PAPER – 1 : FINANCIAL REPORTING

QUESTIONS

Amalgamation of Companies

1. The following are the Balance Sheets of Andrew Ltd. and Barry Ltd., as at 31.12.2009:

Andrew Ltd.

(in Rs.'000s)

Liabilities		Assets	
Share capital		Fixed assets	3,400
3,00,000 Equity shares of Rs.10 each	3,000	Stock (pledged with secured loan creditors)	18,400
10,000 Preference shares of Rs.100 each	1,000	Other Current assets	3,600
General reserve	400	Profit and Loss account	16,600
Secured loans (secured against pledge of stocks)	16,000		
Unsecured loans	8,600		
Current liabilities	13,000		
	42,000		42,000

Barry Ltd.

(in Rs.'000s)

Liabilities		Assets	
Share capital		Fixed assets	6,800
1,00,000 Equity shares of Rs.10 each	1,000	Current assets	9,600
General reserve	2,800		
Secured loans	8,000		
Current liabilities	4,600		
	16,400		16,400

Both the companies go into liquidation and Charlie Ltd., is formed to take over their businesses. The following information is given:

(a) All Current assets of two companies, except pledged stock are taken over by Charlie Ltd. The realisable value of all Current assets are 80% of book values in case of Andrew Ltd. and 70% for Barry Ltd. Fixed assets are taken over at book value.

(b) The break up of Current liabilities is as follows:

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Statutory liabilities (including Rs.22 lakh in case of Andrew Ltd. in case of a claim not having been admitted shown as contingent liability)	72,00,000	10,00,000
Liability to employees	30,00,000	18,00,000

The balance of Current liability is miscellaneous creditors.

(c) Secured loans include Rs.16,00,000 accrued interest in case of Barry Ltd.

(d) 2,00,000 equity shares of Rs.10 each are allotted by Charlie Ltd. at par against cash payment of entire face value to the shareholders of Andrew Ltd. and Barry Ltd. in the ratio of shares held by them in Andrew Ltd. and Barry Ltd.

(e) Preference shareholders are issued Equity shares worth Rs.2,00,000 in lieu of present holdings.

(f) Secured loan creditors agree to continue the balance amount of their loans to Charlie Ltd. after adjusting value of pledged security in case of Andrew Ltd. and after waiving 50% of interest due in the case of Barry Ltd.

(g) Unsecured loans are taken over by Charlie Ltd. at 25% of Loan amounts.

(h) Employees are issued fully paid Equity shares in Charlie Ltd. in full settlement of their dues.

(i) Statutory liabilities are taken over by Charlie Ltd. at full values and miscellaneous creditors are taken over at 80% of the book value.

Show the opening Balance Sheet of Charlie Ltd. Workings should be part of the answer.

Internal reconstruction of a Company

2. The Balance Sheet of Neptune Ltd. as on 31.3.2009 is given below:

Liabilities	Rs.	Rs.	Assets	Rs.
Equity shares of Rs.10 each fully paid (80,000 shares)		8,00,000	Freehold property	5,00,000
6% Cumulative pref. shares of 100 each fully paid (5,000 shares)		5,00,000	Plant & machinery	1,80,000
6% Debentures (secured by freehold property)	3,75,000		Trade investments (at cost)	1,70,000
Arrear interest	22,500	3,97,500	Sundry debtors	4,50,000
Sundry creditors		17,500	Stock in trade	2,00,000

Director's loan	3,00,000	Deferred advertisement expenditure	1,50,000
		Profit and Loss A/c	3,65,000
	20,15,000		20,15,000

The Court approved a scheme of re-organization to take effect on 1.4.2009 and the terms are given below:

(i) Preference shares are to be written down to Rs.75 each and equity shares to Rs.2 each.

(ii) Preference dividend in arrear for 4 years to be waived by 75% and for the balance equity shares of Rs.2 each to be allotted.

(iii) Arrear of debenture interest to be paid in cash.

(iv) Debenture holders agreed to take one freehold property (Book value Rs.3,00,000) at a valuation of Rs.3,00,000 in part payment of their holding. Balance debentures to remain as liability of the company.

(v) Deferred Advertisement Expenditure to be written off.

(vi) Stock value to be written off fully in the books.

(vii) 50% of the Sundry Debtors to be written off as bad debt.

(viii) Remaining freehold property (after take over by Debentureholders) to be valued at Rs.3,50,000.

(ix) Investments sold out for Rs.2,00,000.

(x) 80% of the Director's loan to be waived and for the balance equity shares of Rs.2 each to be issued.

(xi) Company's contractual commitments amounting to Rs.5,00,000 to be cancelled by paying penalty at 3% of contract value.

(xii) Cost of Re-construction Scheme is Rs.20,000.

Show the Journal entries (with narration) to be passed for giving effect to the above transactions and draw Balance Sheet of the company after effecting the Scheme.

Buy-Back of Shares

3. Dee Limited furnishes the following Balance Sheet as at 31st March, 2009:

Liabilities	Rs.'000	Rs.'000
Share Capital:		
Authorised Capital		30,00
Issued and subscribed capital:		

2,50,000 equity shares of Rs.10 each fully paid up	25,00	
2,000, 10% Preference shares of Rs.100 each		
(Issued two months back for the purpose of buy back)	2,00	
		27,00
Reserves and Surplus:		
Capital Reserve	10,00	
Revenue Reserve	30,00	
Securities Premium	22,00	
Profit and Loss A/c	35,00	
		97,00
Current liabilities and provisions:		14,00
		1,38,00

Assets	Rs.'000
Fixed assets	93,00
Investments	30,00
Current assets, loans and advances (Including cash and bank balance)	15,00
	1,38,000

The company passed a resolution to buy back 20% of its equity capital @ Rs.50 per share. For this purpose, it sold all of its investments for Rs.22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet.

Consolidated Financial Statements of Group Companies

4. The Balance Sheets of three companies Angle Ltd., Bolt Ltd., and Canopy Ltd., as at 31st December, 2009 are given below:

Liabilities	Angle Ltd. Rs.	Bolt Ltd. Rs.	Canopy Ltd. Rs.
Share capital			
(Equity shares of Rs.100 each)	15,00,000	10,00,000	6,00,000
Reserves	2,00,000	1,25,000	75,000
Profit and Loss A/c	5,00,000	2,75,000	2,50,000
Sundry creditors	2,00,000	2,50,000	1,00,000

Bills payable	-	-	50,000
Angle Ltd.	-	1,00,000	80,000
	24,00,000	17,50,000	11,55,000

	Angle Ltd. Rs.	Bolt Ltd. Rs.	Canopy Ltd. Rs.
Goodwill	2,50,000	5,80,000	4,50,000
Plant and Machinery	4,00,000	2,50,000	3,25,000
Furniture and Fittings	2,00,000	1,50,000	1,40,000
Shares in-			
Bolt Ltd. (7,500 shares)	9,00,000	-	-
Canopy Ltd. (1,000 shares)	1,50,000		
Canopy Ltd. (3,500 shares)	-	5,20,000	-
Stock in trade	1,00,000	1,50,000	1,60,000
Sundry debtors	1,40,000	70,000	70,000
Bills receivable	50,000	20,000	-
Due from-			
Bolt Ltd.	1,20,000	-	-
Canopy Ltd.	80,000	-	-
Cash in hand	10,000	10,000	10,000
Total	24,00,000	17,50,000	11,55,000

(a) All shares were acquired on 1st July, 2008.

(b) On 1st January, 2008, the balances were:

	Angle Ltd. Rs.	Bolt Ltd. Rs.	Canopy Ltd. Rs.
Reserves	1,00,000	1,00,000	50,000
Profit and Loss account	50,000	(50,000)Dr.	30,000
Profit during 2008 were earned evenly over the year	3,00,000	2,50,000	1,00,000

(c) Each company declared a dividend of 10% in the year 2009 on its shares out of Profits for the year 2008; Angle Ltd. and Bolt Ltd. have credited their Profit and Loss account with the dividends received.

(d) The increase in reserves in case of Angle Ltd., Bolt Ltd., and Canopy Ltd., was affected in the year 2008.

(e) All the bills payable appearing in Canopy Ltd.'s Balance Sheet were accepted in favour of Bolt Ltd., out of which bills amounting Rs.30,000 were endorsed by Bolt Ltd., in favour of Angle Ltd.

(f) Stock with Bolt Ltd. includes goods purchased from Angle Ltd., for Rs.18,000. Angle Ltd., invoiced the goods at cost plus 20%.

Prepare consolidated Balance Sheet of the group as at 31st December, 2009. Working should be part of the answer. Ignore taxation including dividend distribution tax, disclose minority interest as per AS 21.

5. Consolidated balance sheet of A Ltd. group and its associate B Ltd., as on 31.03.08 before adjustment for equity method is given below:

(Rs. in '000s)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital (Rs.10)	600	100	Goodwill	10	
P & L A/c	300	-	Sundry Assets	1,175	130
Minority Interest	75	-	Investment in B Ltd.	15	-
Sundry Liabilities	225	150	P & L A/c	-	120
	1,200	250		1,200	250

A Ltd. acquired 30% of ordinary shares of B Ltd., on 01.04.06 for Rs.15,000. The balance of B Ltd., profit and loss account on that date was Rs.40,000 (Debit).

Show adjustment for equity method and redraft the consolidated balance sheet of the group as on 31.3.08.

Valuation of Shares

6. The following abridged Balance Sheet as at 31st March, 2009 pertains to Omega Ltd.

Liabilities	Rs. in lakhs	Assets	Rs. in lakhs
Share Capital:		Goodwill, at cost	420
180 lakh Equity shares of Rs. 10 each, fully paid up	1,800	Other Fixed Assets	11,166
		Current Assets	2,910
90 lakh Equity shares of Rs. 10 each, Rs. 8 paid up	720	Loans and Advances	933
		Miscellaneous Expenditure	171
150 lakh Equity shares of Rs. 5 each, fully paid-up	750		
Reserves and Surplus	5,628		
Secured Loans	4,500		
Current Liabilities	1,242		

Provisions	960	
	15,600	15,600

You are required to calculate the following for each one of the three categories of equity shares appearing in the above mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;

(ii) Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industry is 15%, whereas Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2009 the company has earned Rs. 1,371 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of Rs. 10 of a Company in the same industry is Rs. 2.

Valuation of Business

7. Shree Ltd. gives the following information:

Current profit	Rs.210 lakhs
Compound growth rate of profit	7.5% p.a.
Current cash flows from operations	Rs.270 lakhs
Compound growth rate of cash flows	6.5% p.a.
Current price earning ratio	12
Discount factor	20%

Find out the value of Shree Ltd. taking 10 years projected profit or cash flows based on (i) Discounted earnings method, (ii) Discounted cash flows method.

Valuation of Goodwill

8. From the following particulars of two companies, ascertain the value of goodwill. Terms and conditions are as follows:

(i) Assets are to be revalued.

(ii) Goodwill is to be valued at four years' purchase of average super profits for three years. Such average is to be calculated after adjustment of depreciation at ten per cent on the amount of increase/decrease on revaluation of fixed assets. Income tax is to be ignored.

(iii) Normal profit on capital employed is to be taken at 10 per cent, capital employed being considered on the basis of net revalued amounts of tangible assets.

The summarized Balance Sheets and relevant information are given below:

Liabilities	Ram Ltd.	Sam Ltd.	Assets	Ram Ltd.	Sam Ltd.
Equity shares of Rs.10 each	12.00	14.00	Goodwill	-	1.00
Reserves	2.00	1.00	Net tangible block	16.00	12.00
10 percent debentures	4.00	-	Current assets	6.00	5.00
Trade and expenses creditors	4.00	3.00			
	22.00	18.00		22.00	18.00

	Ram Ltd.	Sam Ltd.
	Rs.	Rs.
Revaluation of tangible block	20,00,000	10,00,000
Revaluation of current assets	7,00,000	2,80,000
Average annual profit for three years before charging debenture interest	3,60,000	2,88,000

Value Added

9. The following is the Profit and Loss Account of Ganpati Ltd. for the year ended 31.03.2009. Prepare a Gross Value Added Statement of Ganpati Ltd. and show also the reconciliation between Gross Value Added and Profit before taxation.

Profit and Loss Account for the year ended 31.03.2009

	Notes		Amount (Rs. in lakhs)
Income:			
Sales		–	890
Other Income		–	55
			945
Expenditure:			
Production and operational expenses	(a)	641	–
Administration expenses (Factory)	(b)	33	–
Interest	(c)	29	–
Depreciation		17	720
Profit before taxes		–	225
Provision for taxes	(d)	–	30

Profit after tax	–	195
Balance as per last Balance Sheet	–	10
		205
Transferred to General Reserve		45
Dividend paid		95
		140
Surplus carried to Balance Sheet		65
		205

Notes:

(a) Production and Operational expenses

	Rs. in lakhs
Consumption of raw materials	293
Consumption of stores	59
Salaries, Wages, Gratuities etc. (Admn.)	82
Cess and Local taxes	98
Other manufacturing expenses	109
	641

(b) Administration expenses include salaries, commission to Directors Rs.9.00 lakhs Provision for doubtful debts Rs. 6.30 lakhs.

(c)

Interest on loan from ICICI Bank for working capital	9
Interest on loan from ICICI Bank for fixed loan	10
Interest on loan from IFCI for fixed loan	8
Interest on Debentures	2
	29

(d) The charges for taxation include a transfer of Rs. 3.00 lakhs to the credit of Deferred Tax Account.

(e) Cess and Local taxes include Excise Duty, which is equal to 10% of cost of bought-in material.

Economic Value Added

10. Calculate economic value added (EVA) with the help of the following information Sun Limited.

Financial leverage: 1.4 times;
Equity Capital Rs.170 lakh;
Reserve and surplus Rs.130 lakh;
10% Debentures Rs.400 lakh;
Cost of Equity: 17.5%
Income Tax Rate: 30%.

Inflation Accounting

11. The following figures have been extracted from the accounts of Tame Ltd.

	31.3.07	31.03.08
	Rs.	Rs.
Trade receivables	1,800	3,000
Trade payable	1,000	1,200

The accounting year is 2007 – 08. The index number for receivables and payable at the beginning and year were 150 and 180 respectively. The average index for the year was 165.

Compute Monetary Working Capital Adjustment (MWCA) and show current cost adjustments.

Employee Share Based Payments

12. At the beginning of year 1, an enterprise grants 300 options to each of its 1,000 employees. The contractual life (comprising the vesting period and the exercise period) of options granted is 6 years. The other relevant terms of the grant are as below:

Vesting Period	3 years
Exercise Period	3 years
Expected Life	5 years
Exercise Price	Rs. 50
Market Price	Rs. 50
Expected forfeitures per year	3%

The fair value of options, calculated using an option pricing model, is Rs. 15 per option. Actual forfeitures, during the year 1, are 5 per cent and at the end of year 1, the enterprise still expects that actual forfeitures would average 3 per cent per year over the 3-year vesting period. During the year 2, however, the management decides that the rate of forfeitures is likely to continue to increase, and the expected forfeiture rate for the entire award is changed to 6 per cent per year. It is also assumed that 840 employees have actually completed 3 years vesting period.

200 employees exercise their right to obtain shares vested in them in pursuance of the ESOP at the end of year 5 and 600 employees exercise their right at the end of year 6. Rights of 40 employees expire unexercised at the end of the contractual life of the option, i.e., at the end of year 6. Face value of one share of the enterprise is Rs. 10.

Human Resource Reporting

13. From the following details, compute value of human resources according to Lev and Schwartz

Model .

(i)	Annual average earning of an employee till the retirement age	Rs.50,000
(ii)	Age of retirement	65 years
(iii)	Discount rate	15%
(iv)	No. of employees	20
(v)	Average age	62 years

Financial Reporting of Financial Institutions

14. (i) Krishna Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it.

(Rs. in lakhs)

	Cost	Market price
Equity Shares:		
Scrip A	40.00	40.80
Scrip B	21.00	16.00
Scrip C	40.00	24.00
Scrip D	40.00	80.00
Scrip E	60.00	70.00
	201.00	230.80
Mutual Funds		
MF_1	26.00	16.00
MF_2	20.00	14.00
MF_3	4.00	6.00
	50.00	36.00
Government Securities		
GV_1	40.00	44.00
GV_2	50.00	48.00
	90.00	92.00

Can the company adjust depreciation of a particular item of investment within a category? What should be the value of investments?

(ii) Investors Mutual Fund is registered with SEBI and having its registered office at Pune. The fund is in the process of finalizing the annual statement of accounts of one of its Open ended Mutual Fund Schemes. From the information furnished below you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31st March, 2009.

Opening Balance of net assets	12,00,000
Net Income for the year (Audited)	85,000
850200 units issued during 2008-09	96,500
752300 units redeemed during 2008-09	71,320
The par value per unit is Rs100	
(Figures given above are in Rs.'000)	

Financial Instruments

15. On 1 April, 2008 Delta Ltd. issued Rs.30,00,000, 6 % convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.12 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%. Being compound financial instrument, you are required to separate equity and debt portion as on 01.04.08.The present value of Re. 1 receivable at the end of the end of each year based on discount rates of 6% and 10% can be taken as:

	6%	10%
End of year 1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

Short Notes

16. Write short notes on:
    (i) Minimum Net Owned Fund
    (ii) Valuation of Portfolio for a Mutual fund
    (iii) Indian Financial Reporting System
    (iv) Obligations of Stock Broker on inspection by the Board
    (v) Shareholders' Value Added
    (vi) Limitations of Market Value Added
    (Vii) Limitations of Historical Cost Based Accounts
    (viii) Life Cycle Model of Brand Valuation
    (ix) Asset-Liability Management
    (x) Global Convergence of Financial Reporting Standards

Indian AS, IFRS and US GAAPs

17. State the treatment of the following items with reference to Indian Accounting Standards, IFRS and US GAAPs:

(i) Constituents of Financial Statements
(ii) Impairment of Assets
(iii) Business Combinations

Accounting Standards and Guidance Notes

18. Write short notes on:

(i) Disclosure of carrying amounts of financial assets and financial liabilities in Balance Sheet

(ii) Financial guarantee contract

(iii) De-recognition of financial liability

(iv) Impairment of asset and its application to inventory

19. Write short notes on:

(i) Graded vesting under an employee stock option plan

(ii) Presentation of MAT credit in the financial statements

(iii) Accounting for investment by a holding company in subsidiaries.

(iv) Provisions of AS 26 relating to retirement and disposal of intangible assets.

(v) Change in accounting estimates.

20. (i) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs.2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal? Discuss.

(ii) The accounting year of X Ltd. ends on 30th September, 2009 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1-10-2008 and ends on 30-9-2009, the quarterly income is as under:-

1st quarter ending on 31-12-2008	Rs. 200 crores
2nd quarter ending on 31-3-2009	Rs. 200 crores
3rd quarter ending on 30-6-2009	Rs. 200 crores
4th quarter ending on 30-9-2009	Rs. 200 crores
Total	Rs. 800 crores

Average actual tax rate for the financial year ending on 31-3-2009 is 20% and for financial year ending 31-3-2010 is 30%. Calculate tax expense for each quarter.

(iii) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the viewpoint of AS -18 on Related Party Disclosures?

(iv) On March 01, 2009, X Ltd. purchased Rs. 5 lakhs worth of land for a factory site. Company demolished an old building on the property and sold the material for Rs. 10,000. Company incurred additional cost and realized salvaged proceeds during the March 2009 as follows:

Legal fees for purchase contract and recording ownership	Rs. 25,000
Title guarantee insurance	Rs. 10,000
Cost for demolition of building	Rs. 50,000

Compute the balance to be shown in the land account on March 31, 2009 balance sheet.

(v) The closing inventory at cost of a company amounted to Rs. 2,84,700. The following items were included at cost in the total:

(a) 400 coats, which had cost Rs. 80 each and normally sold for Rs. 150 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(b) 800 skirts, which had cost Rs. 20 each. These too were found to be defective. Remedial work in April cost Rs. 5 per skirt, and selling expenses for the batch totaled Rs. 800. They were sold for Rs. 28 each.

What should the inventory value be according to AS 2 after considering the above items?

21. (i) A Ltd. acquired 45% of B Ltd. shares on April 01, 2008, the price paid was Rs. 15,00,000. Following are the extract of balance sheet of B Ltd.:

Paid up Equity Share Capital	Rs. 10,00,000
Securities Premium	Rs. 1,00,000
Reserve & Surplus	Rs. 5,00,000

B Ltd. has reported net profits of Rs. 3,00,000 and paid dividends of Rs. 1,00,000. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 2009.

(ii) Mr. X set up a new factory in the backward area and purchased plant for Rs. 500 lakhs for the purpose. Purchases were entitled for the CENVAT credit of Rs. 10 lakhs and also Government agreed to extend the 25% subsidy for backward area development. Determine the depreciable value for the asset.

(iii) The following date apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.09, calculate the actual return on plan assets:

- Benefits paid	2,00,000
- Employer contribution	2,80,000
- Fair market value of plan assets on 31.03.09	11,40,000
- Fair market value of plan asset as on 31.03.08	8,00,000

22. The following are the summarized Balance Sheet of Star Ltd. as on 31st March, 2008 and 2009:

(Rs.'000)

	2008	2009
Equity share capital of Rs.10 each	3,400	3,800
Profit and Loss A/c	400	540
Securities Premium	40	80
Debentures	800	900
Long term borrowings	180	240
Sundry Creditors	360	440
Provision for Taxation	20	40
Proposed Dividend	300	480
	5,500	6,520
Sundry Fixed Assets:		
Gross Block	3,200	4,000
Less: Depreciation	640	1,440
Net Block	2,560	2,560
Investment	1,200	1,400
Inventories	1,000	1,400
Sundry Debtors	640	900
Cash and Bank Balance	100	260
	5,500	6,520

The Profit and Loss account for the year ended 31st March, 2009 disclosed:

	(Rs.'000)
Profit before Tax	780
Less: Taxation	160
Profit after tax	620
Less: Proposed dividends	480
Retained Profit	140

The following information is also available:

(1) 40,000 equity share issued at a premium of Re.1 per share.

(2) The Company paid taxes of Rs.1,40,000 for the year 2008-09.

(3) During the period it discarded fixed assets costing Rs.4 lacs, (accumulated depreciation Rs.80,000) at Rs.40,000 only.

You are required to prepare a cash flow statement as per AS-3 (Revised), using indirect method. Ignore debenture interest.

23. (i) Moon Ltd. entered into agreement with Sun Ltd. for sale of goods of Rs.8 lakhs at a profit of 20 % on cost. The sale transaction took place on 1st February, 2009. On the same day Sun Ltd. entered into another agreement with Moon Ltd. to resell the same goods at Rs. 10.80 lakhs on 1st August, 2009. The pre-determined re-selling price covers the holding cost of Sun Ltd. State the treatment of this transaction in the financial statements of Moon Ltd. as on 31.03.09.

(ii) XY Ltd. was making provisions for non-moving stocks based on no issues for the last 12 months upto 31.03.08. Based on technical evaluation the company wants to make provisions during the year 31.03.09.

Total value of stock --- Rs. 150 lakhs.

Provisions required based on 12 months issue Rs. 4.0 lakhs.

Provisions required based on technical evaluation Rs. 3.20 lakhs.

Does this amount to change in accounting policy ? Can the company change the method of provision?

(iii) From the following information relating to X Ltd., calculate Diluted Earnings Per Share as per AS 20:

Net Profit for the current year	Rs.2,00,00,000
Number of equity shares outstanding	40,00,000
Basic earnings per share	Rs.5.00
Number of 11% convertible debentures of Rs.100 each	50,000
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	Rs.5,50,000
Tax saving relating to interest expense (30%)	Rs.1,65,000

24. (i) A company is engaged in the business of ship building and ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently, invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and the amount. Customer scrutinizes the invoice and any variation is informed to the company. Negotiations take place between the company and the customer. Negotiations may result in a deduction being allowed from the invoiced

amount either as a lumpsum or as a percentage of the invoiced amount. The accounting treatment followed by the company is as follows:

(i) When the invoice is raised, the customer's account is debited and ship repair income account is credited with the invoiced amount.

(ii) Deduction, if any, arrived after negotiation is treated as trade discount by debiting the ship repair income account.

(iii) At the close of the year, negotiation in respect of certain invoices had not been completed. In such cases, based on past experience, a provision for anticipated loss is created by debiting the Profit and Loss account. The provision is disclosed in Balance Sheet.

Following two aspects are settled in the negotiations:

(i) Errors in billing arising on account of variation between the quantities as per work completion certificate and invoice and other clerical errors in preparing the invoice.

(ii) Disagreement between the company and customer about the rate/cost on which prior agreement has not been reached between them.

Comment whether the accounting treatment of deduction as trade discount is correct? If not, state the correct accounting treatment.

(ii) A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at Rs.10 crores out of which Rs.7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

(iii) X Ltd. is a subsidiary of Y Ltd. It holds 9% Rs.100 5-year debentures of Y Ltd. and designated them as held to maturity as per AS 30 "Financial Instruments: Recognition and Measurement". Can X Ltd. designate this financial asset as hedging instrument for managing foreign currency risk?

(iv) Rose Ltd. had made an investment of Rs.500 lakhs in the equity shares of Nose Ltd. on 10.01.2009. The realizable value of such investment on 31.03.2009 became Rs.200 lakhs as Nose Ltd. lost a case of patent rights. Rose Ltd. follows financial year as accounting year. How will you recognize this reduction in Financial statements for the year 2008-09?

25. (i) Axe Limited began construction of a new plant on 1st April, 08 and obtained a special loan of Rs.4, 00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

The expenditure that was made on the project of plant is as follows:

	Rs.
1st April, 08	5,00,000
1st August, 08	12,00,000
1st January, 09	2,00,000

The company's other outstanding non-specific loan was Rs.23,00,000 at an interest rate of 12%. The construction of the plant completed on 31st March, 09. You are required to calculate the amount of interest to be capitalized as per the provisions of AS-16 "Borrowing cost".

(ii) X Ltd. has entered into a contract by which it has the option to sell its identified Property, Plant and Equipment (PPE) to Y Ltd. for Rs.100 million after 3 years whereas its current market price is Rs.180 million. Is the put option of X Ltd. a financial instrument? Is the written put option of Y Ltd. a financial instrument? Explain.

(iii) X Ltd. received a revenue grant of Rs.10 cores during 2006-07 from Government for welfare activities to be carried on by the company for its employees. The grant prescribed the conditions for utilizations. However during the year 2008-09, it was found that the prescribed conditions were not fulfilled and the grant should be refunded to the Government.

State how this matter will have to be dealt with in the financial statements of X Ltd. for the year ended 2008-09.

(iv) Goods of Rs.5,00,000 were destroyed due to flood in September, 2006. A Claim was lodged with insurance company. But no entry was passed in the books for insurance claim. In March, 2009, the claim was passed and the company received a payment of Rs.3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2009.

SUGGESTED ANSWERS/HINTS

1. Balance sheet of Charlie Ltd. as at 31st December, 2009

(in Rs. 'ooos)

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill (W.N.4)	9,470
Authorised		Other Fixed Assets (3,400 + 6,800)	10,200
Shares of Rs.10 each		Current Assets(2,880 + 6,720)	9,600
Issued, subscribed & Paid up:		Cash at Bank	2,000
7,00,000 equity shares of Rs.10 each, fully paid up (W.N. 5) (of the above 5,00,000 shares have been issued for consideration other than cash)	7,000		
Secured loans (1,280 + 7,200)	8,480		

Unsecured Loans (25% of 8,600)	2,150		
Current Liabilities (7,200 + 1,000 + 4,000 +1,440))	13,640		
	31,270		31,270

Working Notes:

1. Value of miscellaneous creditors taken over by Charlie Ltd.

(in Rs. 'ooos)

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Given in balance sheet	13,000	4,600
Less: Statutory liabilities	5,000	1,000
Liability to employees	3,000	1,800
Miscellaneous creditors	5,000	1,800
80% thereof	4,000	1,440

2. Value of total liabilities taken over by Charlie Ltd.

	Andrew Ltd.		Barry Ltd.	
	Rs.	Rs.	Rs.	Rs.
Current liabilities				
Statutory liabilities	7,200		1,000	
Liability to employees	3,000		1,800	
Miscellaneous creditors (W.N.1)	4,000	14,200	1,440	4,240
Secured loans				
Given in Balance sheet	16,000		8,000	
Interest waived	-		800	7,200
Value of Stock (80% of Rs.184 lakhs)	14,720	1,280		
Unsecured Loans (25% of Rs. 86 lakhs)		2,150		-
		17,630		11,440

3. Assets taken over by Charlie Ltd.

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Fixed Assets (Assumed on book value basis)	3,400	6,800

Current Assets 80% and 70% respectively of book value		2,880	6,720
		6,280	13,520

(3) Shares. No.

4. Goodwill / Capital Reserve on amalgamation

Liabilities taken over (W.N. 2)		17,630	11,440
Equity shares to be issued to Preference Shareholders		200	-
	A	17,830	11,440
Less: total assets taken over (W.N. 3)	B	6,280	13,520
	A-B	11,550	(2,080)
		Goodwill	Capital Reserve
Net Goodwill		9,470	

5. Equity shares issued by Charlie Ltd.

			No.
(i)	For Cash		200000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	4,80,000	
(iii)	To Preference shareholders	20,000	5,00,000
			7,00,000
	Value		Rs.10x 7,00,000= Rs. 70 Lakhs

2. In the Books of Neptune Ltd.

Journal Entries

	Particulars		Rs.	Rs.
(i)	6% Preference Share Capital A/c (Rs. 100)	Dr.	5,00,000	
	To 6% Preference Share Capital A/c (Rs. 75)			3,75,000
	To Capital Reduction A/c			1,25,000
	(Being the Preference Shares of Rs.100/- each reduced to Rs.75/- as per scheme)			
(ii)_	Equity Share Capital A/c (Rs.10)	Dr.	8,00,000	
	To Equity Share Capital A/c (Rs.2)			1,60,000
	To Capital Reduction A/c			6,40,000
	(Being the equity shares of Rs.10/- each reduced to Rs.2/- as per scheme)			

(iii)	Capital Reduction A/c	Dr.	30,000	
	To Equity Share Capital A/c			30,000
	(Arrears of preference share dividend of one year to be satisfied by issue of 1,500 equity shares of Rs.2/- each i.e. to the extent of 25% of arrear dividend)			
(iv)	Accrued Debenture Interest A/c	Dr.	22,500	
	To Bank A/c			22,500
	(Accrued Debenture Interest paid)			
(v)	6% Debenture A/c	Dr.	3,00,000	
	To Freehold Property			3,00,000
	(Claim settled in part by transfer of freehold property as per scheme)			
(vi)	Capital Reduction A/c	Dr.	9,40,000	
	To Profit and Loss A/c			3,65,000
	To Deferred Advertising Expenses A/c			1,50,000
	To Stock A/c			2,00,000
	To Sundry Debtors A/c			2,25,000
	(Being the various assets written off as per scheme)			
(vii)	Freehold Property A/c	Dr.	1,50,000	
	To Capital Reduction			1,50,000
	(Appreciation in the value of property i.e. (Rs.3,50,000-2,00,000)			
(viii)	Bank A/c	Dr.	2,00,000	
	To Trade Investment			1,70,000
	To Capital Reduction			30,000
	(Trade Investment sold and profit made)			
(ix)	Director's Loan A/c	Dr.	3,00,000	
	To Equity Share Capital A/c			60,000
	To Capital Reduction A/c			2,40,000
	(Directors loan reduced by 80% and remaining balance discharged by issue of equity shares of Rs. 2 each)			
(x)	Capital Reduction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Payment of 3% penalty for cancellation of Capital Commitments)			

(xi)	Capital Reduction A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Reconstruction expenses paid)			
(xii)	Capital Reduction Account	Dr.	1,80,000	
	To Capital Reserve Account			1,80,000
	(Being balance of capital reduction account transferred)			

Balance Sheet of Neptune Ltd.

as at 1st April, 2009 (As Reduced)

Liabilities	Rs.	Assets	Rs.
Share Capital		Freehold Property	3,50,000
1,25,000, Equity Shares of Rs.2/- each (out of above 45,000 shares have been issued for consideration other than cash)	2,50,000	Plant	1,80,000
5,000, 6% Cumulative Preference Shares of Rs.75/- each fully paid	3,75,000	Debtors	2,25,000
Capital Reserve	1,80,000	Cash at Bank	1,42,500
6% Debentures	75,000		
Creditors	17,500		
	8,97,500		8,97,500

3. Books of Dee Limited

Journal Entries

Date	Particulars		Dr.'000	Cr.'000
	Bank A/c	Dr.	22,00	
	Profit and Loss A/c	Dr.	8,00	
	To Investment A/c			30,00
	(Being the Sale of all investments)			
	Equity Share Capital A/c	Dr.	5,00	
	Premium payable on buy back A/c	Dr.	20,00	
	To Equity shares buy back A/c			25,00
	(Being the amount due on buy back)			
	Securities Premium A/c	Dr.	20,00	
	To Premium payable on buy back A/c			20,00
	(Being the premium payable on buy back provided for)			

Securities Premium A/c	Dr.	2,00	
Revenue Reserve A/c	Dr.	1,00	
To Capital Redemption Reserve A/c			3,00
(Being the amount equal to nominal value of equity shares bought back out of securities premium and free reserves transferred to capital redemption reserve a/c)			
Equity shares buy-back A/c	Dr.	25,00	
To Bank A/c			25,00
(Being the payment made on buy back)			

Balance Sheet of Dee Limited as on 1st April, 2009

(After buy back of shares)

Liabilities	Rs.'000	Rs.'000
Share Capital		
Authorised Capital:		30,00
Issued and Subscribed Capital:		
2,00,000 equity shares of Rs.10 each fully paid up	20,00	
2,000 10% Preference shares of Rs.100 each fully paid up	2,00	22,00
Reserve and Surplus:		
Capital Reserve	10,00	
Capital Redemption Reserve	3,00	
Revenue Reserve	29,00	
Profit and Loss A/c (35,00 – 8,00)	27,00	69,00
Current Liabilities and Provisions		14,00
		10,500
Fixed Assets		93,00
Current assets loans and advances (including cash and bank balance) (15,00+22,00- 25,00)		12,00
		10,500

4. Consolidated Balance Sheet of Angle Ltd. and its subsidiaries

Bolt Ltd and Canopy Ltd

as at 31st December, 2009

Liabilities	Rs.	Assets		Rs.
Share Capital	15,00,000	Goodwill		
(Equity shares of Rs.100 each)		Angle Ltd.	2,50,000	
		Bolt Ltd.	5,80,000	

			Canopy Ltd. 4,50,000	12,80,000	
			Add: Cost of control(W.N.7)	1,55,833	14,35,833
Minority Interest (W.N. 6)			Plant & Machinery		
Bolt Ltd.	3,97,396		Angle Ltd.	4,00,000	
Canopy Ltd.	2,31,250	6,28,646	Bolt Ltd.	2,50,000	
Reserves (2,00,000+14,844+2,083)		2,16,927	Canopy Ltd.	3,25,000	9,75,000
Profit and Loss Account (W.N.4)		7,62,260	Furniture & Fittings		
Sundry Creditors			Angle Ltd.	2,00,000	
Angle Ltd. 2,00,000					
Bolt Ltd. 2,50,000					
Canopy Ltd. 1,00,000		5,50,000			
Bills Payable	50,000		Bolt Ltd.	1,50,000	
Less: Mutually held	50,000	Nil	Canopy Ltd.	1,40,000	4,90,000
			Stock-in-Trade		
			Angle Ltd.	1,00,000	
			Bolt Ltd.	1,50,000	
			Canopy Ltd.	1,60,000	
				4,10,000	
			Less: Provision for unrealised Profit	3,000	4,07,000
			Sundry Debtors		
			Angle Ltd.	1,40,000	
			Bolt Ltd.	70,000	
			Canopy Ltd.	70,000	2,80,000
			Bills Receivable		
			Angle Ltd.	50,000	
			Bolt Ltd.	20,000	
				70,000	
			Less: Mutually held	50,000	20,000
			Cash-in-hand		
			Angle Ltd.	10,000	

	Bolt Ltd.	10,000	
	Canopy Ltd.	10,000	30,000
	Cash-in-Transit / Dues from Bolt Ltd.		20,000
36,57,833			36,57,833

Disclosure in accordance with AS 21

Amount of Equity attributable to minorities on the date of Investment ie. 1.7.2008

	Bolt Ltd	Canopy Ltd.
Share capital	2,50,000	1,50,000
Share in Capital Reserve as on 1.1.08	25,000	12,500
Share in Capital Profits as on 1.1.08	(12,500)	7,500
Share in Capital Profits for the period1.1.08 to 30.6.08	31,250	12,500
	2,93,750	1,82,500
Total amount of Equity attributable to minorities	4,76,250	

Disclosure in accordance with AS 21

Minority Interest as on 31.12.2009

Amount of equity as on the date of Investment ie. 1.7.2008	4,76,250
Add: Movement in equity and proportionate share of Profit less dividend from the date of Investment up to 31.12.09	1,52,396
	6,28,646

Working Notes:

1. Ascertainment of Profits for the year 2009

	Angle Ltd.	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.	Rs.
Balance as on 1st January, 2008	50,000	(50,000)	30,000
Add: Profits earned during 2008	3,00,000	2,50,000	1,00,000
	3,50,000	2,00,000	1,30,000
Less: Dividend Declared	1,50,000	1,00,000	60,000
	2,00,000	1,00,000	70,000

Less: Transfer to Reserve	1,00,000	25,000	25,000
	1,00,000	75,000	45,000
Profit for the year 2009 (Balancing Figure)	4,00,000	2,00,000	2,05,000
Balance as on 31st December, 2009	5,00,000	2,75,000	2,50,000

2. Undistributed profits for the year 2008

	Bold Ltd.	Canopy Ltd.
	Rs.	Rs.
Profits for the year 2008	2,50,000	1,00,000
Less: Dividends declared	1,00,000	60,000
	1,50,000	40,000
Less: Transfer to Reserves	25,000	25,000
	1,25,000	15,000

3. Analysis of Profits

	Capital Profits	Revenue Reserve	Revenue Profits
	Rs.	Rs.	Rs.
Canopy Ltd.			
Reserves as on 1st January, 2008	50,000		
Transfer to Reserve in the year 2008 [(75,000-50,000)/2]	12,500	12,500	
Profit & Loss Account			
Balance as on 1st January, 2008	30,000		
Profit for 2008 remaining undistributed [(1,00,000-25,000-60,000)/2]	7,500		7,500
Profit for the year 2009 (2,50,000-30,000-15,000)		-	2,05,000
(A)	1,00,000	12,500	2,12,500
Minority Interest [¼ th of (A)]	25,000	3,125	53,125
	75,000	9,375	1,59,375
Share of Angle Ltd. [1/6 th of (A)]	16,667	2,083	35,417
Share of Bolt Ltd.	58,333	7,292	1,23,958
Bolt Ltd.			
Reserves as on 1st January, 2008	1,00,000		
Transfer to Reserves 2008	12,500	12,500	

[(1,25,000-1,00,000)/2]			
Profit & Loss Account - Balance (Dr.) as on 1st January, 2008	(50,000)		
Undistributed Profits for 2008 [(2,50,000-25,000-1,00,000)/2]	62,500		62,500
Share in profits of Canopy Ltd.	58,333	7,292	1,23,958
Profit for the year, 2009 (2,75,000+50,000-1,25,000)			2,00,000
(B)	1,83,333	19,792	3,86,458
Less: Minority Interest [¼ th of (B)]	45,833	4,948	96,615
Share of Angle Ltd.	1,37,500	14,844	2,89,843

4. Consolidated Profit and Loss Account of Angle Ltd.

		Rs.
Profit & Loss Account balance as on 31.12.2009		5,00,000
Add:Share in revenue profits of Canopy Ltd.		35,417
Share in revenue profits of Bolt Ltd.		2,89,843
Less:Pre-acquisition dividend		8,25,260
Angle Ltd. ½ (Rs. 75,000 +Rs. 10,000)	42,500	
Bolt Ltd. (½ of Rs. 35,000)	17,500	60,000
		7,65,260
Less:Unrealised Profit in Closing Stock (20/120 × 18,000)		3,000
		7,62,260

5. Consolidated Reserves of Angle Ltd.

	Rs.
Reserves as on 31.12.2007	2,00,000
Add: Share in revenue reserves of Canopy Ltd.	2,083
Add: Share in revenue reserves of Bolt Ltd.	14,844
	2,16,927

6. Minority Interest

	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.
Share Capital	2,50,000	1,50,000
Share of Capital Profits	45,833	25,000
Share of Revenue Reserves	4,948	3,125

Share of Revenue Profits	96,615	53,125
Total	3,97,396	2,31,250
Grand total		6,28,646

7. Cost of Control/Goodwill

	Rs.	Rs.
Cost of investments (9,00,000+1,50,000+5,20,000)		15,70,000
Less: Dividend Attributable to Pre-Acquisition Profits for 6 months i.e. [(75,000+45,000)/2]		60,000
		15,10,000
Less:Face value of Shares		
Bolt Ltd.	7,50,000	
Canopy Ltd.	4,50,000	
Capital Profits		
Bolt Ltd.	1,37,500	
Canopy Ltd.	16,667	13,54,167
Goodwill		1,55,833

8. Cash in Transit /Dues from Bolt Ltd.

		Rs.	Rs.
(i)	Due to Angle Ltd.		
	From Bolt Ltd.	1,20,000	
	From Canopy Ltd.	80,000	2,00,000
(ii)	Due by Angle Ltd.		
	To Bolt Ltd.	1,00,000	
	To Canopy Ltd.	80,000	1,80,000
			20,000

5. (Rs. in '000s)

Closing equity = 30% of (100 – 120) = (6)

Pre-acquisition equity = 30% of (100 – 40) = 18

Calculation of capital reserve/ goodwill

	(Rs. '000s)
Investments in B Ltd.	15
Less : Pre-acquisition equity	18
Capital Reserve	3

Post-acquisition loss = 30% of (120 – 40) = 24

Adjustment for equity method

	Rs.	Rs.	
P & L A/c	18		Balancing figure
To Capital Reserve		3	
To Investment in B Ltd.		15	Carrying amount

Note: Loss not recognized = Rs.24 – Rs.18 = Rs.6

Consolidated Balance Sheet of A Ltd., group as at 31.3.2008

Liabilities	Rs.000	Assets	Rs.000
Share Capital (Rs.10)	600	Goodwill	10
P & L A/c (300 – 18)	282	Sundry Assets	1,175
Capital Reserve	3		
Minority Interest	75		
Sundry Liabilities	225		
	1,185		1,185

6.

(i)

Intrinsic value on the basis of book values	Rs. in lakhs	Rs. in lakhs
Goodwill		420
Other Fixed Assets		11,166
Current Assets		2,910
Loans and Advances		933
		15,429
Less: Secured loans	4,500	
Current liabilities	1,242	
Provisions	960	6,702
		8,727
Add: Notional call on 90 lakhs equity shares @ Rs. 2 per share		180
		8,907

Equivalent number of equity shares of Rs. 10 each.

	Rs. in lakhs
Fully paid shares of Rs. 10 each	180
Partly-paid shares after notional call	90

Fully paid shares of Rs. 5 each, $\left[\frac{\text{Rs.}150\text{ lakhs}}{\text{Rs.}10} \times \text{Rs.}5\right]$ 75

345

Value per equivalent share of Rs. 10 each = $\text{Rs.}\frac{8{,}907\text{ lakhs}}{345\text{ lakhs}} = \text{Rs.}25.82$

Hence, intrinsic values of each equity share are as follows:

Value of fully paid share of Rs. 10 = Rs. 25.82 per equity share.

Value of share of Rs. 10, Rs. 8 paid-up = Rs. 25.82 – Rs. 2 = Rs. 23.82 per equity share.

Value of fully paid share of Rs. 5 = $\frac{\text{Rs.}25.82}{2} = \text{Rs.}12.91$ per equity share.

(ii) Valuation on dividend yield basis:

Value of fully paid share of Rs. 10 = $\frac{20}{15} \times \text{Rs.}10 = \text{Rs.}13.33$

Value of share of Rs. 10, Rs. 8 paid-up = $\frac{20}{15} \times \text{Rs.}8 = \text{Rs.}10.67$

Value of fully paid share of Rs. 5 = $\frac{20}{15} \times 5 = \text{Rs.}6.67$

(iii) Valuation on the basis of EPS:

Profit after tax = Rs. 1,371 lakhs

Total share capital = Rs. (1,800 + 720 + 750) lakhs = Rs. 3,270 lakhs

Earning per rupee of share capital = $\text{Rs.}\frac{1{,}371\text{ lakhs}}{3{,}270\text{ lakhs}} = \text{Re.}0.419$

Earning per fully paid share of Rs. 10 = Re. 0.419 × 10 = Rs. 4.19

Earning per share of Rs. 10 each, Rs. 8 paid-up = Re. 0.419 × 8 = Rs. 3.35

Earning per share of Rs. 5, fully paid-up = Re. 0.419 × 5 = Rs. 2.10

Value of fully paid share of Rs. 10 = $\text{Rs.}\frac{4.19}{2} \times 10 = \text{Rs.}20.95$

Value of share of Rs. 10, Rs. 8 paid-up = $\text{Rs.}\frac{3.35}{2} \times 10 = \text{Rs.}16.75$

Value of fully paid share of Rs. 5 = $\text{Rs.}\frac{2.10}{2} \times 10 = \text{Rs.}10.50$

7. (i) Discounted earnings method

(Rs. in lakhs)

Year	Earnings	Discount Factor @ 20%	Present value
1	225.75	0.8333	188.117
2	242.68	0.6944	168.517
3	260.88	0.5787	150.971
4	280.45	0.4823	135.261
5	301.48	0.4019	121.165
6	324.09	0.3349	108.538
7	348.40	0.2791	97.238
8	374.53	0.2326	87.116
9	402.62	0.1938	78.028
10	432.82	0.1615	69.900
			1204.851

Value of the business Rs.1204.851 Lakhs

(ii) Discounted cash flows method

(Rs. In lakhs)

Year	Earnings	Discount Factor @ 20%	Present value
1	287.55	0.8333	239.615
2	306.24	0.6944	212.653
3	326.15	0.5787	188.743
4	347.35	0.4823	167.527
5	369.92	0.4019	148.671
6	393.97	0.3349	131.941
7	419.58	0.2791	117.105
8	446.85	0.2326	103.937
9	475.89	0.1938	92.227
10	506.83	0.1615	81.853
			1484.272

Value of the business Rs.1484.272 Lakhs.

8. Valuation of Goodwill

	Ram Ltd.	Sam Ltd.
	Rs.	Rs.
Average annual profit after charging debenture interest	3,20,000	2,88,000
Less/Add : Depreciation on amount increased/decreased on revaluation	(-)40,000	+20,000
	2,80,000	3,08,000
Less: Normal profit at 10% on capital employed as calculated in working note	1,90,000	98,000
Super Profit	90,000	2,10,000
Goodwill valued at four years' purchase of super profits	3,60,000	8,40,000

Working Note:

Calculation of Capital Employed

	Ram Ltd.	Sam Ltd.
	Rs.	Rs.
Tangible fixed assets	20,00,000	10,00,000
Current assets	7,00,000	2,80,000
	27,00,000	12,80,000
Less:Debentures and Creditors	8,00,000	3,00,000
	19,00,000	9,80,000

9. Ganpati Ltd.

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

	Rs. in lakhs	Rs. in lakhs
Sales		890
Less: Cost of bought in materials and services:		
Production and operational expenses (293 + 59 + 109)	461	
Administration expenses (33 – 9)	24	
Interest on working capital loan	9	
Excise duty (Refer working note)	55	549
Value added by manufacturing and trading activities		341
Add: Other income		55
Total value added		396

Application of Value Added %

To	Employees			
	Salaries, wages, gratuities etc.		82	20.71%
To	Directors			
	Salaries and commission		9	2.27%
To	Government			
	Cess and local taxes (98 – 55)	43		
	Income tax	27	70	17.68%
To	Providers of capital			
	Interest on debentures	2		
	Interest on fixed loan	18		
	Dividends	95	115	29.04%
To	Provide for maintenance and expansion of the company			
	Depreciation	17		
	General reserve	45		
	Deferred tax	3		
	Retained profits (65 – 10)	55	120	30.30%
			396	100%

Statement showing reconciliation of Gross Value Added with Profits before taxation

		Rs. in lakhs
Profits before taxes		225
Add:		
Depreciation	17	
Directors' remuneration	9	
Salaries, wages & gratuities etc.	82	
Cess and local taxes	43	
Interest on debentures	2	
Interest on fixed loan	18	171
Total value added		396

Working Note:

Calculation of Excise Duty

Say cost of bought in materials and services is 'x'

Excise Duty is 10% of x = x/10

$x = 461 + 24 + 9 + x/10$

x = 494 + x/10 = 549 (approx.)*

Excise Duty = 549 – 494 = Rs. 55

10. Financial Leverage = $\dfrac{\text{EBIT}}{\text{EBIT} - \text{Interest}} = \dfrac{\text{EBIT}}{\text{EBIT} - 10\% \text{ of } 400} = 1.40$

EBIT = {(10% of 400) × 1.40] /0.40 = 140

EBIT (l – t) = 140 (1 – 0.30) = 98

Equity capital = 170 + 130 = 300

Debt Capital = 400

Post-tax cost of debt = 10% (1 – 0.30) = 7%

Overall cost of capital [Post-tax] = 17.5% of 300 + 7% of 400 = 80.5

Economic Value Added (EVA)

= EBIT (l – t) – Overall cost of capital (Post-tax) = 98 – 80.5 = 17.5 (Rs. Lakh)

11. Closing MWC at average price = Rs.1,800 × (165/180) = Rs.1,650

Opening MWC at average price = Rs.800 × (165/150) = Rs.880

Computation of MWCA

	Historical Cost	Average Price	Price Difference
	Rs.	Rs.	Rs.
Closing MWC	1,800	1,650	150
Opening MWC	800	880	80
Increase in MWC	1,000	770	230
	Total change	Volume change	Price change

MWCA = Rs.230 (Increase in value of MWC due to price rise)

CCA Adjustment in books of Tame Ltd.

	Rs.	Rs.	Remarks
Profit & Loss A/c	230		MWCA
To Current Cost Reserve		230	

Monetary assets and liabilities reflect contracted amounts. These are not converted to current costs for the purpose of current cost balance sheet.

* The above calculated excise duty is not exactly 10% of cost of bought in material amounting Rs. 549. The difference is due to approximation.

12.

	Particulars		Dr. (Rs.)	Cr. (Rs.)
Year 1	Employee compensation expense A/c	Dr.	13,69,010	
	To Stock Options Outstanding A/c			13,69,010
	(Being compensation expense recognised in respect of the ESOP)			
Year 2	Employee compensation expense A/c	Dr.	11,22,740	
	To Stock Options Outstanding A/c			11,22,740
	(Being compensation expense recognised in respect of the ESOP)			
Year 3	Employee compensation expense A/c	Dr.	12,88,250	
	To Stock Options Outstanding A/c			12,88,250
	(Being compensation expense recognised in respect of ESOP)			
Year 5	Bank A/c @ Rs.50	Dr.	30,00,000	
	Stock Options Outstanding A/c @ Rs. 15	Dr.	9,00,000	
	To Share Capital A/c @ Rs. 10			6,00,000
	To Securities Premium A/c @ Rs. 55			33,00,000
	(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)			
	Bank A/c @ Rs.50	Dr.	90,00,000	
	Stock Options Outstanding A/c @ Rs. 15	Dr.	27,00,000	
	To Share Capital A/c @ Rs. 10			18,00,000
	To Securities Premium A/c @ Rs. 55			99,00,000
	(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)			
	Stock Options Outstanding A/c	Dr.	1,80,000	
	To General Reserve			1,80,000
	(Being the balance standing to the credit of the Stock Options Outstanding Account, in respect of vested options expired unexercised, transferred to the general reserve)			

Working Notes:

1. The enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below:

   No. of options expected to vest = 300 x 1,000 x 0.97 x 0.97 x 0.97 = 2,73,802 options

   Fair value of options expected to vest = 2,73,802 options x Rs. 15 = Rs. 41,07,030

2. As the enterprise still expects actual forfeitures to average 3 per cent per year over the 3-year vesting period, therefore, it recognizes Rs. 41,07,030/3 towards the employee services.

3. The revised number of options expected to vest

   = 2,49,175 (3,00,000 x .94 x .94 x .94).

   The fair value of revised options expected to vest

   = Rs. 37,37,625 (2,49,175 x Rs. 15).

   The expense to be recognised during the year is determined as below:

Revised total fair value	Rs. 37,37,625
Revised cumulative expense at the end of year 2	
= (Rs. 37,37,625 x 2/3)	Rs. 24,91,750
Less: Expense already recognised in year 1	Rs. 13,69,010
Expense to be recognised in year 2	Rs. 11,22,740

4. The expense to be recognised during the year is determined as below:

   No. of options actually vested = 840 x 300 = 2,52,000

Fair value of options actually vested (Rs. 2,52,000 x Rs. 15) =	Rs. 37,80,000
Expense already recognised	Rs. 24,91,750
Expense to be recognised in year 3	Rs. 12,88,250

13. Value of employees as per Lev and Schwartz method:

$$= \frac{50{,}000}{(1+0.15)^{(65-62)}} + \frac{50{,}000}{(1+0.15)^{(65-63)}} + \frac{50{,}000}{(1+0.15)^{(65-64)}}$$

= 32,875.81 + 37,807.18 + 43,478.26 = 1, 14,161.25

Total value of employees is Rs.1, 14,161.25 × 20 = Rs.22,83,225.

14. (i) Yes, Costs and Market price of current investments should be aggregated under each group. Investments under each category will be valued as:

	Rs.
Equity Shares	201.00
Mutual Funds	36.00
Government Securities	90.00

(ii) Statement showing the Movement of Unit Holders' Funds for the year ended 31st March, 2009

	(Rs.'000)
Opening balance of net assets	12,00,000

Add: Par value of units issued (8,50,200 × Rs.100)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working Note)	15,390
	13,85,410
Less: Par value of units redeemed (7,52,300 × Rs.100)	75,230
Closing balance of net assets (as on 31st March, 2009)	13,10,180

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
	Rs.'000	Rs.'000
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve /Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund	15,390	

15.

Separation of Equity and Debt Portion	Rs.
Present value of the principal repayable in 4 Years	
30,00,000 × 1.10 × 0.68 (10% Discount factor)	22,44,000
Present value of Interest 1,80,000 x 3.17 (4 years cumulative 10% discount factor)	5,70,600
Total liability component (Debt Portion)	28,14,600
Equity Portion (Balance)	1,85,400
Proceeds of the issue	30,00,000

16. (i) The term net owned fund (NOF) is given in the explanation to Section 45-IA of the Reserve Bank of India Act, 1934. As per the definition:

Owned Fund = Aggregate of the paid-up equity capital + Free reserves as disclosed in the latest balance sheet of the company – Accumulated balance of loss – Deferred revenue expenditure – Other intangible assets.

Net Owned Fund = Owned Fund – Investments in shares of subsidiaries/ companies in same group/Other NBFC. – Book value of debentures, bonds, outstanding loans and advances made to and deposits with subsidiaries and companies in the same group (to the extent such sum exceeds 10% of owned fund)

(ii) Market value of portfolio has a direct bearing on the NAV and consequently on portfolio performance. The market value of portfolio is the aggregate market value of different investments. Marker value of a traded security is the last closing price quoted in a stock exchange immediately before the valuation day. In case, a security is traded in more than one stock exchange, the price quoted in an exchange where the security is mostly traded is taken as market value of the security.

Non-traded securities, i.e. securities not traded in a period of 30 days prior to the valuation day, should be valued in the spirit of good faith subject to SEBI regulations. For example, a non-traded debt instrument can be valued by discounting cash flows by YTM of a comparable debt instrument as increased for lack of liquidity. The discounting rate for non-traded government securities should the prevailing market rate.

(iii) India is a federal state with unitary bias. This is perhaps why, unlike in the USA, there is no separate company law for any state in India. Apart from professional regulation, corporate financial reporting in India is governed primarily by one central Act i.e., the Companies Act, 1956. Another body that has a major influence in reshaping Indian financial reporting is the Securities and Exchange Board of India (SEBI). The Companies Act, 1956 prescribes the financial reporting requirements for all the companies registered under it. The reporting requirements that are imposed by the SEBI through its Guidelines and through the Listing Agreement are in addition to those prescribed under the Companies Act. SEBI requirements are to be followed by the companies listed in the Indian stock exchanges. The Companies Act and the SEBI requirements together provide the legal framework of corporate reporting in India. Before elaborating the legal requirements, it may be interesting to discuss the role of the SEBI as it is pioneer to introduce certain changes (e.g., cash flow statement) in the area of corporate financial reporting. For details of reporting requirements as per SEBI and Companies Act, students are advised to refer para 3 of Chapter 3 of Final (New Course) Study Material.

(iv) It shall be the duty of broker on inspection by the Board every director, proprietor, partner, officer and employee of the stock-broker, who is being inspected, to produce to the inspecting authority such books, accounts and other documents in his custody or control and furnish him with the statements and information relating to the transactions in securities market within such time as the said officer may require.

The stock-broker shall allow the inspecting authority to have reasonable access to the premises occupied by such stock- broker or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the stock- broker or any other person and also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant.

The inspecting authority, in the course of inspection, shall be entitled to examine or record statements of any member, director, partner, proprietor and employee of the stock- broker.

It shall be the duty of every director proprietor, partner, officer and employee of the stock broker to give to the inspecting authority all assistance in connection with the inspection, which the stock broker may be reasonably expected to give.

(v) Shareholders' Value Added is a value-based performance measure of a company's worth to shareholders. The basic calculation is net operating profit after tax (NOPAT) minus the cost of capital from the issuance of debt and equity, based on the company's weighted average cost of capital (WACC).

(vi) 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. Limitations of Market Value Added are as follows:

- MVA does not into account the opportunity costs of the invested capital.
- MVA does not consider the interim cash returns to the shareholders.
- MVA can not be calculated at divisional or business unit levels.

(vii) Historical Cost Based Accounting (HCBA), suffers from a major limitation. It is well known that the purchasing power of rupee has been persistently shrinking due to inflationary trends observed in the economy since late fifties, and more alarmingly since early seventies. Thus HCBA overstates the profit by undercharging depreciation and materials cost. Depreciation is undercharged since it is based on the historical cost of fixed assets instead of their current cost. Similar is the case of materials cost as the stocks purchased at historical costs are matched against revenues expressed at current prices. Again, HCBA reflects assets at their historical cost instead of current cost. It results in understatement of the net worth of an enterprise. HCBA thus fails to serve the primary purpose of the financial statements. It presents a distorted view of the profitability by overstating it and of intrinsic worth by understating it.

(viii) Life Cycle Model –Under this approach, the brand value is indicated by means of relating the brand dimensions to the brand strength. This model is applicable to home-grown brands, where the brands are generated, nurtured and developed throughout their life which resembles a product life cycle. The model is so called because the various brand dimensions behave in a way over a period of time thus forming the brand value, to its life. This results in the formation of S-curve. The model merely gives diagrammatic representation of formation and behaviour of brand strength. The various dimension assumed in this approach are difficult to be quantified. The figure depicts the life cycle model of corporate brand strength

(ix) Asset Liability Management (ALM) is a risk management tool that helps a bank/NBFC to manage its liquidity risk and interest rate risk. This is a powerful tool that helps banks/NBFCs plan long term financial, funding, and capital strategy using present value analysis. With ALM, a bank/NBFC can model interest income and expenses for analysis and re-price assets and liabilities. Based on ALM position, banks/NBFCs can also model effect of competitive pricing to create innovative and imaginative new banking products. ALM also helps regulatory compliance for banks/NBFCs by through appropriate investment / disinvestment decisions to maintain the required statutory liquidity ratio (SLR), credit reserve ratio (CRR) and other ratios as per Reserve Bank of India (RBI) guidelines. ALM involves the analysis of Structural Liquidity Gap Analysis, Interest Rate Gap Analysis, Net Interest Income (NII) Analysis, Net Interest Margin (NIM) Analysis, Tolerance Analysis, Cost to Close Analysis, Duration Gap Analysis, Trend Analysis, Comparative Analysis, Present Value Analysis, Forward Analysis and Scenario Analysis

(x) The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements say reinstatement of financial statements. It has the potential to create a new standard of accountability and greater transparency, which are values of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards. It creates an unprecedented opportunity for standard setters and other stakeholders to improve the reporting model. The convergence of US GAAP and International Financial Reporting Standards (IFRS) is now at a critical, early phase. Convergence is a long-term process – it may take years to reach the important goal of a single set of standards.. In the near future, there will be two standard setters and a mix of standards, some prepared and issued jointly, others prepared and issued independently within the framework of convergence. Standards must be as simple and understandable as possible, recognizing the complexity of transactions, and should be practical and cost-effective. Focused on realistic economic representation, accounting standards should address the legitimate needs of key stakeholders and provide a comprehensive overview of financial information. Every stakeholder should gain from active participation in shaping the successive phases of the convergence process.

17. Treatment under Indian AS, IFRS and USGAAPs

Topic	Indian AS	IFRS	US GAAPs
(i) Constituents of financial statements	Required a company's standalone- two years' balance sheets, income statements, cash flow statements, and accounting policies and notes.	Two years' consolidated balance sheets, income statements, cash flow statements, changes in equity and accounting policies and notes. In some circumstances or on a voluntary basis, an entity may present	For US Companies and SEC registrants (public companies) two years' balance sheet and three years income statements, cash flow statements, changes in equity statement and accounting policies and notes. However, in certain circumstances for foreign private issuers

		standalone financial statements along with its consolidated financial statements.	there is a relief from the three-year requirement. Non-US companies with registered securities in US have an option to prepare their financial statements, either based on US GAAPs or on IFRS along with the reconciliation of net income and equity to US GAAPs, as a disclosure in the notes.
(ii) Impairment of assets	Assets are impaired at higher of fair value less costs to sell and value in use based on discounted cash flows. Impairment test is to be conducted every year and if there is upward increase in the vaue of asset than reversal of impairment losses is required in certain circumstances. Assets are not separately classified or disclosed as held for sale on the face of the balance sheet.	Similar to Indian Accounting Standard. However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.	Impairment is assessed on undiscounted cash flows for assets to be held and used. If less than carrying amount, impairment loss is measured using market value or discounted cash flows. Reversal of losses is prohibited.
(iii) Business combinations	No particular Standard has been issued by ICAI till date. However all business acquisitions are business combinations except pooling of interest method for certain amalgamations	All business acquisitions are Combinations as per IFRS 3	All business acquisitions are Combinations.

18. (i) As per AS 32, carrying amounts of each of the following categories, as defined in AS 30, should be disclosed either on the face of the balance sheet or in the notes:

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with AS 30;

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with AS 30; and

(f) financial liabilities measured at amortised cost.

(ii) According to para 8.6 of AS 30, A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

(iii) In accordance with paragraphs 43 to 45 of AS 30, An entity should remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished i.e., when the obligation specified in the contract is discharged or cancelled or expires.

An exchange between an existing borrower and lender of debt instruments with substantially different terms should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, should be recognized in the statement of profit and loss.

(iv) 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 no 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, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from 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.

19. (i) Graded vesting under an employee stock option plan

In case the options/shares granted under an employee stock option plan do not vest on one date but have graded vesting schedule, total plan should be segregated into different groups, depending upon the vesting dates. Each of such groups would be having different vesting period and expected life and, therefore, each vesting date should be considered as a separate option grant and evaluated and accounted for accordingly. For example, suppose an employee is granted 100 options which will vest @ 25 options per year at the end of the third, fourth, fifth and sixth years. In such a case, each tranche of 25 options would be evaluated and accounted for separately.

(ii) Presentation of MAT credit in the financial statements

Balance Sheet

Where a company recognizes MAT credit as an asset on the basis of the considerations specified in the Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961 , the same should be presented under the head 'Loans and Advances' since, there being a convincing evidence of realization of the asset, it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Provision for Taxation' on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head 'Loans and Advances' if it continues to meet the considerations stated in paragraph 11 of the Guidance Note.

Profit and Loss Account

According to paragraph 6 of Accounting Standards Interpretation (ASI) 'Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961', issued by the Institute of Chartered Accountants of India, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss account in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as a separate line item therein.

(iii) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) are carried normally at cost.

(iv) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

(v) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

20. (i) According to para 14 of AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii)the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should

not recognize any revenue of this contract.

(ii) Calculation of tax expense

1st quarter ending on 31-12-2008	200×20%	Rs. 40 lakhs
2nd quarter ending on 31-3-2009	200×20%	Rs. 40 lakhs
3rd quarter ending on 30-6-2009	200×30%	Rs. 60 lakhs
4th quarter ending on 30-9-2009	200×30%	Rs. 60 lakhs

(iii) P Ltd. has direct economic interest in R Ltd to the extent of 14%, and through Q Ltd. in which it is the majority shareholders; it has further control of 12% in R Ltd. (60% of Q Ltd's 20%). These two taken together (14% + 12%) make the total control of 26%.

AS 18 defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Here, Control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and Significant Influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

In the present case, control of P Ltd. in R Ltd. directly and through Q Ltd., does not go beyond 26%. However, significant influence may be exercised as an investing party (P Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd.

As R Ltd. is a listed company and regularly supplies goods to P Ltd. Hence, related party disclosure, as per AS 18, is required.

(iv) Calculation of the cost for Purchase of Land

Particulars		Rs.
Cost of Land		500,000
Legal Fees		25,000
Title Insurance		10,000
Cost of Demolition	50,000	
Less: Salvage value of Material	10,000	40,000
Cost of the Asset		575,000

(v) Valuation of Closing Stock

Particulars	Rs.	Rs.
Closing Stock at cost		2,84,700
Less: Cost of 400 coats (400 x 80)	32,000	
Less: Net Realisable Value (400 x 75) – 5%	28,500	3,500
		2,81,200
Provision for repairing cost to be incurred in future (800 x 5)		4,000
Value of Closing Stock		2,77,200

21. (i) Calculation of the carrying amount of Investment as per equity method

Particulars	Rs.	Rs.
Equity Shares	1,000,000	
Security Premium	100,000	
Reserves & Surplus	500,000	
Net Assets	1,600,000	
45% of Net Asset	720,000	
Add: 45% of Profits for the year	135,000	
	855,000	
Less: Dividend Received	45,000	810,000
Less: Cost of Investment		1,500,000
Goodwill		690,000

Consolidated Balance Sheet (Extract)

Assets	Rs.	Rs.
Investment in B Ltd.	810,000	
Add: Goodwill	690,000	1,500,000

(ii)

	Rs.(in lakhs)
Cost of the plant	500
Less: CENVAT	10
	490
Less: Subsidy	98
Depreciable Value	392

(iii)

		Rs.
Fair Value of Plan Assets on 31.3.08		8,00,000
Add: Employer Contribution		2,80,000
Less: Benefits Paid		2,00,000
	(A)	8,80,000
Fair Market Value of Plan Asset at 31.3.09	(B)	11,40,000
Actual Return on Plan Asset	(B-A)	2,60,000

22.

(A) Cash flow statement for the year ended 31st March, 2009 Rs.('000)

Net Profit before taxation	780	
Add: Adjustment for Depreciation	880	
Loss on sale of fixed assets	280	

	Operating profit before changes in working capital	1,940	
	Less: Increase in Sundry Debtors	(260)	
	Less: Increase in Inventories	(400)	
	Add: Increase in Sundry Creditors	80	
	Cash generated from operations	1,360	
	Less: Income tax paid	(140)	
	Net Cash Generated from operating activities		1,220
(B)	Cash flow from investing activities		
	Purchase of fixed assets	(1,200)	
	Sale of fixed assets	40	
	Purchase of investments	(200)	
	Cash used for investing activities		(1,360)
(C)	Cash flow from financing activities		
	Proceeds from issue of shares including premium (400 + 40)	440	
	Proceeds from issue of 14% debentures	100	
	Proceeds from long term borrowings	60	
	Payment of Dividend	(300)	
	Cash generated from financing activities		300
	Net increase in Cash and Cash equivalent (A+B+C)		160
	Cash and Cash equivalent at the opening		100
	Cash and Cash equivalent at the closing		260

Working Notes:

1.	Income tax paid	Rs.('000)
	Income tax expenses for the year	160
	Add: Tax liability at the beginning of the year	20
		180
	Less: Tax liability at the end of the year	40
		140
2.	Fixed assets purchased	
	Closing gross block	4,000
	Add: Cost of assets discarded during the year	400
		4,400
	Less: Opening gross block	(3,200)
	Fixed assets purchased during the year	1,200
3.	Depreciation charged during the year	
	Closing accumulated depreciation	1,440

Add:	Depreciation charged on assets discarded during the year	80
		1,520
Less:	Closing accumulated depreciation	(640)
Depreciation charged during year		880

23. (i) As the substance of transaction is financing rather than sale and the resulting cash flow of Rs.9.60 lakhs received by Moon Ltd., cannot be considered as revenue as per AS 9 Revenue Recognition. Moon Ltd. will account the transaction as financing rather than sale.

Disclosure in balance sheet of Moon Ltd. as on 31.3.09 (an extract)

Assets	Rs. in lakhs
Current Assets, Loan and Advances	
Goods lying with Sun Ltd.	
(Under sale and repurchase agreement)	8.00
Liabilities	
Secured Loan	
Advance from Sun Ltd.	9.60
Add: Accrued Finance Charges	0.40
	10.00

(ii) 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 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 instant case, as per AS 1, considering the total value of stocks, the change in the amount of required provision of non-moving stocks from Rs.4.0 lakhs to Rs.3.20 lakhs is not material in nature Such change can be disclosed by way of notes to the accounts in the financial statements of XY Ltd., for the year ending on 31.03.09, in the following manner:

"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, the net assets would have been higher by Rs.0.80 lakhs".

(iii) Adjusted Net profit for the current year

2, 00,00,000+5,50,000 – 1,65,000= Rs. 2,03,85,000

Number of equity shares resulting from conversion of debentures

= 50,000 × 8 = 4,00,000 (in number)

Total number of equity shares resulting from conversion of debentures

= 40,00,000 + 4,00,000= 44,00,000 Shares

$\therefore$ Diluted Earnings per share = $\frac{\text{Rs.}2{,}03{,}85{,}000}{44{,}00{,}000}$

= Rs.4.63 (Approximately)

24. (i) As per AS 9 "Revenue Recognition", revenue is recognized at the time when the invoice is raised to the customers; however the treatment of deduction as trade discount is not as per AS 9. Considering the treatment prescribed by AS 4 "Contingencies and Events occurring after the Balance Sheet Date", the correct treatment of the difference between the invoice amount and finally settled amount should be under:

    The adjustment of the difference between the invoiced amount and the amount finally settled against "Ship Repair Income" account is in order. Events occurring up to the date of approval of the accounts by the Board of Directors should be taken into consideration in determining the amount of adjustment to be made in this regard. The description of the difference as "trade discount" is not appropriate.

    (ii) The loss due to break out of fire is an example of event occurring after the balance sheet date. The event does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS 4 states that disclosure is generally made of events in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise at the balance sheet date. In the given case, the loss of assets in a factory is considered to be an event affecting the substratum of the enterprise. Hence, as recommended in paragraph 15 of AS 4, disclosure of the event should be made in the report of the approving authority.

    (iii) Para 82 of AS 30 states that for hedge accounting purposes only instruments that involve a party external to the reporting entity can be designated as hedging instrument. Therefore, debenture issued by the parent company cannot be designated as hedging instrument for the purpose of consolidated financial statements of the group. However, it can be designated as hedging instrument for separate financial statements of X Ltd.

    (iv) Recognition of reduction in value of investment would depend upon the nature of investment and nature of decline as per AS13. If the investments were acquired for long term and decline is temporary in nature, reduction in value will not be recognized and investments would be carried at cost. If the decline is of permanent nature, it will be charged to profit and loss account. If the investments are current investments, the reduction should be recognized and charged to Profit and Loss Account as the current investments are carried at cost or fair value which ever is less.

25. (i) Computation of average accumulated expenses

	Rs.
1st April, 2008 Rs.5,00,000 $\times \frac{12}{12}$	5,00,000
1st August, 2008 Rs.12,00,000 $\times \frac{8}{12}$	8,00,000
1st January, 2009 Rs.2,00,000 $\times \frac{3}{12}$	50,000
	13,50,000
Interest on average accumulated expenses	
On specific borrowing (4,00,000 ×10%)	40,000
On Non-specific borrowings (13,50,000 – 4,00,000) × 12%	1,14,000
Amount of interest to be capitalized	1,54,000
Total expenses to be capitalized for borrowings:	
Cost of Plant (5,00,000 + 12,00,000 + 2,00,000)	19,00,000
Add: Amount of interest to be capitalized	1,54,000
	20,54,000

(ii) It is necessary to evaluate the past practice of X Ltd. If X Ltd. Has the past practice of settling net, then it becomes a financial instrument. If X Ltd. Intends to sell the identified PPE and settle by delivery and there is no past practice of settling net, then the contract should not be accounted for as derivative under AS-30 and AS-31.

(iii) As per para 20 of AS 12, "Government Grants" that became refundable should be accounted for as an extra-ordinary item as per Accounting Standard 5.

Therefore, refund of grant should be shown in the profit and loss account of the company as an extra ordinary item during the year 2008-09.

(iv) As per provisions of AS 5 "Net Profit or Loss for the period, prior period items and changes in accounting policies", prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, 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 current profit or loss can be perceived.

In the given example, it is clearly a case of error in preparation of financial statement for financial year 2006-07. Hence, claim received in financial year 2008-09 is a prior period items and should be separately disclosed in the statement of Profit and Loss.

Note: AS 1 to AS 32 (including limited revisions) and ASI 1 to ASI 30 are applicable for May, 2010 examination.

However, it may be noted that ASI 2 and ASI 11 have been withdrawn.

APPENDIX – I

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR MAY, 2010 EXAMINATION

The following List of Institute's Publications is relevant for the forthcoming examination i.e. May, 2010. Students may kindly take it into consideration while preparing for the examination.

Final Examination

Paper 1: Advanced Accounting

I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards (including limited revisions) – AS 1 to AS 32.

II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
2. Guidance Note on Accrual Basis of Accounting.
3. Guidance Note on Accounting Treatment for Excise Duty.
4. Guidance Note on Accounting for Depreciation in Companies.
5. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
6. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
7. Guidance Note on Accounting for Corporate Dividend Tax.
8. Guidance Note on Accounting for Employee Share-based Payments.
9. Guidance Note on Accounting for Fringe Benefits Tax.
10. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
11. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25

Note: Official Announcements and Notifications (in relation to syllabus) issued till 31st October, 2009 will be applicable for May, 2010 examination.

APPENDIX – II

Companies (Accounting Standards) Amendment Rules, 2009 – Amendments in Annexure

NOTIFICATION NO. G.S.R.225 (E)

DATED 31-3-2009

In exercise of the powers conferred by clause (a) of sub-section (1) of section 642 read with sub-section (1) of section 21A and sub-section (3C) of section 211 of the Companies Act, 1956 (1 of 1956), the Central Government in consultation with the National Advisory Committee on Accounting Standards, hereby makes the following rules to amended the Companies (Accounting Standards) Rules, 2006, namely:-

1. (1) These rules may be called the Companies (Accounting Standards) Amendment Rules, 2009.

   (2) They shall come into force on the date of their publication in the Official Gazette.

2. In the Companies (Accounting Standard) Rules, 2006, in the Annexure, under the heading "B. ACCOUNTING STANDARDS", in the sub-heading "Accounting Standard (AS) 11" relating to "The Effects of Changes in Foreign Exchange Rates", after paragraph 45, the following shall be inserted, namely:-

"46. In respect of accounting periods commencing on or after 7th December, 2006 and ending on or before 31st March, 2011, at the option of the enterprise (such option to be irrevocable and to be exercised retrospectively for such accounting period, from the date this transitional provision comes into force or the first date on which the concerned foreign currency monetary item is acquired, whichever is later and applied to all such foreign currency monetary items), exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, insofar as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/liability but not beyond 31st March, 2011, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with paragraph 15. For the purposes of exercise of this option, an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of 12 months or more at the date of origination of the asset or liability. Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, previously recognized in the profit and loss account before the exercise of the option shall be reversed insofar as it relates to the acquisition of a depreciable capital asset by addition or deduction from the cost of the asset and in other cases by transfer to "Foreign Currency Monetary Item Translation Difference Account" in both cases, by debit or credit, as the case may be, to the general reserve. If the option stated in this paragraph is exercised, disclosure shall be made of the fact of such exercise of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized."

APPENDIX – III

GN(A) 24 (Issued 2006)

GUIDANCE NOTE ON MEASUREMENT OF INCOME TAX EXPENSE FOR INTERIM FINANCIAL REPORTING IN THE CONTEXT OF AS 25

(The following is the text of the Guidance Note on Measurement of Income-tax Expense for Interim Financial Reporting in the context of AS 25, issued by the Council of the Institute of Chartered Accountants of India.)

1. Accounting Standard (AS) 25, 'Interim Financial Reporting', issued by the Council of the Institute of Chartered Accountants of India (ICAI), prescribes the minimum content of an interim financial report and the principles for recognition and measurement in complete or condensed financial statements for an interim period. AS 25 became mandatory in respect of accounting periods commencing on or after 1st April, 2002. In accordance with the Accounting Standards Interpretation (ASI) 27, 'Applicability of AS 25 to Interim Financial Results', the recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in the interim financial results presented under Clause 41 of the Listing Agreement entered into between stock exchanges and the listed enterprises. This Guidance Note deals with the measurement of income tax expense for the purpose of inclusion in the interim financial reports.

2. The general principles for recognition and measurement have been laid down in AS 25 as below:

   "27. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.

   28. Requiring that an enterprise apply the same accounting policies in its interim financial statements as in its annual financial statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an enterprise's reporting should not affect the measurement of its annual results, paragraph 27 acknowledges that an interim period is a part of a financial year. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements."

3. Paragraph 29(c) of AS 25 illustrates the application of the general principles for recognition and measurement of tax expense in interim periods, as below:

   "29…..

(c) income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes."

4. Appendix 3 to AS 25 illustrates the general recognition and measurement principles for the preparation of interim financial reports. Paragraphs 8 to 16 of the Appendix provide guidance on the computation of income-tax expense for the interim period, which are reproduced in Appendix A to this Guidance Note for ready reference. Paragraph 8 of the Appendix states as below:

"8. Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period."

5. The various steps involved in the measurement of income tax expense for the purpose of interim financial reports are as below:

(i) An enterprise will first have to estimate its annual accounting income. For this purpose, an enterprise would have to take into account all probable events and transactions that are expected to occur during the financial year. Such an estimate would involve, e.g., estimating on prudent basis, the depreciation on expected expenditure on acquisition of fixed assets, profits from sale of fixed assets/investments, etc. Such future events and transactions should be taken into account only if there is a reasonable certainty that the same would take place during the financial year.

(ii) The enterprise should next estimate its tax liability for the financial year. For this purpose, the enterprise will have to estimate taxable income for the year. By applying the enacted or the substantively enacted tax rate on the taxable income, an estimate of the current tax for the year is arrived at. The estimates of tax liability would have to be based on the estimated deductions, allowances, etc., that would be available to the enterprise, provided there is a reasonable certainty for the same. The enterprise would also have to estimate the deferred tax assets/liabilities by applying the principles of Accounting Standard (AS) 22, 'Accounting for Taxes on Income', issued by the Institute of Chartered Accountants of India. Special considerations may have to be applied in certain cases as below:

(a) Where brought forward losses exist from the previous financial year (when deferred tax asset was not recognised on considerations of prudence as per AS 22): In such a situation, for estimating the current tax liability, the brought forward losses would have to be deducted from the estimated annual accounting income as explained in paragraph 16 of Appendix 3 to AS 25 (reproduced in Appendix A to this Guidance Note). Since such carried forward losses will get set-off during the year, these would not have any tax consequence in future periods.

(b) Where brought forward losses exist (when deferred tax asset was recognised on the considerations of prudence as per AS 22): In such a situation, current tax would be computed in the same manner as explained in (a) above. However, in the determination of deferred tax, the tax expense arising from the reversal of the deferred tax asset recognised previously, to the extent of reversal of deferred tax asset in the current year, would also be considered.

(iii) The enterprise would now have to calculate the weighted average annual effective tax rate. This tax rate would be determined by dividing the estimated tax expense as arrived at step (ii) above by the estimated annual accounting income as arrived at step (i) above. Where different tax rates are applicable to different portions of the estimated annual accounting income, e.g., normal tax rate and a different tax rate for capital gains, the weighted average annual effective tax rate would have to be calculated separately for such portions of estimated annual accounting income.

(iv) The weighted average annual effective tax rate arrived at step (iii) would be applied to the accounting income for the interim period for determining the income tax expense to be recognised in the interim financial reports.

6. Accounting for interim period income-tax expense as suggested above is based on the approach prescribed in AS 25 that the interim period is part of the whole accounting year (often referred to as the 'integral approach') and, therefore, the said expense should be worked out on the basis of the estimated weighted average annual effective income-tax rate. According to this approach, the said rate is determined on the basis of the taxable income for the whole year, and applied to the accounting income for the interim period in order to determine the amount of tax expense for that interim period. This is in contrast to accounting for certain other expenses such as depreciation which is based on the approach prescribed in AS 25 that the interim period should be considered on stand-alone basis (often referred to as the 'discrete approach') because expenses such as depreciation are worked out on the basis of the period for which a fixed asset was available for use. The aforesaid treatments are, however, consistent with the requirement contained in paragraph 27 of AS 25 that an enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.

7. Appendix B contains examples of computing weighted average annual effective tax rate.

Appendix A

EXTRACTS FROM APPENDIX 3 TO ACCOUNTING STANDARD (AS) 25,

INTERIM FINANCIAL REPORTING

Measuring Income Tax Expense for Interim Period

8. Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

9. This is consistent with the basic concept set out in paragraph 27 that the same accounting recognition and measurement principles should be applied in an interim financial report as are

applied in annual financial statements. Income taxes are assessed on an annual basis. Therefore, interim period income tax expense is calculated by applying, to an interim period's pre-tax income, the tax rate that would be applicable to expected total annual earnings, that is, the estimated average effective annual income tax rate. That estimated average annual income tax rate would reflect the tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 27 of this Statement. Paragraph 16(d) requires disclosure of a significant change in estimate.

10. To the extent practicable, a separate estimated average annual effective income tax rate is determined for each governing taxation law and applied individually to the interim period pre-tax income under such laws. Similarly, if different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across such governing taxation laws or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

11. As illustration, an enterprise reports quarterly, earns Rs. 150 lakhs pre-tax profit in the first quarter but expects to incur losses of Rs 50 lakhs in each of the three remaining quarters (thus having zero income for the year), and is governed by taxation laws according to which its estimated average annual income tax rate is expected to be 35 per cent. The following table shows the amount of income tax expense that is reported in each quarter:

(Amount in Rs. lakhs)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expense	52.5	(17.5)	(17.5)	(17.5)	0

Difference in Financial Reporting Year and Tax Year

12. If the financial reporting year and the income tax year differ, income tax expense for the interim periods of that financial reporting year is measured using separate weighted average estimated effective tax rates for each of the income tax years applied to the portion of pre-tax income earned in each of those income tax years.

13. To illustrate, an enterprise's financial reporting year ends 30 September and it reports quarterly. Its year as per taxation laws ends 31 March. For the financial year that begins 1 October, Year 1 ends 30 September of Year 2, the enterprise earns Rs 100 lakhs pre-tax each quarter. The estimated weighted average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2.

(Amount in Rs. lakhs)

	Quarter Ending 31 Dec. Year 1	Quarter Ending 31 Mar. Year 1	Quarter Ending 30 June Year 2	Quarter Ending 30 Sep. Year 2	Year Ending 30 Sep. Year 2
Tax Expense	30	30	40	40	140

Tax Deductions/Exemptions

14. Tax statutes may provide deductions/exemptions in computation of income for determining tax payable. Anticipated tax benefits of this type for the full year are generally reflected in computing the estimated annual effective income tax rate, because these deductions/exemptions are calculated on an annual basis under the usual provisions of tax statutes. On the other hand, tax benefits that relate to a one-time event are recognised in computing income tax expense in that interim period, in the same way that special tax rates applicable to particular categories of income are not blended into a single effective annual tax rate.

Tax Loss Carry forwards

15. A deferred tax asset should be recognised in respect of carry forward tax losses to the extent that it is virtually certain, supported by convincing evidence, that future taxable income will be available against which the deferred tax assets can be realised. The criteria are to be applied at the end of each interim period and, if they are met, the effect of the tax loss carry forward is reflected in the computation of the estimated average annual effective income tax rate.

16. To illustrate, an enterprise that reports quarterly has an operating loss carryforward of Rs 100 lakhs for income tax purposes at the start of the current financial year for which a deferred tax asset has not been recognised. The enterprise earns Rs 100 lakhs in the first quarter of the current year and expects to earn Rs 100 lakhs in each of the three remaining quarters. Excluding the loss carryforward, the estimated average annual income tax rate is expected to be 40 per cent. The estimated payment of the annual tax on Rs. 400 lakhs of earnings for the current year would be Rs. 120 lakhs {(Rs. 400 lakhs - Rs. 100 lakhs) x 40%}. Considering the loss carryforward, the estimated average annual effective income tax rate would be 30% {(Rs. 120 lakhs/Rs. 400 lakhs) x 100}. This average annual effective income tax rate would be applied to earnings of each quarter. Accordingly, tax expense would be as follows:

(Amount in Rs. lakhs)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expense	30.00	30.00	30.00	30.00	120.00

Appendix B

Examples of Computation of Weighted Average Annual Effective Tax Rate

Example 1: When deferred tax asset was not recognised for carried forward losses from earlier accounting periods.

	Quarter I	Quarter II	Quarter III	Quarter IV	Total
	Rs.	Rs.	Rs.	Rs.	Rs.
Estimated Pre-tax Income (after considering estimated depreciation on the probable acquisition of fixed assets during the year)	(25)	175	(25)	50	175
Carried forward losses from earlier accounting periods, the deferred tax asset in respect of which was not recognised as it did not meet the requirements of prudence laid down in AS 22. During this year, in view of the expected taxable income, this loss is expected to be set off thereagainst. Therefore, it will not have any tax effect on future periods.					(25)
Additional estimated depreciation as per tax laws as compared to the accounting depreciation after considering depreciation on probable capital expenditure on acquisition of fixed assets during the year.					(50)
Estimated taxable income on which tax payable.					100
Applicable tax rate (say)					30%
Estimated current tax expense for the year.					30
Estimated deferred tax expense for the year (50x30/100)					15

Weighted Average Annual Effective Tax Rate (current tax)					$\frac{30}{175}$ x100=17.14%
Weighted Average Annual Effective Tax Rate (deferred tax)_					$\frac{15}{175}$ x 100 =8.57%
Tax expense for the interim period					
Current tax	(4.29)	30	(4.29)	8.57	29.99
Deferred tax	(2.14)	15	(2.14)	4.29	15.01
Total	(6.43)	45	(6.43)	12.86	45.00

(a) The above calculation needs to be done for every interim period for which recognition and measurement of tax expense is required.

(b) It is presumed that there are no other differences between accounting income and taxable income.

Example 2: When deferred tax asset was recognised for carried forward losses from earlier accounting periods.

	Quarter I	Quarter II	Quarter III	Quarter IV	Total
	Rs.	Rs.	Rs.	Rs.	Rs.
Estimated Pre-tax Income (after considering estimated depreciation on the probable acquisition of fixed assets during the year)	(25)	175	(25)	50	175
Carried forward losses from earlier accounting periods, the deferred tax asset in respect of which was recognised on the basis of considerations of AS 22. During this year, in view of the expected taxable income, this loss is expected to be set off thereagainst. This will result in reversal of the deferred tax asset in the current year.					(25)
Additional estimated depreciation as per tax laws as compared to the accounting depreciation after considering depreciation on probable capital expenditure on					(50)

acquisition of fixed assets during the year.					
Estimated taxable income on which tax payable.					100
Applicable tax rate (say)					30%
Estimated current tax expense for the year.					30
Estimated deferred tax expense for the year: (i) Defered tax liability on account of timing difference in depreciation (50x30/100) 15 (ii) Reversal of deferred tax asset (25x30/100) 7.5					22.5
Weighted Average Annual Effective Tax Rate (Current tax)					$\frac{30}{175}$ x100=17.14%
Weighted Average Annual Effective Tax Rate (Deferred tax)					$\frac{22.5}{175}$ x100=12.86%
Tax expense for the interim period Current tax Deferred tax Total	 (4.29) (3.21) (7.50)	 30.0 22.5 52.5	 (4.29) (3.21) (7.50)	 8.57 6.43 15.00	 29.99 22.51 52.50

(a) The above calculation needs to be done for every interim period for which recognition and measurement of tax expense is required.

(b) It is presumed that there are no other differences between accounting income and taxable income.

Example 3: When progressive rates of tax are applicable

Under the Indian tax system, the tax rates for corporates and firms are not progressive (i.e., based on levels of income), but are flat rates. Therefore, the tax rate to be applied in the interim period would be the normal rate applicable to the entity. However, the calculation of weighted average annual effective tax rate can be illustrated as below where the tax rates are progressive:

Estimated annual income Rs.1 lakh

Assumed Tax Rates:

On first Rs. 40,000 30%

On the balance income 40%

Tax expense: 30% of Rs. 40,000 + 40% of Rs. 60,000 = Rs. 36,000

Weighted average annual effective tax rate $= \frac{36,000}{1,00,000} \times 100 = 36\%$

Supposing the estimated income of each quarter is Rs. 25,000, the tax expense of Rs. 9,000 (36% of Rs. 25,000) would be recognised in each of the quarterly financial reports.

Example 4:When different rates of tax are applicable to different portions of the estimated annual accounting income (refer para5(iii))

Estimated annual income	Rs. 1 lakh
(inclusive of Estimated Capital Gains (earned in Quarter II)	Rs. 20,000

Assumed Tax Rates:

On Capital Gains	10%
On other income:	
First Rs. 40,000	30%
Balance income	40%

Assuming there is no difference between the estimated taxable income and the estimated accounting income,

Tax Expense:

On Capital Gains portion of annual income:

10% of Rs. 20,000	Rs. 2,000
On other income: 30% of Rs. 40,000 + 40% of Rs.40,000	Rs.28,000
Total:	Rs.30,000

Weighted Average Annual Effective Tax Rate:

On Capital Gains portion of annual income: $\frac{2,000}{20,000} \times 100 = 10\%$

On other income: $\frac{28,000}{80,000} \times 100 = 35\%$

Supposing the estimated income of each quarter is Rs.25,000, when income of Rs.25,000 for 2nd Quarter includes capital gains of Rs.20,000, the tax expense for each quarter will be calculated as below:

		Income	Tax Expense		
Quarter I:		Rs. 25,000	35% of Rs. 25,000 =	Rs. 8,750	
Quarter II:	Capital Gains:	Rs. 20,000	10% of Rs. 20,000 =	Rs. 2,000	
	Other:	Rs. 5,000	35% of Rs. 5,000 =	Rs. 1,750	Rs.12,500
Quarter III:		Rs. 25,000	35% of Rs. 25,000 =		Rs. 8,750
Quarter IV:		Rs. 25,000	35% of Rs. 25,000 =		Rs. 8,750
Total tax expense for the year					Rs. 30,000

****