Paper-16: Advanced Financial Accounting & Reporting

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

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

Working Notes should form part of the answer.

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

Part A questions are compulsory. Attempt all of them.

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

Part A (25 marks)

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

(i) R. Chandra Ltd. has provided the following information:
Depreciation as per accounting records ₹ 8,00,000, Depreciation as per income tax records ₹ 20,00,000. Unamortized preliminary expenses as per income tax records ₹ 1,20,000, Tax rate 50%. There is adequate evidence of future profit sufficiency. As per AS 22 Deferred Tax Asset/ Liability to be recognized will be
A. ₹ 6,00,000 (DTA)
B. ₹ 5,40,000 (DTL)
C. ₹ 60,000 (Net DTL)
D. None of these

Answer:

B — ₹5,40,000 (Net DTL).

Deferred tax liability = 50% (20,00,000 – 8,00,000)	= ₹6,00,000
Deferred tax asset = 50% of 1,20,000	= ₹60,000
Net Deferred tax liability	= ₹5,40,000

(ii) D Ltd. incurred costs to modify its building and to rearrange its production line. As a result, an overall reduction in production costs is expected. However, the modifications did not increase the building's market value, and the rearrangement did not extend the production line's life.

Should the building modification costs and the production line rearrangement costs be capitalized?

	Building modification costs	Production line rearrangement costs
A.	Yes	No
B.	Yes	Yes
C.	No	No
D.	No	Yes

Answer:

B — Yes,Yes.

As per AS-10, Only expenditure that increases the benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value. In this case future benefits from the existing asset appear to have increased beyond its previously assessed standard of performance as there is overall reduction in production cost which is expected. Therefore both the building modification and production line rearrangement contributed to the improved efficiency in the production process. Therefore, both costs should be capitalized and answer **B** is correct.

(iii) The following data apply to a company's defined benefit pension plan for the year:

Amount (₹)

Fair market value of plan assets (beginning of year)	**8,00,000**
Fair market value of plan assets	**11,40,000**
Employer Contribution	**2,80,000**
Benefit Paid	**2,00,000**

Calculate the actual return on plan assets.

A. ₹11,40,000
B. ₹2,60,000
C. ₹8,00,000
D. ₹3,40,000

Answer:

B — ₹2,60,000.

The actual return is computed as follows:

Particulars	Amount (₹)	Amount (₹)
Fair market value of plan assets (end of year)		11,40,000
Fair market value of plan assets (beginning of year)		8,00,000
Change in plan assets		3,40,000
Adjusted for		
Employer contributions	2,80,000	
Less: Benefit Paid	2,00,000	80,000
Actual return on plan assets		2,60,000

(vi) Mega Ltd. deals in three products A,B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2012-13 the historical cost and net realizable value of the items of closing stock are determined as below:

Items	Historical Cost (₹ in Lakhs)	Net realizable value (₹ in Lakhs)
A	65	56
B	40	46
C	28	23

What will be the value of closing stock?
A. ₹119 Lakhs
B. ₹125 Lakhs
C. ₹133 Lakhs
D. None of these

Answer:

A — ₹119 Lakhs.

Computation of value of closing stock

Lower of Historical Cost and Net Realisable Value will be considered	₹
A	56
B	40
C	23
Value of Closing Stock	**119**

(v) V Ltd. acquired 2,000 equity shares of D Ltd. on April, 01,2013 for a price of ₹ 3,00,000. D Ltd. made a net profit of ₹ 80,000 during the year 2013-14. D Ltd. issued bonus shares of one share for every five shares held out of the post acquisition profits earned during the year 2013-14. The Share Capital of D Ltd. is ₹ 2,50,000 consisting of shares of ₹ 100 each. If the share of V Ltd. in the pre-acquisition profit of D Ltd. is ₹ 56,000, the amount of Goodwill/Capital Reserve to be shown in the Consolidated Balance Sheet as on March 31, 2013 is —
A. ₹ 4,000 (Goodwill)
B. ₹ 4,000 (Capital Reserve)
C. ₹ 44,000 (Goodwill)
D. ₹ 50,000 (Goodwill)

Answer:

A — ₹ 4000 (goodwill).

Cost of investments	₹ 3,00,000
Less: Share of capital profit	₹ 56,000
	2,44,000
Face value of shares (including bonus shares of 400)	₹2,40,000
Cost of control-Goodwill	₹ 4,000

(vi) A firm obtained a contract for construction of a fly-over. Following information is available for the year ended 31.3.2014: Total contract Price = ₹ 3,000 lakhs Work certified = ₹ 1,600 lakhs Work not certified = ₹ 920 lakhs Estimated further cost to completion = ₹ 760 lakhs Progress payment

received = ₹ 1,400 lakhs What will be the foreseeable loss to be shown in the accounts of 2013-14 as per AS-7?
A. No effect in 2013-14
B. ₹200 lakhs
C. ₹1,120 lakhs
D. ₹280 lakhs

Answer:

D — ₹280 lakhs.

Total cost of construction ₹(1,600 + 920 + 760)	= ₹3,280 lakhs.
Less: total contract price	₹3,000 lakhs.
So, foreseeable loss to be recognised in 2013 – 2014	= ₹280 lakhs.

(vii)H LTD. bought a forward contract for three months of US $ 3,00,000 on 1st March, 2013 at 1 US $ = ₹ 64.10 when exchange rate was 1US $ = ₹ 64.12. On 31st March, 2013 when the books were closed forward exchange rate for two months was US $ 1= ₹ 64.16. On 30th April, 2013 the contract was sold at ₹ 64.20 per US Dollar. As per AS-30 the profits from sale of contract to be recognized in the Profit & Loss A/c will be
A. ₹ 6,000
B. ₹ 8,000
C. ₹ 12,000
D. None of these

Answer:

C — ₹12,000.

Sales Rate :	64.20
Less: Fair Value on 31.03.2013	64.16
	0.04

Premium on Contract: US$ 3,00,000
Contract Amount:

Total Profit (3,00,000 x 0.04)= ₹12,000

(viii) On 1-1-2013 Ashwin Ltd. has 1800 equity shares outstanding. On 31-6-2013, it issued 600 equity shares for cash (without bonus claim). On 1-11-2013 it bought back 300 equity shares. Calculate the weighted average number of shares as on 31-12-2013?
A. 2050 shares
B. 2700 shares
C. 2400 sahres
D. None of the above

Answer:

A — 2100 shares.

Computation of weighted average number of shares as per AS-20 is as follows:

$$(1800 \times \frac{6}{12}) + (2400 \times \frac{4}{12}) + (2100 \times \frac{2}{12}) = 2050 \text{ shares.}$$

(ix) During 2013, Madhur Ltd. incurred costs to develop and produce a routine, low-risk computer software product, as follows:

Completion of detailed program design	**₹26,000**
Cost incurred for coding and testing to establish technological feasibility	**₹20,000**
Other coding costs after establishing technological feasibility	**₹58,000**
Other testing costs after establishing technological feasibility	**₹42,000**

What amount should be capitalized as software cost?
A. ₹46,000
B. ₹26,000
C. ₹1,00,000
D. ₹48,000

Answer:

C — ₹1,00,000.

Costs incurred after establishing technological feasibility should be capitalized i.e. (₹58,000+₹42,000)=₹1,00,000 is to capilised and costs incurred before establishing technological feasibility is to be expensed as and when it is incurred.

(x) Miss Dimpy purchased 1,000 shares in M Ltd. at ₹ 600 per share in 2011. There was a rights issue in 2013 at one share for every two held at price of ₹150 per share. If Miss Dimpy subscribed to the rights, what would be carrying cost of 1,500 shares as per AS-13.
A. ₹ 6,00,000
B. ₹ 6,75,000
C. ₹ 7,00,000
D. Data insufficient

Answer:

B — ₹ 6,75,000.

Cost of original holding (Purchase) (1,000 x 600)	= ₹6,00,000
Amount paid for Rights (500 x 150)	= ₹75,000
Total carrying cost of 1500 shares:	**₹6,75,000**

(b) Morning Ltd. has 60% shares in joint venture with Night Ltd. Morning Ltd. Sold a plant WDV of ₹240 lakhs for ₹300 lakhs. Calculate how much profit the Morning Ltd. Should recognize in its book in case joint venture is

- **Jointly controlled operation**
- **Jointly controlled asset**
- **Jointly controlled entity** **[5]**

Answer:

As per AS – 27 (refer point 27.2) in case of jointly controlled operation and jointly controlled assets joint venture, the venture should recognize the profit to the extent of other venturer interest.
In the instant case, Morning Ltd. should recognize profit of ₹(300 – 240) = ₹60 x 40/100 = ₹24 lakhs only.

However in case of jointly controlled entities Morning Ltd. Should recognize full profit of ₹60 lakhs in its separate financial statements. However while preparing consolidated financial statements it should recognize the profit only to the extent of 40% i.e. 24 lakhs.

Part B (75 marks)

2. (a) The following balances are extracted from the Balance Sheets of Upul Ltd and Vipul Ltd.

Particulars	Upul Ltd	Vipul Ltd
Bills Payable	1,50,000	90,000
Trade Creditors	1,00,000	1,40,000
Bills Receivable	70,000	1,00,000
Trade Debtors	1,60,000	1,40,000
Contingent Liability for Bills discounted	40,000	30,000

Additional Information –

(i) Vipul Ltd is wholly owned Subsidiary of Upul Ltd.

(ii) Creditors of Vipul Ltd include ₹50,000 due to Upul for goods supplied by it for ₹60,000. Debtors of Upul however shows a Debit balance of ₹ 60,000 due from Vipul. Vipul had remitted ₹10,000 by Demand Draft to Upul which was not received by Upul on the Balance Sheet date.

(iii) Bills Payable of Vipul include ₹60,000 drawn in favour of Upul Ltd. Upul had discounted Bills worth ₹ 24,000 with its Bankers.

Determine how the above given balances will be disclosed in the Consolidated Balance Sheet of Upul Ltd. [5]

Answer:

Particulars	Bills P'ble	Bills R'ble	Creditors	Debtors	Cont. Liab.
Upul Ltd	1,50,000	70,000	1,00,000	1,60,000	40,000
Vipul Ltd	90,000	1,00,000	1,40,000	1,40,000	30,000
Total before adj. Mutual Owings	2,40,000	1,70,000	2,40,000	3,00,000	70,000
Less: Mutual Owings					
For goods supplied	---	---	(50,000)	(60,000)	---
Bills drawn in favour of Upul (Only to the extent not discounted is reduced)(60,000 – 24,000)	(36,000)	(36,000)	---	---	---
Bills Discounted (only Mutual Bills Discounted is reduced)	---	---	---	---	(24,000)
Balance for Consolidated Balance Sheet	2,04,000	1,34,000	1,90,000	2,40,000	46,000

Note: In addition to the above, in the Consolidated Balance Sheet, ₹10,000 will be shown as "Remittance-in-Transit" under Current Assets after Trade Debtors and Bills Receivable.

(b) T Ltd was incorporated for the purpose of acquiring B Ltd. V Ltd. and S Ltd. The balances in the books of these Companies as on 30th June of a Financial Year are as follows:

Particulars	B Ltd.	V Ltd.	S Ltd.
Tangible Fixed Assets at Cost Less Depreciation	5,00,000	4,00,000	3,00,000
Goodwill	---	60,000	---
Other Assets	2,00,000	2,80,000	85,000

Total Assets	**7,00,000**	**7,40,000**	**3,85,000**
Liabilities:			
Issued Ordinary Share Capital Shares of ₹ 10 each	**4,00,000**	**5,00,000**	**2,50,000**
Profit & Loss Account	**1,50,000**	**1,10,000**	**60,000**
10% Debentures	**70,000**	**---**	**40,000**
Sundry Creditors	**80,000**	**1,30,000**	**35,000**
Total Liabilities	**7,00,000**	**7,40,000**	**3,85,000**

Particulars	B Ltd.	V Ltd.	S Ltd.
Average Annual Profits before Debenture Interest	**90,000**	**1,20,000**	**50,000**
Professional Valuation of Tangible Assets on 30th June	**6,20,000**	**4,80,000**	**3,60,000**

The Directors in their negotiations agreed that (i) the recorded Goodwill of V Ltd. is valueless, (ii) the Other Assets of the B Ltd. are worth ₹ 30,000, (iii) the valuation of 30th June in respect of Tangible Fixed Assets should be accepted, (iv) these adjustments are to be made by the individual Company before the completion of the acquisition.

The acquisition agreement provides for the issue of 12% Unsecured Debentures to the value of the Net Assets of the Companies B Ltd, V Ltd. and S Ltd and for the issuance of ₹ 10 nominal value ordinary shares for the capitalized average Profits of each acquired Company in excess of the Net Assets contributed. The Capitalization Rate is taken at 10%.

You are required to calculate purchase consideration and show the purchase consideration as discharged. [10]

Answer:

A. Computation of Net Assets and Debentures to be issued

Particulars	B Ltd.	V Ltd.	S Ltd.
Tangible Fixed Assets (as per Valuation)	6,20,000	4,80,000	3,60,000
Other Assets (as per agreement)	30,000	2,80,000	85,000
Total Assets	6,50,000	7,60,000	4,45,000
Less: Sundry Creditors	(80,000)	(1,30,000)	(35,000)
Debentures	(70,000)	---	(40,000)
Net Assets	5,00,000	6,30,000	3,70,000

B. Settlement of Purchase Consideration

Particulars	B Ltd.	V Ltd.	S Ltd.
Average Annual Profits (after Debenture Interest)	90,000 - 7,000 = 83,000	1,20,000	50,000 - 4,000 = 46,000
Capitalisation at 10%	8,30,000	12,00,000	4,60,000
Less: Net Assets as calculated above	(5,00,000)	(6,30,000)	(3,70,000)
Excess to be settled by Shares	3,30,000	5,70,000	90,000
Issued by T Ltd			
- Equity Shares (for the excess portion)	3,30,000	5,70,000	90,000
- 12% Debentures (for the Net Assets)	5,00,000	6,30,000	3,70,000

Total Purchase Consideration	8,30,000	12,00,000	4,60,000

3. (a) Given- (i) Future Maintainable Profit before Interest -₹ 250 Lakhs; (ii) Normal Rate of Return on Long Term Funds is 20% and on Equity Funds is 25%; (iii) Long Term Funds of the Company is ₹640 Lakhs of which Equity Funds is ₹ 420 Lakhs; (iv) Interest on loan Fund is 18%. Find out leverage effect on the Goodwill if tax rate is =30%. [6]

Answer:

A. Long Term Loan Funds= Total Long Term funds Less Equity Funds
= ₹ (640 - 420) lakhs = ₹220 Lakhs

Interest at 18% Thereon = ₹ 220 Lakhs X18% = ₹ 39.60 lakhs

B. Computation of future Maintainable Profit (₹Lakhs)

Particulars	**Shareholders' funds approach (₹)**	**Long Term Funds approach (₹)**
Profit Before Interest Less: Interest on Long term loan	250.00 39.60	250.00 N.A
Future Maintainable Profits before tax Less : Tax Expense at 30%	210.40 63.12	250.00 75
Future Maintainable Profit After tax	147.28	175.00

C. Computation of Goodwill under different approaches (₹Lakhs)

Particulars	**Shareholders' funds approach**	**Long Term Funds approach**
a. Future Maintainable Profit after tax	147.28	175.00
b. Normal Rate of Return	25%	20%
c. Normal Capital Employed =(a÷b)	589.12	875.00
d. Actual Capital Employed (given)	420.00	640.00
e. goodwill= (c-d)	**169.12**	**235.00**

(b) The following are the information relating to two Companies for the year ended 31st March –

Particulars	**B Ltd.**	**D Ltd.**
Equity Shares of ₹10 each	**₹8,00,000**	**₹ 10,00,000**
10% Preference Shares of ₹10 each	**₹6,00,000**	**₹ 4,00,000**
Profit After Tax	**₹3,00,000**	**₹ 3,00,000**

Assume that Market Expectation is 18% and that 80% Profits are distributed.

i. What is the rate you would pay for the Equity Shares of each Company -
- **If you are buying a small lot;**
- **If you are buying controlling interest shares.**

ii. If you plan to invest only in Preference Shares, which Company's Preference Shares would you prefer?

iii. Would your rates to be different for buying a small lot, if B Ltd retains 30% and D Ltd 10% of the Profits? [9]

Answer:

Note: For purchase of small lots, the dividend-yield method is appropriate. However, for purchase of controlling interest/majority holdings, the earnings-yield (or earnings capitalization) method shall be adopted.

A. Valuation of Equity Shares at 80% Profit Distribution

Particulars	B Ltd.	D Ltd.
Profit after Tax Less: Preference Dividend at 10% of ₹6,00,000; ₹4,00,000	₹3,00,000 (₹ 60,000)	₹3,00,000 (₹ 40,000)
Equity Earnings	₹2,40,000	₹2,60,000
Number of Equity Shares (Equity Share Capital ÷ ₹10) Earnings Per Share = Equity Earnings ÷ No. of Shares Dividend Per Share = EPS x 80% Payout Ratio	80,000 Shares ₹3.00 ₹2.40	1,00,000 Shares ₹2.60 ₹2.08
Preference Dividend Coverage Ratio = [Profit After Tax ÷ Preference Dividend]	5.00 times	7.50 times
Value Per Equity Share for:		
(a) Controlling Acquisition = EPS ÷ Market Expectation	(₹3.00 ÷18%) = ₹16.67	(₹2.60 ÷ 18%) = ₹ 14.44
(b) Small Acquisition = DPS ÷ Market Expectation	(₹2.40 ÷18%) = ₹13.33	(₹2.08 ÷ 18%) = ₹11.55

Note: Market Expectation is assumed to be post tax.

B. Evaluation of Preference Shares

Preference Dividend Coverage Ratio is higher in D Ltd. than in B Ltd. Hence, risk element of Preference Shares is low in D Ltd. So, an Investor will prefer D Ltd's Preference Shares.

Valuation of Equity Shares at 30% & 10% Profit Retention by B Ltd. and D Ltd.

Particulars	B Ltd.	D Ltd.
Earnings per Share (as calculated above)	₹3.00	₹2.60
Dividends per Share (70% and 90% payout ratio)	(₹3.00 x 70%) = ₹2.10	(₹2.60 x 90%) = ₹2.34
Value per Share for Small Acquisition = DPS ÷ Market Expectation	(₹2.10 ÷18%) = ₹11.67	(₹2.34 ÷ 18%) = ₹13.00

4. The following was the Balance Sheet of A Ltd as on 31st December –

	EQUITY AND LIABILITIES	₹
(1)	**Shareholders' Funds:**	
	(a) Share Capital	
	24,000 Shares of ₹ 10 each	**2,40,000**
	Less: Calls Unpaid (₹ 3 per Share on 6,000 Sh)	**(18,000)**
	(b) Reserves & Surplus – P&L A/c	
	As per Last B/Sheet (Loss b/fd) 44,000	
	(Less) Profit for the Year 2,400	**(41,600)**
(2)	**Current Liabilities:**	
	(a) Trade Payables – Sundry Creditors	**30,850**

	(b)Short Term Provisions – Provision for Taxation	**8,000**
	Total	**2,19,250**
	ASSETS	
(1)	**Non-Current Assets:**	
	(a)Fixed Assets: (i)Tangible Assets	
	- Land & Buildings	**41,000**
	-Machinery	**1,01,700**
	(ii) Intangible Assets – Goodwill	**20,000**
	(b)Other Non-Current Assets	
	- Preliminary Expenses	**3,000**
(2)	**Current Assets:**	
	(a) Inventories	**20,550**
	(b) Trade Receivables–Book Debts	**30,000**
	(c) Cash & Cash Equivalents	**3,000**
	Total	**2,19,250**

Note: Authorised Capital is ₹ 4,00,000 being 40,000 Equity Shares of ₹ 10 each.
The Directors have had a valuation made for the Machinery and find it overvalues by ₹ 20,000. It is proposed to write down this asset to its true value and to extinguish the deficiency in the Profit and Loss Account and to write off Goodwill and Preliminary Expenses, by adoption of the following course –

(i) Forfeit the Shares on which the Call is outstanding.
(ii) Reduce the Paid-up Capital by ₹ 3 per Share.
(iii) Reissue the Forfeited Shares at ₹ 5 per Share.
(iv) Utilize the Provision for Taxes, if necessary.

The Shares on which the Calls were in Arrears were duly Forfeited and reissued on payment of ₹ 5 per Share. Give the Journal Entries and the Balance Sheet of the Company after carrying out the above scheme. [15]

Answer:

A. Journal Entries

	Particulars		**Debit (₹)**	**Credit (₹)**
1.	Equity Share Capital A/c To Calls in Arrears A/c To Share Forfeiture A/c (Being 6,000 Shares forfeited for non-payment of calls)	Dr.	60,000	 18,000 42,000
2.	Equity Share Capital (₹ 10) A/c To Equity Share Capital (₹ 7) To Reconstruction A/c (Being par value and paid up value of Equity Shares brought down to ₹ 7 per share under the reconstruction scheme approved)	Dr.	1,80,000	 1,26,000 54,000
3.	Bank A/c Share Forfeiture A/c (Balancing figure) To Equity Share Capital (Forfeited shares reissued at ₹ 5 per share as ₹ 7 paid up. Balance adjusted against Shares Forfeiture Account)	Dr. Dr.	30,000 12,000	 42,000
4.	Share Forfeiture A/c	Dr.	30,000	

	To Capital Reserve A/c (Balance in Share Forfeiture Account transferred to Capital Reserve)		30,000
5.	Reconstruction A/c Dr. Capital Reserve A/c Dr. Provision for Taxation A/c (Balancing figure A/c) Dr. To Profit and Loss A/c To Preliminary Expenses A/c To Machinery A/c To Goodwill A/c (Being balance in Reconstruction A/c and Capital Reserve A/c utilized to eliminate overvaluation of assets and write off balances in Preliminary Expenses A/c and Profit and Loss A/c)	54,000 30,000 600	 41,600 3,000 20,000 20,000

B. Balance Sheet of A Ltd. (and Reduced) as at 31st December

	Particulars as at 31st December	Note	This Year (₹)	Prev. Yr. (₹)
I	Equity and Liabilities			
(1)	Shareholders' Funds: Share Capital	1	1,68,000	
(2)	Current Liabilities			
	(a)Trade Payables -Creditors		30,850	
	(b)Short Term Provisions -Provision for Taxation (8,000 - 600)		7,400	
	Total		2,06,250	
II	Assets			
(1)	Non-Current Assets -Fixed Assets (Tangible Assets)	2	1,22,700	
(2)	Current Assets			
	(a)Inventories		20,550	
	(b)Trade Receivables -Book Debts		30,000	
	(c)Cash & Cash Equivalents –(3,000 + 30,000)		33,000	
	Total		2,06,250	

Notes to the Balance Sheet:

Note 1: Share Capital

Particulars	This Year (₹)	Prev. Yr. (₹)
Authorized: 20,000 Equity Shares of ₹ 10 each	4,00,000	
Issued, Subscribed & Paid up: 24,000 Equity Shares of ₹ 7 each	1,68,000	

Note: Reconciliation of Shares (Quantity & Value) will be provided by the Company along with annual Financial Statements.

Note 2: Tangible Assets

Particulars	This Year (₹)	Prev. Yr. (₹)
(a)Land & Building	41,000	
(b)Machinery	81,700	
Total	1,22,700	

5. Mathi Ltd acquired 8,000 Shares of ₹100 each in Nidhi Ltd on 30.09.2012. The summarized Balance Sheets of the two Companies as on 31.03.2013 were as follows –

(₹'000)

EQUITY AND LIABILITIES	Mathi	Nidhi
(1)Shareholders' Funds:		
(a)Share Capital (₹ 100)	3,000	1,000
(b)Reserves & Surplus		
-Capital Reserve	---	550
-General Reserve	300	50
-Profit & Loss A/c	382	180
(2)Non-Current Liabilities:		
-Long Term Borrowings		
(Loan from Nidhi Ltd)	21	---
(3)Current Liabilities:		
Trade Payables		
-Sundry Creditors	179	70
-Bills Payable	---	17
(incl. ₹ 5,000 to Mathi Ltd)		
Total	3,882	1,867
ASSETS		
(1)Non-Current Assets:		
(a)Fixed Assets	1,500	1,447
(b)Non-Current Investments		
-Investments in Nidhi Ltd	1,700	---
(2)Current Assets:		
(a)Inventories	400	200
(b)Trade Receivables		
-Debtors	250	180
-Bills Receivable	12	---
(incl. ₹ 5,000 to Nidhi Ltd)		
(c)Cash & Cash Equivalents	20	20
(d)Short Term Loans & Adv.		
-Loan to Mathi Ltd	---	20
Total	3,882	1867

Contingent Liability (Mathi Ltd.): Bills discounted of ₹ 6,000.

Additional information:

(i) Nidhi Ltd made a Bonus issue on 31.03.2013 of one share for every two shares held, reducing the Capital Reserve equivalently, but the accounting effect to this has not been given in the above Balance Sheet.

(ii) Interest receivable for the year (₹1,000) in respect of the loan due by Mathi Ltd. to Nidhi Ltd had not been credited in the accounts of Nidhi Ltd.

(iii) The credit balance in Profit & Loss Account of Nidhi Ltd. on 01.04.2012 was ₹21,000.

(iv) The Directors decided on the date of the acquisition that the Fixed Assets of Nidhi Ltd were overvalued and should be written down by ₹50,000. Consequential adjustments on depreciation are to be ignored.

Prepare the Consolidated Balance Sheet as at 31.03.2013, showing your workings. [15]

Answer:

A. Basic Information

Company Status	Dates	Holding Status
Holding Company = Mathi Ltd	Acquisition: 30.09.2012	Holding Company = 80%
Subsidiary = Nidhi Ltd	Consolidation: 31.03.2013	Minority Interest = 20%

B. Analysis of Reserves and Surplus of Nidhi Ltd.

(a) Capital Reserve

Balance as on date of Consolidation	₹ 5,50,000	Remarks
Less: Bonus Issue (₹10,00,000 x ½)	₹ 5,00,000	The entire balance is considered as **Capital Profit**
Corrected Balance	₹ **50,000**	

(b) Revaluation of Assets: Loss (₹50,000) = Capital Profit

(c) General Reserve

Balance as per B/s ₹50,000

As on 01.04.12 (Date of previous B/s) ₹50,000.

Assumed that entire balance is available

01.04.09 to 31.03.13 (upto Consolidation) ₹ NIL (balancing figure)

Revenue Reserve

(d) Profit and Loss Account

Balance as on date of Consolidation	₹ 1,80,000
Add: Interest on Loan to Mathi (Given)	₹ 1,000
Corrected Balance	₹ **1,81,000**

Balance on 01.04.12 (Date of previous B/s) ₹ 21,000

Profit for 2012 – 13 (Balancing Figure) ₹ 1,60,000

Upto date of acquisition 01.04.12 to 30.09.12 ₹1,60,000 x 6/12

Capital Profit ₹ 80,000

Acquisition to Consolidation 30.09.2012 to 31.03.2013 ₹1,60,000 x 6/12

Revenue Profit ₹ 80,000

Total Capital Profits: 21,000 + 80,000 = ₹ 1,01,000, Total Revenue Profits: ₹ 80,000.

C. Consolidation of Balances

Particulars	Total	Minority Interest	Pre-Acquisition	Post Acquisition	
Nidhi Ltd (Holding 80%, Minority 20%)				Gen. Res.	P&L A/c
Equity Capital [₹ 10,00,000 + Bonus Shares ₹ 5,00,000]	15,00,000	3,00,000	12,00,000		

General Reserves	50,000	10,000	40,000		
Profit and Loss A/c	1,81,000	36,200	80,800		64,000
Capital Reserve	50,000	10,000	40,000		
Loss on Revaluation of Assets	(50,000)	(10,000)	(40,000)		
Minority Interest		3,46,200			
Total [Cr]			13,20,800		64,000
Cost of Investment [Dr.]			(17,00,000)		
Parent's Balances				3,00,000	3,82,000
For Consolidated Balance Sheet		3,46,200	(3,79,200) (Goodwill)	3,00,000	4,46,000

D. Consolidated Balance Sheet of Mathi Ltd and its Subsidiary Nidhi Ltd as at 31.03.13

	Particulars	Note	This Year	Prev. Yr.
I	EQUITY AND LIABILITIES			
(1)	Shareholders' Funds:			
	(a) Share Capital	1	30,00,000	
	(b) Reserves & Surplus	2	7,46,000	
(2)	Minority Interest		3,46,200	
(3)	Current Liabilities: Trade Payables	3	2,61,000	
	Total		43,53,200	
II	ASSETS			
(1)	Non-current Assets			
	Fixed Assets: (i) Tangible Assets (15,50,000+14,47,000-Revaln 50,000)		28,97,000	
	(ii) Intangible Assets – Goodwill on Consolidation		3,79,200	
(2)	Current Assets			
	(a) Inventories = 4,00,000 + 2,00,000		6,00,000	
	(b) Trade Receivables	4	4,37,000	
	(c) Cash & Cash Equivalents = 20,000 + 20,000		40,000	
	Total		43,53,200	

Contingent Liability for Bills Discounted ₹ 6,000.

Notes to the Balance Sheet

Note 1: Share Capital

Particulars	This Year	Prev. Yr.
Authorized: ……………Equity Shares of ₹ 100 each		
Issued, Subscribed & Paid Up: 30,000 Equity Shares of ₹ 100 each.	30,00,000	

Note 2: Reserves and Surplus

Particulars	This Year	Prev. Yr.
(a) Other Reserves - General Reserve	3,00,000	
(b) Surplus (Balance in P&L A/c)	4,46,000	
Total	7,46,000	

Note 3: Trade Payables

Particulars	This Year	Prev. Yr.
(a) Sundry Creditors	2,49,000	
(b) Bills Payable	12,000	
Total	2,61,000	

Note 4: Trade Receivables

Particulars	This Year	Prev. Yr.
(a) Sundry Debtors (2,50,000 + 1,80,000)	4,30,000	
(b) Bills Receivable (12,000 – 5,000 Mutual Owings)	7,000	
Total	4,37,000	

Note: Fixed Assets have been revalued for the purpose of consolidation, and the depreciation on the Revaluation Loss has been ignored as it is specifically stated in the question.

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

Debt Capital 12%	**₹8,000 crores**	**Risk free rate**	**9%**
Equity capital	**₹2,000 crores**	**Beta factor**	**1.05**
Reserves & Surplus	**₹30,000 crores**	**Market rate of return**	**19%**
Capital Employed	**₹40,000 crores**	**Equity(market) risk premium**	**10%**
Operating profit after tax	**₹8,400 crores**	**Tax rate**	**30%**

[7]

Answer:

Particulars	
Cost of Equity (k_e)= Risk free rate + (Beta × market risk premium)	9 + (1.05 × 10)=19.5%
Cost of Debt (K_d) = Interest × (100% - tax rate)	12 × 70% = 8.40%
Debt - Equity Ratio (as given in the question)	20%
WACC = [(K_d) × Debt % + (k_e) × Equity %]	(8.40 × 20% + 19.50 × 80%)=17.28%
Operating profit after tax	₹8,400 crores
Capital charge = Capital employed × WACC	₹6,912 crores
Economic Value Added	₹(8,400 – 6,912)=₹1,488 crores

(b) Mr. Bose buys a stock option of PQR Co. Ltd. in July, 2013 with a strike price on 30.07.2013 of ₹270 to be expired on 30.08.2013. The premium is ₹20 per unit and the market lot is 100. The margin to be paid is ₹120 per unit.
Show the accounting treatment in the books of Buyer when :
(i) the option is settled by delivery of the asset, and
(ii) the option is settled in cash and the index price is ₹280 per unit. **[8]**

Answer:

Journals

Date	Particulars	Debit (₹)	Credit (₹)
	At the time of inception		
2013 July	Stock Option Premium Account Dr. To Bank Account (Being premium paid to buy a stock option)	2,000	2,000

	Deposit for Margin Money Account Dr. To Bank Account (Being margin money paid on stock option)	12,000	12,000
At the time of settlement			
August	**(i) Option is settled by delivery of the asset** Shares of PQR Ltd. Account Dr. To Deposit for Margin Money Account To Bank Account (Being option exercised and shares acquired, ₹12,000 margin money adjusted and the balance amount was paid)	 27,000	 12,000 15,000
	Profit and loss Account Dr. To Stock Option Premium Account (Being the premium transferred to profit and loss account on exercise of option)	2,000	 2,000
	(ii) Option is settled in cash Profit and loss Account Dr. To Stock Option Premium Account (Being the premium transferred to profit and loss Account)	 2,000	 2,000
	Bank Account (100 × ₹ 10) Dr. To Profit and Loss Account (Being profit on exercise of option)	1,000	 1,000
	Bank Account Dr. To Deposit for Margin Money Account (Being margin on equity stock option received back on exercise of option)	12,000	 12,000

7. **(a) A factory started it activities on 1st April, 2013. From the following data, compute the value of closing stock on 30th April, 2013.**
   - **Raw Materials purchased during April - 40,000 kg at ₹24 (out of which Excise Duty = ₹ 4 per kg). Stock on hand as on 30th April – 2,500 kg.**
   - **Production during April – 7,000 units (of which 5,000 units were sold). In addition to the production, 500 units were lying as WIP on 30th April (100% complete as to Materials and 60% complete as to conversion).**
   - **Wages and Production Overheads - ₹60**
   - **Selling Price - ₹ 220 per unit (of which Excise Duty is ₹20 per unit).** **[6]**

Answer:

Particulars	Computation	₹
1. Raw Material Valuation (net of Input Excise Duty)	2,500kg x ₹ 20 per kg	50,000
2. WIP Valuation (net of RM input duty)	(₹100 + 60% of ₹60) x 500 units	68,000

3. Finished Goods Valuation (including ED on SP)	(RM 100 + Lab & OH 60 + ED 20) = ₹180 x (7,000 units – 5,000 units)	3,60,000
Total		**4,78,000**

Computation of Cost per unit of production:

- Raw Materials: (40,000 – 2,500) = 37,500 kg for 7,500 units total = 5 kg x ₹ 20 (net of ED) = ₹100
- Wages and Production Overhead = ₹60 per completed unit (given).

(b) Discuss the nature of risks as classified under AS-32. [3]

Answer:

Under AS - 32, the risks are classified as - credit risk, liquidity risk and market risk

- Credit risk - the risk that one party to a financial instrument will cause a financial loss for the other party, by failing to discharge an obligation.
- Liquidity risk - the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities
- Market risk - the risk that the fair value or future cash flow of a financial instrument will fluctuate because of changes in market prices. This risk can again be sub-classified as currency risk (changes in foreign exchange rates), interest rate risk (changes in market interest rates) and other price risk (changes in market prices other than those arising from interest rate risk or currency risk).

(c) Uniformity in Accounting Policies is necessary for consolidation purposes. [6]

Answer:

Uniformity in Accounting Policies:

- Uniform Accounting Policies: Consolidated Financial Statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances.
- Adjustment for Different Accounting Policies: If a member of the group uses accounting policies other than those adopted in the Consolidated Financial Statements for like transactions and events in similar circumstances, appropriate adjustments are made to its Financial Statements when they are used in preparing the Consolidated Financial Statements.
- Adjustments not possible for different Accounting Policies: If it is not practicable to use uniform accounting policies in preparing the Consolidated Financial Statements, that fact should be disclosed together with the proportions of the items in the Consolidated Financial Statements to which the different accounting policies have been applied.
- Adjustments in case of Consolidation for the first time: Any adjustments to Opening Balances, consequent to applying uniform accounting policies to the entities in the group, could be adjusted in the Opening Balances of Reserves. When a charge to reserves is required, and there are inadequate reserves to support the charge, the amount of shortfall in Reserves could be adjusted by charging the same to the Opening Balance of Accumulated Losses.

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

(a) Market Value Added (MVA);
(b) Objections to Segmental Reporting;
(c) Derivatives and their Characteristics;
(d) General Principles of Government Accounting.

Answer:

(a) Market Value Added (MVA):

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

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

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

(b) Objections to Segmental Reporting:

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

(i) It is generally felt that Segmental Revenues and Expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence of a strong product line. Also many joint costs are only separable arbitrarily.

(ii) Much of segmental results depend on the inter-departmental transfer pricings which are not always logically established.

(iii) Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio.

(iv) Since the users are not in position to know the proper base for cost allocation, the segment results would be less than meaningful.

(v) The last objection consists of the competitive implications to the firm. Some academics contend that company secrets will be disclosed while others referred to the competitive hardship suffered by some firms if segmented data is required. Suppose that Company X, a small company, has a segment identical to one in Company Y, a huge conglomerate. Company X would have to disclose the segment while Company Y would not because the segment is not considered material to Y's operations.

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

(c) Derivatives and their Characteristics:

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. 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.

(d) General Principles of Government Accounting:

General Principles of Government Accounting are as follows:

(i) The Government Expenditure are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account, the accounting is more elaborate than that followed in commercial accounts. The method of budgeting and accounting under the service heads is not designed to bring out the relation in which Government stands to its material assets in use, or its liabilities due to be discharged at more or less distant dates.

(ii) In its Budget for a year, Government is interested to forecast with the greatest possible accuracy what is expected to be received or paid during the year, and whether the former together with the balance of the past year is sufficient to cover the later. Similarly, in the compiled accounts for that year, it is concerned to see to what extent the forecast has been justified by the facts, and whether it has a surplus or deficit balance as a result of the year's transactions. On the basis of the budget and the accounts, Government determines (a) whether it will be justified in curtailing or expanding its activities (b) whether it can and should increase or decrease taxation accordingly.

(iii) In the field of Government accounting, the end products are the monthly accounts and the annual accounts. The monthly accounts serve the needs of the day-to-day administration, while the annual accounts present a fair and correct view of the financial stewardship of the Government during the year.