PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Holding Company Accounts

1. The Balance Sheets of Bat Ltd. and Ball Ltd. as on 31.3.2009 are as follows:

	Bat Ltd.	*Ball Ltd.*		*Bat Ltd.*	*Ball Ltd.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Share Capital			Investments		
(Shares of Rs. 10 each)	1,60,000	2,00,000	Shares in Ball Ltd.	1,96,000	–
Profit and Loss account	50,000	60,000	Debtors	–	1,20,000
Creditors	–	16,000	Stock	–	80,000
			Cash at Bank	–	70,000
			Cash in hand	14,000	6,000
	2,10,000	2,76,000		2,10,000	2,76,000

Particulars of Bat Ltd.:

(1) This company was formed on 1.4.2008.

(2) It acquired the shares of Ball Ltd. as under:

Date of Acquisition	*No. of Shares*	*Cost*
		Rs.
1.4.2008	8,000	1,10,000
31.7.2008	6,000	86,000

(3) The shares purchased on 31.7.2008 are ex-dividend and ex-bonus from existing holders.

(4) On 31.7.2008 dividend at 10% was received from Ball Ltd. and was credited to Profit and Loss Account.

(5) On 31.7.2008 it received bonus shares from Ball Ltd. in the ratio of one share on every four shares held.

(6) Bat Ltd. incurred an expenditure of Rs. 500 per month on behalf of Ball Ltd. and this was debited to the Profit and Loss Account of Bat Ltd., but nothing has been done in the books of Ball Ltd.

(7) The balance in the Profit and Loss Account as on 31.3.2009 included Rs. 36,000 being the net profit made during the year.

(8) Dividend proposed for 2008-2009 at 10% was not provided for as yet.

Particulars of Ball Ltd.:

(1) The balance in the Profit and Loss Account as on 31.3.2009 is after the issue of bonus shares made on 31.7.2008.

(2) The net profit made during the year is Rs. 24,000 including Rs. 6,000 received from insurance company in settlement of the claim towards loss of stock by fire on 30.06.2008 (Cost Rs. 10,800 included in opening stock).

(3) Dividend proposed for 2008-2009 at 10% was not provided for in the accounts.

Prepare the Consolidated Balance Sheet of Bat Ltd. as on 31.3.2009.

Statutory Financial Statements of a Company

2. On 1st November, 2008 Yash Ltd. was incorporated with an authorized capital of Rs. 1,000 crores. It issued to its promoters equity capital of Rs. 50 crores which was paid for in full. On that day it purchased the running business of Vijay Ltd. for Rs. 200 crores and allotted at par equity capital of Rs. 200 crores in discharge of the consideration. The net assets taken over from Vijay Ltd. were valued as follows: Fixed Assets Rs. 150 crores, Inventory Rs. 10 crores, Customers' dues Rs. 70 crores and Creditors Rs. 30 crores.

Yash Ltd. carried on business and the following information is furnished to you:

(a) Summary of cash/bank transactions (for year ended 31st October, 2009).

		(Rs. in crores)
Equity capital raised:		
Promoters (as shown above)	50	
Others	250	300
Collections from customers		4,000
Sale proceeds of fixed assets (cost Rs.18 crores)		20
		4,320
Payments to suppliers	2,000	
Payments to employees	700	
Payment for expenses	500	3,200
Investments in Upkar Ltd.		100
Payments to suppliers of fixed assets:		
Instalment due	600	
Interest	50	650
Tax payment		270
Dividend		50
Closing cash/bank balance		50
		4,320

(b) On 31st October, 2009 Yash Ltd.'s assets and liabilities were:

	(Rs. in crores)
Inventory at cost	15
Customers' dues	400
Prepaid expenses	10
Advances to suppliers	40
Amounts due to suppliers of goods	260
Amounts due to suppliers of fixed assets	750
Outstanding expenses	30

(c) Depreciation for the year under:

(i) Companies Act, 1956 — Rs. 180 crores

(ii) Income tax Act, 1961 — Rs. 200 crores

(d) Provide for tax at 38.5% of "total income". There are no disallowables for the purpose of income taxation. Provision for tax is to be rounded off.

Yash Ltd. asks you to prepare:

(i) Revenue statement for the year ended 31st October, 2009 and

(ii) Balance Sheet as on 31st October, 2009 from the above information.

Corporate Restructuring

Amalgamation of Companies

3. System Ltd. and HRD Ltd. decided to amalgamate as on 01.04.2008. Their Balance Sheets as on 31.03.2008 were as follows:

(Rs. in '000)

Particulars	*System Ltd.*	*HRD Ltd.*
Source of Funds :		
Equity share capital (Rs. 10 each)	150	140
9% preference share Capital (Rs. 100 each)	30	20
Investment allowance Reserve	5	2
Profit and Loss Account	10	6
10 % Debentures	50	30
Sundry Creditors	25	15
Tax provision	7	4
Equity Dividend Proposed	30	28
Total	307	245

Application of Funds :		
Building	60	50
Plant and Machinery	80	70
Investments	40	25
Sundry Debtors	45	35
Stock	36	40
Cash and Bank	40	25
Preliminary Expenses	6	—
Total	307	245

From the following information, you are required to prepare the draft Balance Sheet as on 01.04.2008 of a new company, Intranet Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

(i) 50 % Debenture are to be converted into Equity Shares of the New Company.

(ii) Out of the investments, 20% are non-trade investments.

(iii) Fixed Assets of Systems Ltd. were valued at 10% above cost and that of HRD Ltd. at 5% above cost.

(iv) 10 % of sundry Debtors were doubtful for both the companies. Stocks to be carried at cost.

(v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.

(vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of Rs. 10 each of the new company at a premium of Rs. 5 per share.

Amalgamation is in the nature of purchase.

Internal Reconstruction of a Company

4. 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 investment (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-organisation 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) Debentureholders 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

5. 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.

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 Goodwill

7. From the following information supplied to you, ascertain the value of goodwill of A Ltd., which is carrying on business as retail trader, under Super Profit Method (at 5 years' purchase of Super Profits):-

Balance Sheet as on 31st March, 2009

	Rs.		*Rs.*
Paid up capital:		Goodwill at cost	50,000
5,000 shares of Rs.100 each fully paid	5,00,000	Land and Building at cost	2,20,000
Bank Overdraft	1,16,700	Plant and Machinery at cost	2,00,000
Sundry Creditors	1,81,000	Stock in trade	3,00,000
Provision for taxation	39,000	Book debts less provision for bad debts	1,80,000
Profit & Loss Appropriation A/c	1,13,300		
	9,50,000		9,50,000

The company commenced operations in 1990 with a paid up capital of Rs.5,00,000. Profits for recent years (after taxation) have been as follows:-

Year ended 31st March	Rs.	
2005	40,000	(Loss)
2006	88,000	

2007	1,03,000
2008	1,16,000
2009	1,30,000

The loss in 2005 occurred due to a prolonged strike.

The income-tax paid so far has been at the average rate of 40%, but it is likely to be 50% from 2010 onwards. Dividends were distributed at the rate of 10% on the paid up capital in 2006 and 2007 and the rate of 15% in 2008 and 2009. The market price of shares is ruling at Rs.125 at the end of the year ended 31st March, 2009. Profits till 2009 have been ascertained after debiting Rs.40,000 as remuneration to the managing director. The government has approved a remuneration of Rs.60,000 with effect from 1st April, 2009. The company has been able to secure a contract for supply of materials at advantageous prices. The advantage has been valued at Rs.40,000 per annum for the next five years.

Valuation of Business

8. 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, and (ii) Discounted cash flows method.

Value Added Statement

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.

		Rs. in 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. (a) What is economic value added and how is it calculated? Discuss.

(b) 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%.

Human Resource Accounting

11. From the following details, compute value of human resources according to Lev and Schwartz (1971) 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

Corporate Social Reporting

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

(b) From the following information of Steel India Ltd. for the year ended 31st March, 2009, prepare their Social Balance Sheet as on that date:

- A specialist has valued their human assets at Rs.828 lakhs.
- Their investments were classified as:

(Rs. in lakhs)

	Residential	*Hospital*	*School*	*Welfare*
Buildings	17.00	1.00	1.40	0.80
Equipments	2.80	1.00	1.00	-

- Water, electricity and gas supply systems totalled Rs.1 lakh.
- Their Net owned funds were Rs.26 lakhs.

Financial Reporting of Financial Institutions

13. Write short notes on:
    - (i) Minimum net owned fund in the context of NBFC
    - (ii) Valuation of portfolio for a mutual fund
    - (iii) Obligations of stock broker on inspection by the Board
    - (iv) Books of account required to be maintained by a Stock Broker
    - (v) Asset management company in the context of a mutual fund
14. A Mutual Fund raised 100 lakh on April 1, 2009 by issue of 10 lakh units of Rs. 10 per unit. The fund invested in several capital market instruments to build a portfolio of Rs. 90 lakhs. The initial expenses amounted to Rs. 7 lakh. During April, 2009, the fund sold certain securities of cost Rs. 38 lakhs for Rs. 40 lakhs and purchased certain other securities for Rs. 28.20 lakhs. The fund management expenses for the month amounted to Rs. 4.50 lakhs of which Rs. 0.25 lakh was in arrears. The dividend earned was Rs. 1.20 lakhs. 75% of the realized earnings were distributed. The market value of the portfolio on 30.04.2009 was Rs. 101.90 lakh. Determine NAV per unit.
15. 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
	101.00	80.80
Mutual Funds		
MF_1	26.00	16.00
MF_2	20.00	24.00
	46.00	40.00
Government Securities		
GV_1	50.00	44.00
GV_2	50.00	58.00
	100.00	102.00

   - (i) Can the company adjust depreciation of a particular item of investment within a category?
   - (ii) What should be the value of investments?

Accounting for Not-for-profit Organizations

16. A University receives two grants — one from the Ministry of Human Resources to be used for Aids Research. This grant is for Rs. 45,00,000, which includes Rs. 3,00,000 to cover indirect expenses incurred in administering the grant. The second grant of Rs. 35,00,000 received from a reputed Trust is to be used to set up a centre to conduct seminars on Aids related matters from time to time. During the year, it also received Rs. 5,00,000 worth of equipment donated by a well wisher to be used for Aids research. During the year 2008-2009, the University spent Rs. 32,25,000 of the government grant and incurred Rs. 3,00,000 overhead expenses. Rs. 28,00,000 were spent from the grant received from the Trust. Show the necessary Journal Entries.

Indian AS, IFRS and US GAAPs

17. State the treatment of the following items with reference to Indian Accounting Standards and IFRS:
    (i) Impairment of assets
    (ii) 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) S Ltd. grants 1,000 stock options to its employees on 1.4.2005 at Rs.60. The vesting period is two and a half years. The maximum period is one year. Market price on that date is Rs.90. All the options were exercised on 31.7.2008. Journalize, if the face value of equity share is Rs.10 per share.

(ii) 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.

(iii) 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?

(iv) 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. Consolidated Balance Sheet of Bat Ltd. and its subsidiary Ball Ltd. as at 31st March, 2009

Liabilities	*Amount Rs.*	*Assets*	*Amount Rs.*
Share Capital		Stock	80,000
(Shares of Rs. 10 each)	1,60,000	Debtors	1,20,000
Minority Interest	50,800	Cash at Bank	70,000
Capital Reserve	3,040	Cash in hand	20,000
Profit and Loss Account	44,160		
Creditors	16,000		
Proposed Dividend	16,000		
	2,90,000		2,90,000

Working Notes:

(1) *Analysis of profits of Ball Ltd.*

		Capital Profits Rs.	*Revenue Profits Rs.*
Profit and Loss Account on 1.4.2008 (60,000 – 24,000)		36,000	
Profit for the year	24,000		
Add back: Loss by fire	4,800		
	28,800		
Less: Expenses not considered	6,000		
	22,800		
Pre-acquisition profits = $\frac{4}{12} \times 22,800 =$	7,600		
Less: Loss in pre-acquisition period =	4,800	2,800	
Post-acquisition profits $\left(\frac{8}{12} \times 22,800\right)$			15,200
		38,800	15,200
Bat Ltd.'s share (80%*)		31,040	12,160
Minority's share (20%)		7,760	3,040

$$*\frac{8{,}000+6{,}000+\text{Bonus shares }\frac{8{,}000}{4}\text{ i.e. }2{,}000}{20{,}000}\times 100$$

$$=\frac{16{,}000}{20{,}000}\times 100=80\%$$

(2) *Minority interest*

		Rs.
Share capital		40,000
Capital profits		7,760
Revenue profits		3,040
		50,800

(3) *Cost of control*

		Rs.
Face value of investments	1,60,000	
Capital profits	31,040	1,91,040
Investment in Ball Ltd.	1,96,000	
Less: Pre-acquisition dividend	8,000	(1,88,000)
Capital Reserve		3,040

(4) *Profit and Loss Account – Bat Ltd.*

	Rs.
Balance	50,000
Less: Pre-acquisition dividend wrongly credited	8,000
	42,000
Less: Proposed dividend	16,000
	26,000
Add: Expenses of Ball Ltd. written back	6,000
Add: Share in Ball Ltd.	12,160
	44,160

2. **Yash Ltd.**

Balance Sheet as at 31st October, 2009

	Schedule		(Rs. in crores)
I SOURCES OF FUNDS			
(1) Shareholders' funds:			
(a) Capital	A	500	
(b) Reserves and surplus		387	
			887

	(2)	Loan funds			750
		TOTAL			1,637
II		APPLICATION OF FUNDS			
	(1)	Fixed assets:			
		(a) Gross block		1,482	
		(b) *Less*: Depreciation		180	
		(c) Net block			1,302
	(2)	Investments in Upkar Ltd.			100
	(3)	Current assets, loans and advances:			
		(a) Inventories	15		
		(b) Sundry debtors	400		
		(c) Cash and bank balances	50		
		(d) Loans and advances:			
		Advances to suppliers	40		
		Prepaid expenses	10		
		Tax payment	270	785	
		Less: Current liabilities and provisions:			
		(a) Creditors for			
		Goods	260		
		Expenses	30		
			290		
		(b) Provision for taxation	260	550	
		Net current assets			235
		TOTAL			1,637

Schedule to Balance Sheet *(Rs. in crores)*

A.	Share Capital:	
	Authorised:	1,000
	Issued and paid-up:	
	50 crores equity shares of Rs. 10 each fully paid up	500
	Of the above shares, 20 crores equity shares have been issued for consideration other than cash, on take over of business of Vijay Ltd.	

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

		(Rs. in crores)
Sales		4,330
Expenditure:		
Stock taken over from Vijay Ltd.	10	
Purchases	2,190	
	2,200	
Closing stock	15	
Inventory consumed/sold	2,185	
Employee cost	700	
Expenses	520	(3,405)
Profit before interest, depreciation and tax		925
Interest		(50)
Profit after interest but before depreciation		875
Depreciation		(180)
Profit after depreciation		695
Profit on sale of fixed assets		2
Profit before tax		697
Provision for tax		(260)
Net profit		437
Dividend		(50)
Balance carried forward		387

Working Notes:

(Rs. in crores)

(1) Net assets of Vijay Ltd. taken over:

Fixed Assets	150
Inventory	10
Customers' dues	70
	230
Less: Creditors	30
	200

Purchase consideration: 20 crores equity shares of Rs. 10 each.

(2) **Customers' Account**

		Rs.			Rs.
To	Business Purchase A/c	70	By	Bank A/c	4,000
To	Sales A/c (Balancing figure)	4,330	By	Balance c/d	400
		4,400			4,400

Suppliers' (Goods) Account

		Rs.			Rs.
To	Bank A/c (2,000 – 40)	1,960	By	Business Purchase A/c	30
To	Balance c/d	260	By	Purchases A/c (Balancing figure)	2,190
		2,220			2,220

Suppliers' (Fixed Assets) Account

		Rs.			Rs.
To	Bank A/c	650	By	Fixed Assets A/c (Balancing figure)	1,350
To	Balance c/d (Loan funds)	750	By	Interest A/c	50
		1,400			1,400

Fixed Assets Account

		Rs.			Rs.
To	Business Purchase A/c	150	By	Bank A/c	20
To	Profit and Loss A/c	2	By	Balance c/d	1,482
To	Suppliers' A/c	1,350			
		1,502			1,502

Expenses Account

		Rs.			Rs.
To	Bank A/c	500	By	Profit and Loss A/c (Balancing figure)	520
To	Balance c/d (Outstanding expenses)	30	By	Balance c/d (Prepaid expenses)	10
		530			530

(3) Calculation of tax provision:

	Rs.
Profit before depreciation	875
Less: Depreciation under Income Tax Act	200
Total income under Income Tax Act	675
Tax due thereon @ 38.5% (rounded off)	260

As sale proceeds of fixed assets are reduced from the appropriate "block of assets" for income tax purpose, and depreciation under Income Tax Act is given in the question, no adjustment for profit on sale of fixed assets Rs. 2 crores needs to be made for tax purposes.

Notes:

(1) Students may provide for dividend distribution tax @ 15%.

(2) The par value of an equity share has been taken as Rs. 10.

3. **M/s Intranet Ltd.**

Draft Balance Sheet as at 1.4.2008

Liabilities	*(Rs.)*	*Assets*	*(Rs.)*
Equity share capital 27,799 Equity shares of Rs.10 each, fully paid up (W.N.2)	2,77,990	Building (Rs. 66,000+Rs. 52,500)) Plant and machinery (Rs. 88,000+Rs. 73,500)	1,18,500 1,61,500
9% Preference share capital (Share of Rs.100 each) (W.N.2)	50,000	Investments (Rs. 40,000+ Rs. 25,000)	65,000
Securities premium (W.N.2)	1,38,995	Stock (Rs. 36,000+ Rs. 40,000)	76,000
Investment allowance reserve (Rs. 5,000+ Rs. 2,000)	7,000	Sundry Debtors 90% of (Rs.45,000+ Rs. 35,000)	72,000
10% Debentures (50% of Rs. 80,000)	40,000	Cash and Bank (Rs.40,000+ Rs.25,000 – Rs.15)	64,985
Sundry creditors (Rs. 25,000+ Rs. 15,000)	40,000	Amalgamation Adjustment Account	7,000
Tax provision (Rs. 7,000+ Rs. 4,000)	11,000		
	5,64,985		5,64,985

Working Notes:

1. Calculation of value of equity shares issued to transferor companies

		System Ltd.		*HRD Ltd.*
		(Rs.)		*(Rs.)*
Assets taken over:				
Building		66,000		52,500
Plant and machinery		88,000		73,500
Investments (trade and non-trade)		40,000		25,000
Stock		36,000		40,000
Sundry Debtors		40,500		31,500
Cash & Bank		40,000		25,000
		3,10,500		2,47,500
Less: Liabilities:				
10% Debentures	50,000		30,000	
Sundry Creditors	25,000		15,000	
Tax Provision	7,000	82,000	4,000	49,000
		2,28,500		1,98,500
Less: Preference Share Capital		30,000		20,000
		1,98,500		1,78,500

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	System Ltd.	*HRD Ltd.*	*Total*
Equity shares issued @ Rs.15 per share (including Rs.5 premium)			
$\frac{\text{Rs.}1{,}98{,}500}{15}$	13,233 shares[1]		
$\frac{\text{Rs.}1{,}78{,}500}{15}$		11,900 shares	25,133 shares
Equity share capital @ Rs.10	Rs. 1,32,330	Rs.1,19,000	Rs. 2,51,330
Securities premium @ Rs.5	Rs. 66,165	Rs. 59,500	Rs. 1,25,665
	Rs.1,98,495	Rs. 1,78,500	Rs. 3,76,995

[1] Cash paid for fraction of shares = Rs. 1,98,500 less Rs. 1,98,495 = Rs. 5

50% of Debentures are converted into equity shares @ Rs.15 per share			
50,000/2 = 25,000/15	1,666 shares[2]		
30,000/2 = 15,000/15		1,000 shares	2,666 shares
Equity share capital @ Rs.10	Rs. 16,660	Rs.10,000	Rs. 26,660
Security premium@ Rs.5	Rs. 8,330	Rs. 5,000	Rs. 13,330
	Rs. 24,990	Rs. 15,000	Rs. 39,990
9% Preference share capital issued	Rs. 30,000	Rs. 20,000	Rs. 50,000

4. **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)			

[2] Cash paid for fraction of shares = Rs. 25,000 less Rs. 24,990 = Rs. 10

(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	2,50,000	Plant	1,80,000

Rs.2/- each (out of above 45,000 shares have been issued for consideration other than cash)			
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

5. **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

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. Valuation of Goodwill of A Ltd.

(i) Capital employed:

		Rs.	Rs.
Land and Building at Cost			2,20,000
Plant and Machinery at Cost			2,00,000
Stock in trade			3,00,000
Sundry Debtors			1,80,000
			9,00,000
Less:	Sundry Liabilities:		
	Bank overdraft	1,16,700	
	Sundry Creditors	1,81,000	
	Provision for taxation	39,000	3,36,700
Capital employed at the end of the year			5,63,300
Add Back: Dividend paid for the year		75,000	
	Less: Half of the profits	65,000	10,000
Average Capital employed			5,73,300

(ii) Normal Rate of Return

Average Dividends for the last 4 years 12 ½ %

Market price of shares on 31st March Rs.125.

Normal Rate of Return: $\frac{12.5 \times 100}{125} = 10\%$

(iii) Normal Profit on average capital employed

@ 10% on Rs.5,73,300 57,330

(iv) Future maintainable profit-weighted average

Year	Profit Rs.	Weight	Product Rs.
2006	88,000	1	88,000
2007	1,03,000	2	2,06,000
2008	1,16,000	3	3,48,000
2009	1,30,000	4	5,20,000
		10	11,62,000

Average annual profit (after tax) 1,16,200

Average annual profit (before tax)

$1{,}16{,}200 \times \frac{100}{60}$ 1,93,667

Adjustments		
Increase in remuneration	-20,000	
Saving in cost of materials	+40,000	20,000
		2,13,667
Less: Taxation @ 50%		1,06,833
Super Profits		1,06,834

8. Valuation of Business

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

Discounted cash flow 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

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. **(a)** Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

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

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

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

COC = Cost of Control

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

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

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

(b) Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT} - \text{Interest}} = \frac{\text{EBIT}}{\text{EBIT} - 10\% \text{ of } 400} = 1.40$

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

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

11. 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.

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

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

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

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

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

(b) **Social Balance Sheet of Steel India Ltd.**

as at 31.03.2009

(Rs. in lakhs)

Liabilities:		
Organization Equity		26.00
Social Equity (Contribution by staff)		828.00
Total		854.00
Assets:		
Social Capital Investment:		
(a) Buildings		
(i) Residential	17.00	
(ii) Hospital	1.00	
(iii) School	1.40	
(iv) Welfare	0.80	20.20

(b)	Equipments		
(i)	Residential	2.80	
(ii)	Hospital	1.00	
(iii)	School	1.00	4.80
(c)	Water, Electricity and Gas supply systems		1.00
Human assets (as valued by the specialist)			828.00
Total			854.00

13. (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) 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.

(iv) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

(a) Register of transactions (Sauda book)/Daily transaction list;

(b) Clients ledger;

(c) General ledger;

(d) Journals;

(e) Cash book;

(f) Bank Pass Book;

(g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;

(h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;

(i) Counterfoils or duplicates of contract notes issued to clients;

(j) Written consent of clients in respect of contracts entered into as principals;

(k) Margin deposit book;

(l) Register of accounts of sub-brokers;

(m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scrip wise client wise list in respect of scripts of specified group, client upla statement, duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of valan balance sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorizing directors and employees and copies of pool account statements.

(v) "Asset Management Company" means a company formed and registered under the Companies Act, 1956 and approved as such by the Securities and Exchange Board of India to manage the funds of a mutual fund.

14.

	Rs. in lakhs	*Rs. in lakhs*	*Rs. in lakhs*
Opening Bank (100- 90-7)	3.00		
Add: Proceeds from Sale of Securities	40.00		
Add: Dividend Received	1.20	44.20	
Deduct:			
Cost of Securities purchased	28.20		
Fund Management Expenses paid (4.50 – 0.25)	4.25		
Capital Gains distributed 75% of (40.00 – 38.00)	1.50		
Dividend Distributed (75% of 1.20)	0.90	(34.85)	
Closing Bank			9.35
Closing Market Value of Port Folio			101.90
			111.25
Less: Arrears of Expenses			0.25
Closing Net Assets			111.00
Number of Units (Lakhs)			10.00
Closing NAV (Rs.)			11.10

15. **(i)** Yes, Costs and Market price of current investments should be aggregated under each group.

		Rs.
(ii)	Equity Shares	80.80
	Mutual Funds	40.00
	Government Securities	100.00

16. Journal Entries

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

17. Treatment under Indian Accounting Standards (AS)and International Financial Reporting Standards (IFRS)

		AS	IFRS
(i)	**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 value of asset than reversal of impairment losses is required in certain	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.

		circumstances. Assets are not separately classified or disclosed as held for sale on the face of the balance sheet.	
(ii)	**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

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	$200 \times 20\%$	Rs. 40 lakhs
2nd quarter ending on 31-3-2009	$200 \times 20\%$	Rs. 40 lakhs
3rd quarter ending on 30-6-2009	$200 \times 30\%$	Rs. 60 lakhs
4th quarter ending on 30-9-2009	$200 \times 30\%$	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)

Books of S Ltd.
Journal Entries

Date	*Particulars*		*Debit* *Rs.*	*Credit* *Rs.*
31.3.06	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of Rs.30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.07	Employees Compensation Expense Account	Dr.	12,000	
	To Employees Stock Option Outstanding Account			12,000
	(Being compensation expense recognized in respect of 1,000 options granted to employees at discount of Rs.30 each, amortized on straight line basis over 2½ years)			
	Profit and Loss Account	Dr.	12,000	
	To Employees Compensation Expense Account			12,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.3.08	Employees Compensation Expense	Dr.	6,000	
	To Employees Stock Option Outstanding Account			6,000
	(Being balance of compensation expense amortized Rs.30,000 less Rs. 24,000)			
	Profit and Loss Account	Dr.	6,000	
	To Employees Compensation Expense Account			6,000
	(Being employees compensation expense of the year transferred to P&L A/c)			
31.7.08	Bank Account (Rs. 60 × 1,000)	Dr.	60,000	
	Employees Stock Option Outstanding Account (Rs.30×1,000)	Dr.	30,000	
	To Equity Share Capital Account			10,000
	To Securities Premium Account			80,000
	(Being exercise of 1,000 options at an exercise price of Rs.60 each)			

Working Notes:

1. Total employees compensation expense

   = 1,000 x (Rs.90 – Rs.60) = Rs.30,000

2. Employees compensation expense has been written off during 2½ years on straight line basis as under:

   I year = Rs.12,000 (for full year), II year = Rs.12,000 (for full year),

   III year = Rs.6,000 (for half year)

(ii) 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 the balance sheet will be as follows:

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

(iii) 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".

(iv) 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 = $\frac{\text{Rs.2,03,85,000}}{\text{44,00,000}}$

= 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 $\times$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 EXAMINATIONS

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 examinations.

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) <u>(3.21)</u> (7.50)	 30.0 <u>22.5</u> <u>52.5</u>	 (4.29) <u>(3.21)</u> (7.50)	 8.57 <u>6.43</u> <u>15.00</u>	 29.99 <u>22.51</u> <u>52.50</u>

(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

****