is to be reported along with results. If possible, effect of research and development activities may be quantified in terms of cost saved/profit added. Any tax advantage/subsidy received is to be reported as social cost incurred along with the generation of social benefits from research and development.

V. Contribution to Government exchequer by way of sales tax, income tax, excise, custom and other duties needs to be reported as an item of social benefits.

VI. Contribution to social projects may be further classified into direct involvement of corporate enterprise and donations to different organisations. Social projects like construction of road, establishment of school, college, research institute, hospital, stadium, etc. may be earmarked alongwith the categories of beneficiaries and cost involved.

In case of donation to any organisation, the nature of the organisation may be stated along with the tax advantage received by way of such donations.

(Contribution of the corporate enterprise for development of sports and games, cultural matters and self-employment programmes may be reported as creation of social benefit).

VII. Negative social effect caused by the corporate enterprise may be quantified stating use of irreplaceable resources and nature of pollution caused. Action taken and cost involved for pollution control should be reported as an item of social benefit.

VIII. Failures in terms of complaints received against improper quality, poor service etc. may be reported under social costs. Action taken and cost involved for undertaking quality control and customers' service should be reported under social benefits.

(c) Corporate Social Reporting is the information communique with respect to discharge of social responsibilities of corporate entity. The transition in accounting function from historical cost based profitability accounting to social responsibility accounting is a good fit to the present-day data requirement of the "Users of accounts".

The content of Corporate Social Report is essentially based on the social objectives, namely Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

Considering the major socio-economic problems of the country, eight major heads can be identified for social reporting purpose:

(i) Employment Opportunities;

(ii) Foreign Exchange Transactions;

(iii) Energy Conservation;

(iv) Research and Development;

(v) Contribution to Government Exchequer;

(vi) Social Projects;

(vii) Environmental Control;

(viii) Consumerism.

Initially, it is difficult to express social costs incurred by a corporate enterprise and social benefits generated in money terms. Until suitable methodologies are available for conversion of social cost-benefit in money terms, it is desirable to begin with descriptive social report. Further research is necessary in this area either to improve heads of corporate social reporting in the context of dynamic socio-economic environment.

Q. 39. Write short notes on :

(a) Jaggi and Lau model on valuation on group basis of Human Resources.

(b) Opportunity cost (HRA).

(c) Human Resource Accounting.

Answer 39.

(a) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees 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 but 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 attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process, they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

(b) **Opportunity Cost:** It is one of the Economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.

(c) Human Resource Accounting (HRA) is an attempt to identify, quantify and report investments made in human resources of an organization. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information. Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resource. Human resources are not thus recognized as 'assets' in

the Balance Sheet. While investments in human resources are not considered as assets and not amortised over the economic service life, the result is that the income and expenditure statement comprising current revenue and expenditure gives a distorted picture of the real affairs of the organization.

Accountants have been severely criticized by the Behavioural Scientists for their failure to value human resources, as this has come out as a handicap for effective management.

Human resource accounting provides scope for planning and decision making in relation to proper manpower planning. Also, such accounting can bring out the effect of various new rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes and laws.

Q. 40. Prepare a segmental report for publication in Glorified Ltd. from the following details of the company's three divisions and the head office :

	Rs. ('000)
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
	10,800
Bright Bar Division	
Sales to Fitting Division	45
Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	**Head Office Rs. ('000)**	**Forging Shop Division Rs. ('000)**	**Bright Bar Division Rs. ('000)**	**Fitting Division Rs. ('000)**
Pre-tax operating result		240	30	(12)
Head office cost reallocated		72	36	36
Interest costs		6	8	2
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

Answer 40.

Glorified Ltd.
Segmental Report

(Rs.'000)

Particulars	Divisions Forging shop	Bright Bar	Fitting	Inter Segment Eliminations	Consolidated Total
Segment revenue					
Sales:					
Domestic	90	—	—	—	90
Export	6,135	300	270	—	6,705
External Sales	6,225	300	270	—	6,795
Inter-segment sales	4,575	45	—	4,620	—
Total revenue	10,800	345	270	4,620	6,795
Segment result (given)	240	30	(12)		258
Head office expenses					(144)
Operating profit					114
Interest expense					(16)
Profit before tax					98
Information in relation to assets and liabilities:					
Fixed assets	300	60	180	—	540
Net current assets	180	60	135	—	375
Segment assets	480	120	315	—	915
Unallocated corporate assets (75+72)	—	—	—	—	147
Total assets					1,062
Segment liabilities	30	15	180	—	225
Unallocated corporate liabilities					57
Total liabilities					282

Sales Revenue by Geographical Market

(Rs.'000)

	Home Sales	Export Sales (by forging shop division)	Export to Rwanda	Export to Maldives	Consolidated Total
External sales	90	6,135	300	270	6,795

Q. 41. (a) What are derivatives and what are its characteristics?

(b) Explain currency options related to foreign exchange.

(c) Write short note on Interest Rate Swaps.

Answer 41.

(a) Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index or reference rate), in a contracted manner. The underlying asset can be equity, forex, commodity or any other asset. For example, farmers may wish to sell their harvest of wheat at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of the derivative is driven by the spot price of wheat which is the "underlying asset".

Derivative financial instruments can either be on the balance-sheet or off the balance sheet and include options contract, interest rate swaps, interest rate flows, interest rate collars, forward contracts, futures etc. A derivative instrument is therefore a financial instrument or other contract with the following three characteristics:

(i) It has one or more underlying and one or more notional amounts or payments provisions or both. These terms determine the amount of settlement or settlements and in some cases, whether or not settlement is required;

(ii) It requires no initial net investment or an initial net investment that is smaller than what is required for similar responses to changes in market factors.

(iii) Its terms require or permit net settlement; it can readily be settled net by means outside the contract or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Accounting for foreign exchange derivatives is guided by AS 11 (Revised 2003). The ICAI has also issued a Guidance Note dealing with the accounting procedures to be adopted while accounting for Equity Index Options and Equity Stock Options.

(b) Currency Options give the client the right, but not the obligation, to buy/sell a specific amount of currency at a specific price on a specific date. Currency options provide a tool for hedging foreign exchange risk arising out of the firm's operations. Currency options enable the business house to remove downside risk without limiting the upride potential. Options can be put option or call option. A put option is a contract that specifies the currency that the holder has the right to sell. A call option is a contract that specifies the currency that the holder has the right to buy.

(c) Interest rate swap can be defined as a financial contract between two parties (called counter parties) to exchange on a particular date in the future, one series of cash flows (fixed interest) for another series of cash flows (variable or floating interest) in the same currency on the same principal (an agreed amount called notional principal) for an agreed period of time. The contract will specify the interest rates, the benchmark rate to be followed, the notional principal amount for the transaction, etc. Interest rates are of two types, fixed interest rates and floating rates which vary according to changes in a standard benchmark interest rate. An investor holding a security which pays a floating interest rate is exposed to interest rate risk. The investor can manage this risk by entering into an interest rate swap.

Q. 42. On 24th January, 2009 Chinnaswamy of Chennai sold goods to Watson of Washington, U.S.A. for an invoice price of $40,000 when the spot market rate was Rs.44.20 per US $. Payment was to be received after three months on 24th April, 2009. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, Chinnnaswamy immediately acquired a forward contract to sell on 24th April, 2009 US $ 40,000 @ Rs. 43.70. Chinnaswamy closed his books of

account on 31st March, 2009 when the spot rate was Rs. 43.20 per US $. On 24th April, 2009, the date of receipt of money by Chinnaswamy, the spot rate was Rs. 42.70 per US $.

Pass journal entries in the books of Chinnaswamy to record the effect of all the above mentioned effects.

Answer 42.

Journal Entries in the books of Chinnaswamy

2009			Rs.	Rs.
Jan. 24	Watson	Dr.	17,68,000	
	To Sales Account			17,68,000
	(Credit sales made to Watson of Washington, USA for $40,000 recorded at spot market rate of Rs. 44.20 per US $)			
" "	Forward (Rs) Contract Receivable Account	Dr.	17,48,000	
	Deferred Discount Account	Dr.	20,000	
	To Forward ($) Contract Payable			17,68,000
	(Forward contract acquired to sell on 24th April, 2009 US $40,000 @ Rs.43.70)			
March 31	Exchange Loss Account	Dr.	40,000	
	To Watson			40,000
	(Record of exchange loss @ Re.1 per $ due to market rate becoming Rs.43.20 per US $ rather than Rs.44.20 per US $)			
" "	Forward ($) Contract Payable	Dr.	40,000	
	To Exchange Gain Account			40,000
	(Decrease in liability on forward contract due to fall in exchange rate)			
" "	Discount Account	Dr.	14,667	
	To Deferred Discount Account			14,667
	(Record of proportionate discount expense for 66 days out of 90 days)			

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
April 24	Bank Account Exchange Loss Account To Watson (Receipt of $40,000 from Watson, USA customer @ Rs.42.70 per US $; exchange loss being Rs.20,000)	Dr. Dr.	17,08,000 20,000	 17,28,000
" "	Forward ($) Contract Payable Account To Exchange Gain Account To Bank Account (Settlement of forward contract by payment of $40,000)	Dr.	17,28,000	 20,000 17,08,000
" "	Bank Account To Forward (Rs.) Contract Receivable (Receipt of cash in settlement of forward contract receivable)	Dr.	17,48,000	 17,48,000
" "	Discount Account To Deferred Discount Acount (Recording of discount expense for 24 days: $\text{Rs. } 20{,}000 \times \frac{24 \text{ days}}{90 \text{ days}} = \text{Rs. } 5{,}333$	Dr.	5,333	 5,333

Q. 43. Write a short notes on:

(a) Accounting issues involved in Environmental Accounting.

(b) Environmental Accounting.

Answer 43.

(a) Major accounting issues involved in environmental accounting can be explained as follows:

(i) Distinction between environmental expenditure and normal business expenditure: Many new machines may incorporate state-of-the-art environmental technology and accordingly, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. It is necessary to frame guidelines indicating whether the reporting entity should properly allocate the capital and revenue expenditures between environmental expenditure and normal business expenditure.

(ii) Capitalisation of environmental expenditures vis-a-vis expensing them during the current accounting period: Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is recoursed to and/or persuaded to follow environmental accounting, the adverse impact in EPS is a major concern. Accordingly many Western Corporations prefer to capitalise environment costs instead of immediate expensing and adopt an amortisation policy extending upto 10 years. Although this accounting practice has no theoretical support and rather contradicts the well established accounting concept of "prudence", it is considered as a practical solution to off-load burden of accumulated environmental costs without abruptly disturbing the cash flows attributable to the lenders, Government and finally to the shareholders. However, recognition of environmental

costs should not necessarily be restricted to the expenses accrued in view of the applicable environmental laws. It should be guided by ethical consideration.

(iii) Recognition of environment related contingent liabilities: Environmental contingent liabilities are a matter of increasing concern throughout the world. Recognising a liability of hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably.

In fact, identification and measurement of contingent liabilities are highly debatable accounting aspects. The United Nations Conference on Environment and Development (UNCTAD) papers raise the basic question why environmental contingencies should not be merged with other business contingencies. There is an urgent need for tightening the reporting rules on contingencies incorporating specific requirements for disclosure of environmental contingencies along with other contingencies.

(b) The term 'environment' includes everything in all its manifest forms, on the earth, beneath the earth and above the earth. A business enterprise takes support of social and ecological system in order to maximize wealth. Economic activity, social welfare and a diverse environment, all are linked and ultimately depend on each other. The functioning of an enterprise may have some favourable and some adverse effects on the environment. Hence, it is felt that there is a need for maintaining accounts of the effects of activities of business entity on the environment. Environmental accounting can be defined as a system (methodology) for measuring environmental performance and communicating the results of these measurements to users. It helps in presenting the utilization of natural resources by an enterprise, the costs incurred to use them and the income earned therefrom in a transparent manner. Environmental accounting, entirely a new concept, is a faithful attempt to identify the resources exhausted and the costs rendered reciprocally to the enterprise by a business corporation. Thus environmental accounting stands for recording and documenting environmental performance to facilitate effectiveness of environmental management system with reference to compliance, safety and quality control. It provides a data base for taking corrective steps and future action for developing organisation's environmental strategy and for identifying environmentally based opportunities for gaining an edge over one's competitors. If proper environmental accounting system is established, the enterprise will be able to anticipate environmental damage and therefore can prevent it from happening.

Of course environmental accounting is still in an early stage of evolution and it is being groomed under the voluntary leadership of a variety of enterprises around the world. Recognising the importance of protecting and preserving the environment, a number of laws have been enacted throughout the world.

Q. 44. Explain the concept of fund theory and fund based accounting.

Answer 44.

Fund theory and fund based accounting: Although, the profit motive is the driving force for any business entity, there are certain organisations which are run without profit motive. Such organisations may be governmental institutions or any non-profit institutions like colleges, universities, charitable hospitals etc. The accounting for these not-for profit entities is primarily based on the fund theory. The fund theory is based on the equation - Assets = Restrictions on assets. Assets represent prospective services to the fund and liabilities represent restrictions against the assets of the fund. For example, in case of a university, the most commonly used specific funds are endowment funds, development funds etc. Each of these funds has its specific assets restricted for particular purposes. Under the fund theory, the balance sheet is considered an 'inventory statement' of assets and those restrictions applicable to the assets. Revenues represent an increase in assets into the fund that are completely free of equity restrictions other than the final restriction imposed by the residual equity. The residual equity represents a final restriction on the

assets and establishes the equality of assets and equities. Expenses represent the release of services for designated purposes specified in the objective of the fund. Thus, the fund theory calls for fund based accounting rather than entity based accounting.

A fund may be defined as an accounting entity "with a self balancing set of accounts regarding cash and/ or other resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations". Thus, every fund is aimed at fulfilling some purpose and the services embodied in the assets are the primary means to achieve that purpose. Fund based accounting essentially involves preparation of financial statements fundwise and consolidation of those statements to represent the financial results/position of the organisation as a whole.

Q. 45. What are the special features of accounting for Educational Institutions?

Answer 45.

Special Features of Accounting for Educational Institutions: An educational institution is generally not run for profit. Its, administrators, as custodians of public funds, are accountable of their proper expenditure for educational purpose. The marked difference between commercial accounting and that for educational institutions is that the former places emphasis on proper ascertainment of profits, while the latter is more generally concerned with exercising control over expenditure so as to conform to the stipulated norms and to the academic objectives of the institution to which it relates.

In the case of institutions like colleges and universities, separate ledgers are maintained for each fund. Funds may be broadly classified into two categories - Revenue Funds and Specific Funds. Revenue Funds may be further classified as Unrestricted Fund and Restricted Fund. Specific Funds are Endowment Funds, Annuity and Life Income Funds, Development Funds etc. Separate balance sheet is prepared for each fund and a statement of activity (popularly known, as Income and Expenditure Account) is prepared for only revenue funds- both restricted and unrestricted. Finally, each individual balance sheet is consolidated to get a general balance sheet of the institution as a whole.

Revenue Funds- Restricted and Unrestricted: Revenue funds essentially record normal revenue transactions. However, the use of revenue fund may be restricted or unrestricted. In the case of restricted funds, income is recognised to the extent of expenditure incurred. The accounting basis of the unrestricted fund is the accrual method as used for commercial entities.

There may be transfers out of revenue funds to specific funds and vice-versa. Some transfers are mandatory and some are non-mandatory.

Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds.

Specific Funds: Specific funds are earmarked for well defined purposes. Contributions and transfers arc directly credited to respective fund balances. Expendable resources are transferred to revenue funds except for capital outlay and debt retirement which are accounted for in development or asset fund and loan fund respectively. For the specific funds no statement of income is prepared.

However a statement is prepared showing the movements in fund balances. The features of certain important specific funds are dis-cussed below.

(a) **Endowment Funds :** Incomes from these funds usually are transferred to another fund where it may be expended. Interest revenue out of such fund is accrued at the end of accounting year. The fund is usually invested in some securities and such invest-ment is valued at cost price. If the income out of such investment is available for unrestricted purposes it is recognised in the unrestricted fund. On the other hand if the income is to be used for some specific purpose it is transferred to that specific fund. The only time, the investment income is recognised in the endowment fund is when the terms of agreement specify that the income must be added to the endow-ment principal.

(b) **Loan Funds:** Loan funds account for resources that may be loaned to faculty or staff. No revenue or expense accounts are used in the loan fund. All transactions affecting fund balance are recorded directly to fund balance. Interest on loan is credited to the fund balance on accrual basis. Investment income is also accrued. Administra-tion and collection costs relating to granting and recovery of loans are directly charged to this fund. Any bad debt or provision for doubtful loans are also charged to this fund.

(c) **Annuity and Life Income Funds:** These funds account for resources that are given to a not for profit organisation provided that the organisation agrees to make periodic payments to a designated recipient. In the case of annuity funds, the amount of periodic payment is fixed whereas payments vary with the amount of income earned in the case of life income funds.

(d) **Development Funds:** These funds are utilised for developmental purposes like ac-quisition of building and equipments, major repairs to fixed assets etc. Separate fund may be maintained for each developmental activity. Alternatively a combined development fund may be maintained to account for all acquisitions and/or construc-tion of fixed assets. Any expenditure incurred for the purpose of construction or acquisition of building, laboratory etc. are met out of this fund and the asset is recognised in the general balance sheet. Consequently that portion of the fund which has been utilised for the acquisition or construction of the asset should be transferred to unrestricted fund. Depreciation on these fixed assets should be shown as part of operating expenses of unrestricted revenue fund.

To sum up the following statements are to be prepared to get a consolidated picture the organisation as a whole :

(a) Income and Expenditure Account for revenue funds.

(b) Statement showing changes in fund balances.

(c) Balance Sheet of individual funds.

(d) General Balance Sheet.

Q. 46. A University receives two grants % one from the Ministry of Human Resources to be used for Aids Research. This grant is for Rs. 45,00,000, which includes Rs. 3,00,000 to cover indirect expenses incurred in administering the grant. The second grant of Rs. 35,00,000 received from a reputed Trust is to be used to set up a centre to conduct seminars on Aids related matters from time to time. During the year, it also received Rs. 5,00,000 worth of equipment donated by a well wisher to be used for Aids research. During the year 2007-2002, the University spent Rs. 32,25,000 of the government grant and incurred Rs. 3,00,000 overhead expenses. Rs. 28,00,000 were spent from the grant received from the Trust. Show the necessary Journal Entries.

Answer 46.

Journal Entries

		Dr. Rs.	Cr Rs.
(i)	Bank A/c Dr. To Revenue Fund (Restricted) A/c (To record grants received from the Government Department and Private organisation)	80,00,000	 80,00,000
(ii)	Expenses A/c Dr. To Bank A/c (To account for Rs.32,25,000 spent from out of Government grant and Rs.28,00,000 from out of Private grant)	60,25,000	 60,25,000
(iii)	Equipment A/c Dr. To Restricted Revenue Fund A/c (To record the receipt of donation of assets from a well wisher)	5,00,000	 5,00,000
(iv)	Revenue Fund (Restricted) A/c Dr. To Income (Govt. grant) A/c To Income (Private grant) A/c (To recognise revenue)	60,25,000	 32,25,000 28,00,000
(v)	Revenue Fund (Restricted) A/c Dr. To Bank A/c (To account for overhead expenses incurred)	3,00,000	 3,00,000

Note: Actually, the expenses are incurred in unrestricted revenue fund and reimbursed to the above.

Q. 47. Compare as per IGAAP-USGAAP-IFRS

(a) Balance Sheet

(b) Income Statement

Answer 47.

The comparative analysis of IGAAP-USGAAP-IFRS.

(a) Balance Sheet

Basis of Difference	IFRS	USGAAP	IGAAP
Format	IFRS does not prescribe any format, but stipulates minimum line items like PPE, Investment property, Intangible assets, Financial assets, Biological assets, inventory, receivables, etc.	US GAAP also doesnot prescribe any format , but Rule S-X of SEC stipulates for listed companies minimum line items to be disclosed either on face of Balance sheet or Notes to Accounts.	IGAAP provides two format of Balance Sheet- Horizontaland Vertical format (Part I ofschedule VI to the Companies Act, 1956).
Order	Under IFRS, lineitems are presented in increasing order of liquidity.	Under US GAAP,items in assets and liabilities are presented in decreasing order of liquidity.	In IGAAP, line items are presented in increasing order of liquidity.
Consolidation	Consolidation of Financial statements of subsidiaries is not compulsory until it is required under some other law or regulation.	Under US GAAP con-solidation of results of Subsidiariesand Variable interestentity (FIN 46R) is compulsory.	It is not mandatory for companies to prepare CFS under AS 21. However, listed enterprises are mandatorily required by listing agreement of SEBI to prepare and present CFS.
Current/Non-Current	An organisation hasan option to adopt Current or Noncurrent classi-fication of assets and liabilities	Bifurcation into current & non-current items is cumpulsorily required.	No such requirement

(b) Income Statement

Basis of Difference	IFRS	USGAAP	IGAAP
Format	IFRS does not prescribe any standard format for income statement but prescribes minimum disclosure includes revenue, finance costs, share of posttax results of JV andassociates usingequity method.	There is no prescribed format, SEC guidelines Rule S-X prescribe minimum line items to be shown on the fac of income statement & suggest 2 alternatives a) a single step format where expenses are classified by function and b) a Multiple step format where Cost of sales is deducted from sales	Under Indian GAAP no format is prescribed, but minimum line items have been specified in Part II of schedule VI to Companies Act, 1956 including Aggregate Turnover, Gross Service revenue for Commission paid to Sole selling agent, Brokerage and discount on sales etc.
Prior Period Items	A prior period item/error should be corrected by retro-spective effect by restatement of opening balance of assets, liabilities or equities	Mandates retrospective application of errorand requiresre statement of comparative opening balance with suitable footnote disclosure.	Requires separate dis-closure of prior period inthe current financial statement & no restate-ment of retained earnings arerequired.
Discounting	IFRS provides that where the inflow of cash is significantly deferred without interest, discounting is needed.	US GAAP also permits discounting in certain cases for instance discounting is done incase of loans, debentures, bonds and upfront fees	There is no concept of discounting under IGAAP.
Change in accounting policy	IFRS requires retro-active application for the earliest period practical and adjust-ment of opening retained earning.	Requires prospective application of change in accounting policy and proforma disclosure of effect on income before extraordinary items on the face of income statement as separate section. Only inspecific case retro-spective is applicable	Under IGAAP, effect for change in accounting policy is given with prospective effect, if the same is material.
Bifurcation of Cost	There is no specific provision in this regard	Total cost is required to be shown separately under : a) Cost of Sales b) Selling and Administration c) R & D	There is no specific provision in this regard. There are certain disclosure requirements under varied A Swhich should be complied.

Basis of Difference	IFRS	USGAAP	IGAAP
Extra ordinary Events	Disclosure isprohibited	Nature should be both : a) Infrequent b) Unusual Disclosed separatelyon the face of Income Statement net of Taxes after results from operations	Distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. The nature and the amount of each extra ordinary item should be separately disclosed in the statement of P & L in a manner that it simpact on current profit or loss can be perceived.

Q. 48. Compare as per IFRS-USGAAP-IGAAP

(a) Cash Flow Statement
(b) Dividend on Equity Shares
(c) Investments
(d) Impairment of Assets
(e) Business Combinations
(f) Internally Generated Internal Assets

Answer: 48.

(a) CASH FLOW STATEMENT

Basis of Difference	IFRS	USGAAP	IGAAP
Exemptions	No exemptions	Limited exemptions for certain investment entities	Unlisted enterprises, enterprises with a turnover less than Rs. 500 million and those with borrowings less than Rs. 100 million
Direct/Indirect Method	Both allowed	Both allowed	Both allowed. Listed companies-Indirect method Insurance companies-Direct Method
Periods to be presented	2 years	3 years	2 years
Interest paid	Operating and financing activity	Operating activity (to be disclosed by way of a note)	Financing. In case of a financial enterprise, operating activities

Basis of Difference	IFRS	USGAAP	IGAAP
Interest received	Operating or investing activity	Operating activity	Investing. In the case of a financial enterprise, operating activity.
Dividends paid	Operating or financing	Financing	Financing
Tax payments	Operating	Operating(to be disclosed by way of a note)	Operating
Dividends received	Operating or investing	Operating	Investing. In the case of a financial enterprise, operating activity.

(b) Dividend on equity shares

IGAAP

Presented as a appropriation of profits. Dividends are accounted in the year when proposed.

US GAAP

Presented as a deduction in the statement of changes in shareholders' equity. Cash Dividends are accounted in the year when declared. Only in case of Stock dividend adjustments is done in accounts.

IFRS

Presented as a deduction in the statement of changes in shareholders' equity

Dividends are accounted in the year when declared

(c) INVESTMENTS

IGAAP: AS 13

Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'

(A) Current Investments – Lower of Cost or Fair Value

(B) Long term Investments. – At cost. If Permanent decline then reduce the carrying value to declined FMV.

All changes in carrying value is taken to P&L

Reclassification – Long term to Current – at lower of cost and carrying amount

Reclassification – Current to Long term – at lower of cost and Fair Value

INVESTMENTS : US GAAP

(A) Held to Maturity – *At Cost*. (with discount or premium amortized over the effective yield basis). *Most Restrictive category*. securities can be so classified if there is positive intent and ability to hold (maintain the securities) till maturity.

(B) Available for Sale. – *At FMV*. Unrealized gain / loss due to Fair value are accounted under OCI. In case of Permanent decline, the reduction is taken to income statement.

(C) Trading Securities – *AT FMV.* Unrealized gains and losses are entirely taken to Income Statement.

*Investment in unlisted securities is valued at cost .*There are very stringent limitations on reclassification of Investments.

IF "HTM" securities are sold, use of this category is prohibited. *Provision for diminution (in value of the long-term investment) created in earlier years cannot be reversed, whereas in Indian GAAP it can be reversed.*

INVESTMENTS: IFRS

(A) Held to Maturity – *At Cost*. (with discount or premium amortized over the effective yield basis). *Most Restrictive category*. securities can be so classified if there is positive intent and ability to hold (maintain the securities) till maturity.

(B) Available for Sale. – *At FMV*. Unrealized gain / loss due to Fair value are accounted under OCI. In case of Permanent decline, the reduction is taken to income statement.

(C) Trading Securities – *AT FMV.* Unrealized gains and losses are entirely

taken to Income Statement.

Investment in unlisted securities can be valued at FMV.

There are very stringent limitations on reclassification of Investments.
IF "HTM" securities are sold, use of this category is prohibited for next two years

(d) IMPAIRMENT OF ASSETS

Difference Criterion	IFRS and IGAAP	US GAAP
Timing of impairment review	Annually	Whenever events or changes in circumstances indicate that the carrying amount may not be recovered
Asset is impaired if	Recoverable amount < Carrying amount	Fair value < Carrying amount
Recoverable amount/ Fair Value	Recoverable amount ishigher of· • Net Selling Price • Value in use	Fair Value is the amount atwhich an asset or liability could be bought or settled in a current transaction between willing parties
Cash flows for calculating value in use/ fair value	Use discounted cash flows for calculating the value in use	Use discounted cash flows for calculating the fair value
Reversal of impairment loss	Whenever there is a change in the economic conditions	Prohibited

(e) BUSINESS COMBINATION

Indian GAAP:

If the combination satisfies the specified conditions, it is an amalgamation in the form of a merger (Pooling of Interest Method), else an amalgamation in the nature or purchase.

Pooling of Interest Method and Purchase Method allowed

US GAAP:

Acquisition of net assets that constitute a business or controlling equity interests of entities.

Prohibits Pooling of Interest.

IFRS:

Bringing together of separate entities or operations into one reporting entity.

Prohibits Pooling of Interest.

Issues	IFRS	USGAAP	IGAAP
Date of acquisition	When control is transferred	When assets received or equity issued	Date specified by the court or the purchase agreement
Valuation of assets and liabilities	Fair value	Fair value	In pooling of interests method-book valueIn purchase method-book value or fair value
Treatment of goodwill	Capitalize and test for impairment	Capitalize and test for impairment	Estimate the useful life and amortize accordingly
Negative goodwill	Recognized in the income statement	Reduce fair value of non-monetary assets	Disclose as capital reserve
Reverse acquisition	Acquisition accounting is based on substance. Accordingly legal acquirer is treated as acquiree and legal acquiree is treated as acquirer	Similar to IFRS	Acquisition accounting is based on form.Legal Acquirer is treated as acquirer and legal acquiree is treated as acquiree for legal as well as accounting purpose.

(f) INTERNALLY GENERATED INTANGIBLE ASSETS

Issues	IFRS	USGAAP	IGAAP
Research Cost	Charge off	Charge off	Charge off
Development Cost	Capitalize if criterion is met	Charge off	Capitalize if criterion is met