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 your workings/reasons briefly (= 1 mark) : [10×2=20]**

(i) M/s. XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are: Segment X ₹ 2.00 crore, Segment Y ₹ 6.00 crores and Segment Z ₹ 12.00 crores. Deferred tax assets included in the assets of each Segments are: X ₹ 1.00 crore, Y ₹ 0.80 crore and Z ₹ 0.60 crore. As per AS 17

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

(ii) DING-DONG CONSTRUCTION Ltd. undertook a contract on January 1, 2013 to construct a building for ₹ 140 lakh. The Company found on March 31, 2013 that it had already spent ₹ 104 lakh on the construction. Prudent estimate of additional cost for completion was ₹ 56 lakhs. Contract value to be recognized as Turnover in the final accounts for the year ended March 31, 2013 as per AS-7 (revised) will be

A. ₹ 105 lakh
B. ₹ 100 lakh
C. ₹ 91 lakh
D. None of these

(iii) P&P Ltd. bought a forward contract for three months of US \$ 2,00,000 on 1st March at 1 US \$ = ₹ 50.10 when spot exhange rate was US \$ 1 = ₹ 50.11. On 31 st March when the books were closed forward exchange rate for two months was US \$ 1 = ₹ 50.15. On 30th April, the contract was sold at ₹ 50.18 per dollar. As per AS 30, the profits from sale of contract to be recognized in the P & L A/c will be :

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

(iv) A&B Ltd. obtained a Loan from a bank for ₹ 240 lakhs on 30.04.2012. It was utilized for : Construction of a shed ₹ 100 lakhs, Purchase of a machinery ₹ 80 lakhs, Working Capital ₹ 40 lakhs, Advance for purchase of truck ₹ 20 lakhs, Construction of shed was completed in March 2014. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31.03.2014 was ₹ 36 lakhs. As per AS 16, Interest to be debited to Profit & Loss Account will be :

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

(v) Amrit Ltd. has provided depreciation in accounts for ₹ 160 lakhs, but as per tax records it is ₹240 lakhs. Unamortized preliminary expenses, as per tax records is ₹80,000. There is adequate evidence of future profit sufficiently. Tax rate is 30%. How much deferred tax assets/liability should be recognized as per AS-22?

A. ₹ 24.00 lakhs
B. ₹ 23.76 lakhs
C. ₹ 11.88 lakhs
D. Nil

(vi) PARTHAN LTD. reports quarterly and estimates an annual income of ₹ 200 crores. Assume Tax rates on first ₹ 100 crores at 30% and on the balance income at 40%. The estimated quarterly incomes are ₹ 15 crores, ₹ 50 crores, ₹ 75 crores and ₹ 60 crores respectively. The Tax expenses to be recognized in the last quarter as per AS-25 is

A. ₹ 24 crores
B. ₹ 21 crores
C. ₹ 19 crores
D. Insufficient Information

(vii) RAJRSHII Ltd. ordered 16,000 kg. of certain material at ₹160 per unit. The purchase price includes excise duty ₹10 per kg. in respect of which full CENVAT credit admissible. Freight incurred amounted to ₹1,40,160. Normal transit loss is 2%. The company actually received 15,500 kg. and consumed 13,600 kg. of material. The cost of inventory as per AS 2 will be

A. ₹ 3,20,644
B. ₹ 3,01,644
C. ₹ 3,07,800
D. None of these

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

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

(ix) PRARTHANA Ltd. is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ` 6 lakhs. It contributes ` 5 lakhs annually for its pension schemes. The average remaining life of the employee is estimated to be 6 years. As per AS 15 (Revised)

A. Surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the Profit and Loss Statement for the current year
B. Surplus of ₹ 6 lakhs can be spread over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs
C. Surplus of ₹ 6 lakhs is to be spread over the average remaining life of the employees of 6 years by crediting to the Profit and Loss Statement of each year
D. None of these

(x) S. S. CORPORATE SECURITIES Ltd. is showing an intangible asset at ₹ 72 lakhs as on 01.04.2013 and that an item was acquired for ₹ 96 lakhs on 01.04.2010 and that the item was available for use from that date. It has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. As per AS 26
A. ₹ 4.8 lakhs should be adjusted against the current year's profits
B. ₹ 4.8 lakhs should be adjusted against the opening balance of revenue reserves
C. ₹ 9.6 lakhs should be adjusted against the opening balance of revenue reserves
D. None of these

Answer:

(i) — D.
According to AS 17 "Segment Reporting", Segment Assets do not include income tax assets.
Therefore, the revised total assets are 17.6 crores [20 crores - (1.00+0.80+0.60)].
Segment X holds total assets of 0.5 crore (2 crore – 1crore); Segment Y holds 5.20 crores (3 crores – 0.80 crores); and Segment Z holds 11.40 crores (12 crores – 0.60 crores). Thus, Only Z and Y hold more than 10% of the total assets and hence, only Y and Z are reportable segments.

(ii)- C : ₹91.00 lakh
Contract work-in-progress (104÷ 140) lakh = 65%
Proportion of total contract value to be recognized as Turnover
= 0.65 x ₹140,00,000 = ₹91 lakh.

(iii) – C

Sale Rate	₹ 50.18
Less: Fair Value on 31st March	₹ 50.15
Premium on Contract	₹ 0.03
Contract Amount	US$ 2,00,000
Total Profit (2,00,000 × 0.03)	₹ 6,000

(iv) - B. ₹ 21 Lakhs
Qualifying Asset as per AS-16 = ₹ 100 lakhs (construction of a shed)
Borrowing cost to be capitalized = 36 × 100/240 = ₹ 15 lakhs
Interest to be debited to Profit or Loss account = ₹ (36 – 15) lakhs = ₹ 21 lakhs

(v) - B : ₹ 23.76 lakhs
The difference between taxable income and accounting income. Excess depreciation as per tax (240 - 160) = ₹ 80.00 lakhs Less, Expenses provided to taxable income = ₹ 0.80 lakhs
Timing difference = ₹ 79.20 lakhs
So, deferred tax liability = ₹ 79.20 lakhs x 30% = ₹ 23.76 lakhs

(vi) - B : ₹21 Crores.

Tax Expenses : 30% on ₹100 Crores = ₹30 Crores.
40% on remaining ₹100 Crores = ₹40 Crores.
Total Tax = (30 + 40) = ₹70 Crores.
Weighted average Annual Income Tax Rate [70 ÷ 200] = 35%
Tax expenses to be recognized in last quarter: 35% on ₹60 Crores = ₹21 Crores.

(vii) — **C**.
Revised cost per kg. = [25,60,000 – 1,60,000 + 1,40,160]/(16,000 kg.× 98%) = 162
Cost of Closing inventory = (15,500 kg – 13,600 kg) × 162 = ₹ 3,07,800

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

(ix) — **A.**
According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.

(x) As per para 63 of AS 26 "Intangible Assets", the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.
The company has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified under AS 26. Accordingly, The company would be required to restate the carrying amount of intangible asset as on 1.4.2013 at ₹ 96 lakhs less ₹ 28.8 lakhs (₹ 9.6 lakhs × 3 years) = ₹ 67.2 lakhs. If amortisation had been as per AS 26, the carrying amount would have been ₹ 67.2 lakhs. The difference of ₹ 4.8 lakhs i.e. (₹ 72 lakhs – ₹ 67.2 lakhs) would be required to be adjusted against the opening balance of revenue reserves. The carrying amount of ₹ 67.2 lakhs would be amortised over 7 (10 less 3) years in future.

(b) Five Star Ltd. expects that a plant has become useless which is appearing in the books at ₹20 lakhs gross value. The Company charges SLM depreciation on a period of 10 years estimated scarp value of 3%. At the end of 7th year the plant has been assessed as useless. Its estimated net realizable value is ₹6,20,000. Determine the loss/gain on retirement of the fixed assets. [5]

Answer:

Cost of the plant	₹20,00,000
Estimated realizable value	₹60,000
Depreciable amount	₹19,40,000
Depreciation per year	₹1,94,000

Written down value at the end of 7th year= ₹20,00,000 - ₹(1,94,000 x 7)=₹6,42,000

As per Para 14.2 of AS-10, items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realizable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement. Accordingly, the loss of ₹22,000(6,42,000 - 6,20,000) to be shown in the profit and loss account and asset of ₹6,20,000 to be shown in the balance sheet separately.

Part B (75 marks)

2. Techno Ltd. has 2 divisions Laptops and Mobiles.

Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March 2012 the division-wise draft Balance Sheet was: (₹ in crores)

		Laptops	Mobiles	Total
Fixed assets cost		**250**	**500**	**750**
Depreciation		**(225)**	**(400)**	**(625)**
Net Assets	**(A)**	**25**	**100**	**125**
Current assets:		**200**	**500**	**700**
Less: Current liabilities		**(25)**	**(400)**	**(425)**
	(B)	**175**	**100**	**275**
Total (A+B)		**200**	**200**	**400**
Financed by:				
Loan funds		**-**	**300**	**300**
Capital: Equity ₹10 each		**25**	**-**	**25**
Surplus		**175**	**(100)**	**75**
		200	**200**	**400**

Division Mobiles along with its assets and liabilities was sold for ₹50 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹10 each at a premium of ₹40 per share to the members of Techno Ltd. in full settlement of the consideration, in proportion to their shareholding in the company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Techno Ltd.

(ii) Prepare the Balance Sheet of Techno Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd. [15]

Answer:

Journal of Techno Ltd. (₹ in crores)

		Dr. ₹	Cr. ₹

(1)	Turnaround Ltd. Dr. Loan Funds Dr. Current Liabilities Dr. Provision for Depreciation Dr. To Fixed Assets To Current Assets To Capital Reserve (Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd.)	50 300 400 400	 500 500 150
(2)	Capital Reserve Dr. To Turnaround Ltd. (Being allotment of 1 crore equity shares of ₹10 each at a premium of ₹40 per share to the members of Techno Ltd. in full settlement of the consideration)	50	 50

Notes:

(1) Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

(2) Profit on sale of division may, alternatively, be credited to Profit and Loss Account instead of Capital Reserve, in accordance with the requirements of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and changes in Accounting Policies.

Techno Ltd,

Balance Sheet after reconstruction

		Note No.		
I.	**Equity and liabilities**			
	(1) **Shareholders' funds**			
	(a) Share Capital		25	
	(b) Reserves and surplus	1	175	200
	(2) **Current Liabilities**			25
	Total			225
II.	**Assets**			
	(1) **Non-current assets**			
	(a) Fixed assets			25
	(2) **Current assets**			200
	Total			225

Notes to Accounts

1.		(₹ in crores)
	Reserves and Surplus	75
	Add: Capital Reserve on reconstruction	100
		175

Note to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ₹10 each at a premium of ₹15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd.

		Note No.		
1.	**Equity and liabilities**			
	(1) **Shareholders' funds**			
	(a) Share Capital	1	10	
	(b) Reserves and surplus:			
	Securities Premium		40	50
	(2) **Non-current liabilities**			
	Long term borrowings			300
	(3) **Current liabilities**			400
	Total			750
	Assets			
II.	**(1) Non-current assets**			
	Fixed assets			
	(i) Tangible assets		100	
	(ii) Intangible assets	2	150	250
	(2) Current assets			500
	Total			750

Notes to Accounts

		(₹ in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 10 each fully paid up	10
	(All the above shares have been issued for consideration other than cash, to the members of Techno Ltd. on takeover of Division Mobiles from Techno Ltd.)	
2.	**Intangibles Assets:**	
	Goodwill (WN 1)	150

Working Note

1. **Calculation of Goodwill/Capital Reserve for Turnaround Ltd.**

Assets taken over

Non Current Assets	100
Current Assets	500
Total Assets(A)	600
Loan Funds	300
Current Liabilities	400
Total Liabilities (B)	700
Net Assets C= (A-B)	(100)
Purchase Consideration (given) D	50
Goodwill (D-C)	150

3. **The draft consolidated data of A Ltd., and its 100% subsidiary B Ltd. and also information of C Ltd. relating to the year end 31st March, 2012 is given below:**

DRAFT BALANCE SHEET **(₹ in thousand)**

	CBS of A Ltd. and its 100% Subsidiary B Ltd.	C Ltd.
Issued ordinary share capital	2,000	1,000
Reserves	3,450	2,000
Debentures	2,000	1,500
Current liabilities	4,550	2,500
Total	12,000	7,000
Fixed assets (net)	6,500	4,000
Investment in C Ltd. at cost	2,000	-
Current assets	3,500	3,000
Total	12,000	7,000

PROFIT AND LOSS ACCOUNT (DRAFT)

	A Ltd and its 100% Subsidiary B Ltd.	C Ltd.
Sales	2,000	1,200
Expenses	(900)	(500)
Trading profit before tax	1,100	700
Dividend from Uncertain Ltd.	100	—
Taxation	(600)	(200)
Profit after tax	600	500
Opening Balance	3,150	1,100
Dividends paid	(300)	(200)
Retained Profit	3,450	1,400

A Ltd. acquired 50% of the ordinary share capital of C Ltd. on 1st April, 2011 for ₹2,000 thousands when its reserves were ₹1,700 thousands and sold this holding on 3rd April, 2012 for ₹2,050 thousands.

You are required to prepare the 'Group' Profit and Loss account (draft) and Balance Sheet (draft) on four bases as follows:

1. **When C Ltd. is treated as a subsidiary**
2. **When C Ltd. is treated as an associated company**
3. **When C Ltd. is treated as an investment**
4. **When C Ltd. is treated as a Joint Venture.** **[15]**

Answer:

When C Ltd. is treated as a subsidiary or an Investment company

	Particulars	Subsidiary	Investment
a.	Accounting Standard Applicable	21	13
b.	Method	Full Consolidation	Cost method
c.	Date of Acquisition	1st April 2011	1st April 2011
d.	Shareholding	A Ltd -50% Minority Int. - 50%	Not applicable
e.	Analysis of reserves	1) Opening balance 1,700 thousands pre- acquisition 2) Current year retained profit 300	Not applicable

		thousands post-acquisition	
f.	Apportionment of Profits 1) Pre-acquisition 2) Post-acquisition	1) A Ltd. - 850 thousand 2) Minority – 850 thousands 1)A Ltd.-150 thousands 2) Minority - 150 thousands	Not applicable
g.	Outsider's interest	Minority Interest 1) Share capital - 500 thousands 2) Pre-acquisition - 850 thousands 3) Post acquisition - 150 thousands Total 1500 thousands	
h.	Goodwill/Capital Reserve	1) Cost of Investment -2,000. thousands 2) Share of Net Assets on the date of Investment - Share Capital 500 thousands - Capital Profits 850 thousands 1350 thousands 3) Goodwill 650 thousands	Not applicable
I.	Inter Company Transactions 1) Inter Company Owings 2) Unrealised Profits	 Eliminate in full Eliminate in full	Not applicable
J.	Reserves for CBS	*	Not applicable
k.	Carrying amount of Investment in CBS	Nil	2000 thousand

When C Ltd. treated as an associated company or as a Joint Venture

	Particulars	Associate	Joint venture
a.	Accounting Standard Applicable	23	27
b.	Method	Equity method	Proportionate consolidation
c.	Date of Acquisition	1st April 2011	1st April 2011
d.	Shareholding	Extent of investment 50%	Extent of financial interest 50%
e.	Analysis of reserves	1) Opening balance 1,700 thousand pre-acquisition 2) Current year retained profit 300 thousands post acquisition	1) Opening balance 1,700 thousand pre-acquisition 2) Current year retained profit 300 thousands post acquisition
f.	Apportionment of Profits 1) Pre-acquisition 2) Post-acquisition	1) A Ltd. – 850 thousand (investing Co. Interest) 2) A Ltd. – 150 thousands	1) A Ltd. – 850 thousand (investing Co. Interest) 2) A Ltd. – 150 thousands.
g.	Outsider's interest	Not applicable	Not applicable

h.	Goodwill/Capital Reserve	1) Cost investment 2,000 thousands 2) Share of net assets on the date of investment -share capital 500 thousands -capital profits 850 thouisands Total 1,350 thousands - Goodwill 650 thousands	1) Cost investment 2000 thousands 2) Share of net assets on the date of investment -share capital 500 thousands -capital profits 850 thouisands Total 1,350 thousands - Goodwill 650 thousands
I.	Inter Company Transactions 1) Inter Company Owings 2) Unrealised Profits	 Not applicable Eliminate to the extent of investing co's interest	 Eliminate to the extent of venturer's interest
J.	Reserves for CBS	*	*
k.	Carrying amount of Investment in CBS	a) Amount invested i) Share of Net Assets 1,350 thousands ii) Goodwill - 650 thousands 2000 thousands b) Add: Share of Post Acquisition profits 250 thousands c) Less: Dividend Received 100 thousands Total 2150 thousands	Nil

* Reserves for CBS

Draft Consolidate Profit and Loss A/c
as at 31.03.2012

₹ in thousands

Particulars	Subsidiary	Investment	Associate	Joint Venture
Sales	3,200	2,000	2,000	2,600
Expenses	(1,400)	(900)	(900)	(1,150)
Dividend	-	100	-	-
PBT	1,800	1,200	1,100	1,450
Tax	(800)	(600)	(600)	(700)
PAT	1,000	600	500	750
Share of profits from Associate	-	-	250	-
Opening Balance B/d	3,150	3,150	3,150	3,150
Dividend Paid	(300)	(300)	(300)	(300)
Share of Minority Interest	(250)	-	-	-
Balance carried forward to Balance Sheet	3,600	3,450	3,600	3,600

Draft Consolidated Balance Sheet
As at 31.03.2012

₹ in thousands

	If Subsidiary	If Investment	If Associate	If Joint Venture
Equity and Liabilities				
Share Capital	2,000	2,000	2,000	2,000
Reserves	3,600	3,450	3,600	3,600
Debentures	3,500	2,000	2,000	2,750
Current Liabilities	7,050	4,550	4,550	5,800
Minority Interest	1,500	-	-	-
Total Assets	17,650	12,000	12,150	14,150
Non-current assets				
Fixed Assets				
Tangible Assets	10,500	6,500	6,500	8,500
Intangible Assets	650	-	-	650
Investments	-	2,000	2,150 (Goodwill - ₹ 650 thousands)	-
Current Assets	6,500	3,500	3,500	5,000
Total	17,650	12,000	12,150	14,150

4.(a) From the following information, calculate the value of a share if you want to buy a small lot of shares[Market Expectation is 12%]

Year	Profit (₹)	Capital Employed (₹)	Dividend %
2009	**55,00,000**	**3,43,75,000**	**12**
2010	**1,60,00,000**	**8,00,00,000**	**15**
2011	**2,20,00,000**	**10,00,00,000**	**18**
2012	**2,50,00,000**	**10,00,00,000**	**20**

[5]

Answer :

Buying a small lot of shares

If the purpose of valuation is to provide database to aid a decision of buying a small (non-controlling) position of the equity of a company, dividend yield method is most appropriate. Dividend rate is rising continuously, weighted average will be more appropriate for calculation of average dividend.

Year	Rate of dividend	Weight	Product
2009	12	1	12
2010	15	2	30
2011	18	3	54
2012	20	4	80
		10	**176**

Average dividend = $\frac{176}{10} = 17.6\%$

Value of share on the basis of dividend for buying a small lot of shares will be

$$\frac{\text{Average dividend rate}}{\text{Market expectation rate}} \times ₹100 = \frac{17.60}{12} \times 100 = ₹146.67 \text{ per share.}$$

(b)

Equity Share Capital	**₹ 10,00,000**
Reserves & Surplus	**₹ 3,00,000**
12% Preference Share Capital	**₹ 2,00,000**
10% Debenture	**₹ 4,00,000**
Immovable property (held as investment)	**₹ 1,00,000**
Profit after tax	**₹ 2,00,000**
Rate of tax	**40%**

Companies with Beta factor of 1 in similar business have market rate of return 15% . Beta factor of Anant Ltd. is 1.1 calculate EVA assuming Risk Free Return-7%. [6]

Answer :

EVA = (Return on operating capital – weighted average cost of capital) X Operating Capital
=(12.44%-13.33%) X 18,00,000 = (16,020)

Working Note – 1

Operating Capital	₹
Equity Share Capital Reserves & Surplus 12% Preference Share Capital 10% Debenture	10,00,000 3,00,000 2,00,000 4,00,000
Total Less: Non operating Investment	19,00,000 1,00,000
Operating Capital	18,00,000

Working Note – 2
Calculation of Return on operating Capital

	₹
NOPAT = Profit after Tax + Taxes $(2,00,000 \times 40/60)$	2,00,000 1,33,333
 +Interest Expense	3,33,333 40,000
Operating EBIT (-) Economic taxes @ 40%	3,73,333 1,49,333
NOPAT	2,24,000

Working Note – 3

Calculation of WACC	
Kd = 10% (1-0.40) X 4,00,000/19,00,000 =1.26 Kp = 12% X 2,00,000/19,00,000 = 1.26 Ke = 7% + 1.1(15%-7%) = 15.8% X 13/19 = 10.81	 13.33%

Working Note – 4
Return on operating capital (%) = (₹2,24,000/₹18,00,000)×100=12.44%

(c) What is on Interest Rate Swaps? [4]

Answer:

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.

5. (a) Future maintainable profit before interest is ₹154 lakhs, normal rate of return on long term fund is 20% and on equity fund is 25%. Long term fund is of the company is ₹640 lakhs and equity fund is ₹420 lakhs. Interest on long term fund is 18% . Find out leverage effect of goodwill. [5]

Answer:

Valuation of Goodwill **(₹ in lakhs)**

Particulars		Shareholders fund approach	Long term funds approach
a. Future maintainable profits	(WN#2)	114.40	154.00
b. Normal rate of return		25%	20%
c. Normal capital employed		457.60	770.00
d. Actual capital employed		420.00	640.00
e. Goodwill		37.60	130.00
f. Leverage effect of Goodwill		92.40	

WN # 1: Ascertainment of Long Term Fund (interest thereon)

(₹ in lakhs)

Particulars	Amount
a. Total long term funds	640.00
b. Less: Equity funds	(420.00)
c. Long term fund (excluding Equity)	220.00
d. Interest @ 18%	39.60

WN # 2: Future Maintainable Profit **(₹ in lakhs)**

Particulars	Shareholders fund approach	Long term funds approach

a.	Profit before interest	154.00	154.00
b.	Less: Interest	39.60	N.A.
c.	Future maintainable profits	114.40	154.00

(b) The following figures for a period were called out from the books of Asha Corporation:

Particulars	₹
Sales	**24,80,000**
Purchase of raw materials	**10,00.000**
Agent's commission	**20,000**
Consumable stores	**25,000**
Packing material	**10,000**
Stationery	**10,000**
Audit fees	**4,000**
Staff welfare expenses	**1,58,000**
Insurance	**26,000**
Rent rate & taxes	**16,000**
Managing director's remuneration	**84,000**
Traveling expenses	**21,000**
Fuel and oil	**9,000**
Electricity	**5,000**
Material used in repairs:	
1. Materials to plant and machinery	**24,000**
2. Materials to buildings	**10,000**
Advertisement	**25,000**
Salaries and wages	**6,30,000**
Postage and telegMadhus	**14,000**
Contribution to provident fund, etc.	**60,000**
Directors' sitting fees & traveling expenses	**40,000**
Subscription paid	**2,000**
Carriage	**22,000**
Interest on loans taken	**18,000**
Dividend to shareholders	**30,000**
Depreciation provided	**55,000**
Income-tax provided	**1,00,000**
Retained earnings	**1,25,000**
Opening stock : raw Material	**85,000**
Finished goods	**2,00,000**
Closing Stock: raw Material	**1,08,000**
Finished goods	**2,40,000**

From the above you are required to prepare a statement detailing the source and disposal to added value. [10]

Answer:

Statement showing the sources and disposal of Added Value

Sources:	**Amount (₹)**	**Amount (₹)**
Sales		24,80,000

Less: Agents' commission		20,000
Add change in finished stocks (W.N 1)		40,000
Gross Output		25,00,000
Less:		
(a) Raw Materials :		
Purchases	10,00,000	
Less: Change in Stock	23,000	
	9,77,000	
Other Materials:		
Consumables	25,000	
Packing Materials	10,000	
Stationary	10,000	
Fuel & oil	9,000	
Electricity	5,000	
Repair – Plant & Machinery	24,000	
Repair – Building	10,000	
Cost of brought in inputs	10,70,000	
(b) Purchased Services:		
Audit Fees	4,000	
Insurance	26,000	
Rent, Rates & Taxes	16,000	
Traveling Expenses	21,000	
Advertisement	25,000	
Postal & Telegraph	14,000	
Subscription	2,000	
Staff Welfare Expenses	1,58,000	
Carriage	22,000	
		13,58,000
Add Value		11,42,000
Disposal:		
To Employee Costs		
MD Remuneration	84,000	
Director Sitting Fees & Expenses	40,000	
Salaries & Wages	6,30,000	
Contribution to PF	60,000	8,14,000
To Government		
Tax Provided		1,00,000
Provider of Finance		
Interest on Loan		18,000
To, Pay Share Holders		
Dividend		30,000
To Entity		
Depreciation	55,000	
Retained Earnings	1,25,000	1,80,000
Added Value		11,42,000

W.N 1 This adjustment is necessary because the cost relating to this closing stock stands included in purchase

6. **(a) A factory started its activities on 1st April, 2012. From the following data, compute the value of closing stock on 30th April, 2012.**

- **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) A Ltd. acquired 5,000 Shares of S Ltd. at ₹ 48 per Share Cum-Dividend constituting 62.50% holding in the latter. Immediately after purchase, S Ltd. declared and distributed a dividend at ₹ 4 per Share, which S Ltd. credited to its Profit and Loss Account.

One year later, S Ltd. declared a Bonus of 1 fully paid Equity Share of ₹ 10 each for every 5 Shares held. Later on, S Ltd. proposed to raise funds and made a Rights Issue of 1 Share for 5 held at ₹ 36 per Share. A Ltd. exercised its right.
After some time, at its AGM, S Ltd. had decided to split its Equity Share of ₹ 10 into Two Equity Shares of ₹ 5 each. The necessary resolutions were passed and share certificates issued to all its existing shareholders.
To increase its stake in S Ltd. to 80%, A Ltd. acquired sufficient number of shares at ₹ 30 each.
Ascertain the Cost of Control as on 31st December if S's share in Capital Profits (duly adjusted for purchase in lots) as on that date was ₹ 3,15,000. **[9]**

Answer :

A. Cost of Investment

Particulars	Shares	₹

	Cost of First Acquisition	(5,000 x ₹ 48)	5,000	2,40,000
Less:	Pre-Acquisition Dividend	(5,000 × ₹ 4 per Share)	N.A.	(20,000)
	Corrected Cost of Investment		5,000	2,20,000
Add:	Bonus Shares	(1/5 × 5,000 Shares)	1,000	–
	Cost after Bonus Shares		6,000	2,20,000
Add:	Rights Shares	(1/5 x 6,000 Shares x ₹ 36)	1,200	43,200
	Cost after Rights Issue before Share Split		**7,200**	**2,63,200**
	Cost after share split (WN 1)	(2 Sh. for 1 for 7,200 Sh = 7,200 x 2)	14,400	2,63,200
Add:	Acquisition to increase holding to 80% (Note B)	(4,032 x ₹ 30)	4,032	1,20,960
	Balance on date of Consolidation		**18,432**	**3,84,160**

Notes:

A. **Share Split:** In case of Share Split, the Cost of Acquisition will not undergo any change. Only the number of Equity Shares and the face value will change. This is similar to adjustment for Bonus Issue. However, for Bonus Issue, the face value and paid up value of the share will be the same as the original share. In share split, the face value and paid up value will be lesser than that of the original shares.

B. **Calculation of Number of Shares to be acquired to increase stake to 80%**

	Particulars			**Shares**
a.	Shares held before acquisition			14,400
b.	% of holding			62.5%
c.	Hence, Total Number of Shares of S Ltd.	(a ÷ b)	= (14,400 ÷ 62.50%)	23,040
d.	80% of above (c x 80%)		= (23,040 x 80%)	18,432
e.	Number of Shares to be acquired	(d - a)	= (18,432 - 14,400)	4,032

2. Cost of Control

Particulars		₹
Cost of Investment	**(A)** (from 1 above)	**3,84,160**
Nominal Value of Equity Capital	(18,432 x ₹ 5 per Share)	92,160
Share in Capital Profit		3,15,000
Total of Above	**(B)**	**4,07,160**
Capital Reserve (if B < A)	**(B-A)**	23,000

7.(a) K Ltd. furnishes you with the following Balance Sheet as at 31st March, 2012:

(₹ in lakhs)

Sources of Funds

Share capital :		
Authorised		**200**
Issued:		
16% Redeemable Preference shares of ₹ 100 each fully paid	**150**	
Equity shares of ₹ 10 each fully paid	**50**	**200**
Reserves and surplus		
Capital Reserve	**30**	
Securities Premium	**50**	
Revenue Reserves	**520**	**600**
		800
Funds employed in:		
Fixed assets (Tangible) : cost	**200**	
Less: Provision for depreciation	**200**	**nil**
Investments at cost (Market value ₹ 800 lakhs)		**200**
Current assets	**680**	
Less: Current liabilities	**80**	**600**
		800

The company redeemed preference shares on 1st April 2012. It also bought back 1 lakh equity shares of ₹ 10 each at ₹ 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. **Value equity share on net asset basis.** **[5+4]**

Answer:

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

(**₹ in lakhs**)

Particulars		*Debit*	*Credit*
a. Redemption of Preference Shares on 1st April 2012			
i. Due Entry			
16% Preference Share Capital A/c	Dr.	150	
To Preference Shareholders A/c			150
ii. Payment Entry			
Preference Shareholders A/c	Dr.	150	
To Bank A/c			150
b. Shares bought back			
i. On buy back			
Shares bought back A/c	Dr.	50	
To Bank A/c			50
(1 lakhs shares × ₹ 50 per share)			

ii.	On Cancellation			
	Equity Share Capital A/c (1 Lakhs × ₹ 10)	Dr.	10	
	Securities Premium A/c (1 Lakhs × ₹ 40)	Dr.	40	
	To Shares bought back A/c			50
iii.	Transfer to Capital Redemption Reserve			
	Revenue Reserve A/c	Dr.	160	
	To Capital Redemption Reserve A/c			160
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

Part - III - Net Asset Value of Equity Shares

(₹ in Crores)

Particulars			***Amount***	***Amount***
a.	i.	Fixed assets	Nil	
	ii.	Investments (at market value)	800	
	iii.	Current assets(680-200)	480	1,280
b.	Less : Current liabilities			(80)
	Net assets available for equity share holders			1,200
c.	No. of equity shares outstanding (in lakhs)			4
d.	Value per equity share of ₹ 10 each = (1,200÷4)			₹ 300

(b) Kalpana Ltd. purchased an old well for $200 million. It estimates that the well contains 500 million barrels of oil. The oil well has no salvage value. If the company extracts and sells 20,000 barrels of oil during the first year, how much depletion expense should be recognized as per IFRS 6? [6]

Answer:

In the above situation we will compute the depletion rate and depletion expense as per IFRS 6

"Exploration for and Evaluation of Mineral Resources"

Depletion rate = Current period production / Total barrels of production

= 20,000 barrels / 500,000,000 barrels
=0.00004

Depletion expense for the first year
=Purchase price x Depletion rate
= $ 200,000,000 x 0.00004
= $ 8000.

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

(a) Jaggi and Lau model on valuation of group basis of Human Resources;
(b) Forward Contract
(c) Significance of Environmental Accounting;
(d) Impairment of asset and its application to inventory.

Answer:

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

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

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

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

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

(b) Forward Contract

A forward contract is an agreement between two parties whereby one party agrees to buy from, or sell to, the other party an asset at a future time for an agreed price (usually referred to as the 'contract price'). The parties to forward contracts may be individuals, corporates or financial institutions. At maturity, a forward contract is settled by delivery of the asset by the seller to the buyer in return for payment of the contract price. For example, a person (X) may enter into a forward contract with another person (Y) on June 15, to buy 10 kgs. of silver at the end of 90 days at a price of ₹ 8,200 per kg. At the end of the 90 days, Y will deliver 10 kgs. of silver to X against payment of ₹ 82,000. If the price of silver, at the end of the 90 days, is ₹ 8,300 per kg., X would make a profit of ₹ 1,000 and Y would lose ₹ 1,000, as X could sell silver bought at ₹ 82,000 for ₹ 83,000, whereas Y would have to buy silver for ₹ 83,000 and sell for ₹ 82,000. On the other hand, if the price of silver at the end of the 90 days is ₹ 7,800 per kg., X would lose ₹ 4,000, whereas Y would make a profit of ₹ 4,000, as X would have to sell silver bought at ₹ 82,000 for ₹ 78,000, whereas Y would buy silver for ₹ 78,000, which he would sell to X at ₹ 82,000.

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

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

(d) Impairment of asset and its application to inventory:

The objective of AS 28 "Impairment of Assets" is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at not more than their recoverable amount. An asset is carried at more than its recoverable amount, if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, except the following:
i) Inventories (AS2-Valuation of Inventories);
ii) Assets arising out of a construction contracts (AS 7- Accounting for Construction Contracts);
iii) Financial assets, including investments which are included in the scope of AS 13- Accounting for Investments;
iv) Deferred tax assets (AS 22- Accounting for Taxes on income).

AS 28 does not apply to inventories, assets arising out of a construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.