C.A. Final (New Course)

First Study

Subject: Financial Reporting

Instructions :

(i) ***All questions are compulsory.***

(ii) ***Date of Examination : 15.02.2010***

(iii) ***Total Number of Questions : 6***

(iv) ***Total marks : 100***

(v) ***Total duration : 3 Hours***

(vi) ***Use of two colour pens (black & blue or Black or Pink etc) is NOT allowed. Use only single colour pen.***

(vii) ***Begin answer of the next question in new page.***

(viii) ***Answer all the questions serially.***

Question 1.

A Ltd. acquired 80% of both classes of shares in B Ltd. on 1.4.2007.The draft Balance Sheets of two companies on 31st March, 2008 were as follows:

(Rs. in '000s)

Liabilities	**A Ltd.**	**B Ltd.**	**Assets**	**A Ltd.**	**B Ltd.**
Share Capital:					
Equity shares of Rs.10 each, full paid up	3,000	600	Plant & machinery	2,060	600
14% Preference shares of Rs.100 each, fully paid up	-	400	Furniture & fixtures	600	540
General reserve	1,900	40	Investments in equity shares of B Ltd.	1,920	-
Profit and loss account	1,600	720	in preference Shares of Ltd.	320	-
Creditors	300	320	Stock	680	404
			Debtors	560	316
			Cash at bank	660	220
Total	**6,800**	**2,080**	**Total**	**6,800**	**2,080**

Note: Contingent liability – A Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – Rs.1,55,000.

Additional Information:

(i) General reserve balance of B Ltd. was the same as on 1.4.2007.

(ii) The balance in Profit and Loss A/c of B Ltd. on 1.4.2007 was Rs.3,20,000, out of which dividend of 16% p.a. on the Equity capital of Rs.6,00,000 was paid for the year 2006-07.

(iii) The dividend in respect of preference shares of B Ltd. for the year 2007-08 was still payable as on 31.3.2008.

(iv) A Ltd. credited its Profit and Loss A/c for the dividend received by it from B Ltd. for the year 2006-07.

(v) Sundry creditors of A Ltd. included an amount of Rs.1,20,000 for purchases from B Ltd., on which the later company made a loss of Rs.10,000.

(vi) Half of the above goods were still with the closing stock of A Ltd. as at 31.3.2008.

(vii) At the time of acquisition by A Ltd., while determining the price to be paid for the shares in B Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%.There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.

(viii) The directors of A Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31st March, 2008, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer.

(20 Marks)

Answer.

Consolidated Balance Sheet of A Ltd. and its subsidiary B Ltd. as at 31st March 2008

(Rs. in 000)

Liabilities		Amount	Asset		Amount
Share Capital :30,000 Equity			Goodwill (WN 5)		1088.00
shares of Rs. 10 each fully paid up		3000.00	P & M :		
Minority Interest (WN 4)		360.40	A Ltd	2,060.00	
General Reserve		1900.00	B Ltd.	750.00	2810.00
P&L account (WN 6)		1894.60	Furniture & Fixtures :		
Creditors :			A Ltd	600.00	
A Ltd.	300.00		B Ltd.	432.00	1032.00
B Ltd.	320.00		Stock :		
Total	620.00		A Ltd	680.00	
Less: Mutual Owning	120.00	500.00	B Ltd.	404.00	
			Total	1084.00	
			+ Unrealised Loss	5.00	1089.00
			Debtors :		
			A Ltd	560.00	
			B Ltd.	316.00	
			Total	876.00	
			Less: Mutual Owning	120.00	756.00
			Cash :		
			A Ltd	660.00	
			B Ltd.	220.00	880.00
Total		**7655.00**	**Total**		**7655.00**

Contingent liability: Claim against damages lodged by a contractor against A Ltd. is pending in a law suit Rs. 155 thousands (W.N. 9).

Working Notes:

1. Calculation of capital profits (pre-acquisition) *(Rs. in '000s)*

General reserve balance as on 1-04-2007		40.00
Profit and loss account balance as on 1-04-2007	320.00	
Less: Dividend at 16% p.a. on Rs. 6,00,000 for 2006-07	96.00	224.00
		264.00
Add: Profit on revaluation of plant and machinery (W.N.7)		200.00
		464.00
Less: Loss on revaluation of furniture and fixtures (W.N.8)		120.00
		344.00
Share of A Ltd. (80%)		275.20
Share of Minority Interest (20%)		68.80

2. Calculation of revenue profits (post-acquisition) *(Rs. in '000s)*

Profits during the year 2007-08 (720.0 – 224.0)	496.00
Less: Preference dividend for 2007-08 @ 14% on Rs.4,00,000	56.00
	440.00

Less: Under charging of depreciation on P&M due to upward revaluation

(Rs.2,00,000 x 25%)	50.00
	390.00
Add: Excess depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%)	12.00
	402.00
Share of A Ltd. (80%)	321.60
Share of Minority Interest (20%)	80.40

3.Calculation of dividend on preference shares of B Ltd.	*(Rs. in '000s)*
Dividend on preference shares (Rs. 4,00,000 x 14%)	56.00
Share of A Ltd.(80%)	44.80
Share of Minority Interest (20%)	11.20
	56.00

4.Calculation of Minority Interest	*(Rs. in '000s)*
Equity share capital (20%)	120.00
Preference share capital (20%)	80.00
Share of capital profits (W.N. 1)	68.80
Share of Revenue profit (W.N.2)	80.40
Share of preference dividend (W.N.3)	11.20
	360.40

5. Calculation of Cost of Control – Goodwill	*(Rs. in '000s)*
Investment by A Ltd. in	
Equity shares of B Ltd.	1,920.00
Less: Dividend received for 2006-07 (600 x 80% 16%)	76.80
	1,843.20
Preference shares	320.00
	2,163.20
Less: Paid up value Equity shares (80%)	480.00
Preference shares (80%)	320.00
Share in Capital Profit (W.N. 1)	275.20
Goodwill	1,075.20
	1,088.00

6. Calculation of Consolidated Profit and Loss Account	*(Rs. in '000s)*
Balance in Profit and loss A/c of A Ltd. as on 1-04-2007	1,600.00
Add: Revenue profit from B Ltd (W.N. 2)	321.60
Preference dividend of B Ltd. (W.N. 3)	44.80
Share of unrealised loss on stock (Rs. 10,000 x 50%)	5.00
	1,971.40
Less: Dividend wrongly credited	76.80
	1,894.60

7. Value of Plant and Machinery of B Ltd.	*(Rs. in '000s)*
Value as on 1.04.07 (600 x 100/75)	800.00
Add: Appreciation on revaluation (25%)	200.00
Revalued figure	1,000.00

Less: Depreciation :		
Already charged (800-600)	200.00	
Due to upward revaluation (200 x 25%)	50.00	(250.00)
		750.00

8. Value of Furniture and Fixtures of B Ltd. *(Rs. in '000s)*

Value as on 1.4.2007 (540 x 100/90)	600.00
Less: Diminution on revaluation (20%)	(120.00)
Revalued Figure	480.00
Less: Depreciation already charged (600 - 540)	60.00
Less: Depreciation written back due to downward revaluation (120 x 10%)	(12.00)
	(48.00)
	432.00

9. As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability". Therefore, it would be incorrect to ignore the contingent liability.

Question 2. On 1.7.2002, Abhilash, an IIT Graduate in Mechanical Engineering, formed a Company, Abhilash Ltd. The entire Share Capital was held by Abhilash and his wife Lakshana.

On the same day, Balaji, a Management Graduate in Marketing from SP Jain Institute of Management, floated a Company Balaji Ltd. Balaji, together with his wife Subha, held 100% of the Share Capital of the Company. He commenced trading in Chennai.
To synergise the operations and also to cut down costs, Abhilash Ltd and Balaji Ltd decided that with effect from 1.7.2004 a Holding Company, Subhaiakshana Ltd would be formed to take over the Shares in both the Companies.

It was agreed that the accounts of Abhilash Ltd for the two years ended 30.6.2004 should be adjusted., as necessary, so as to conform to the accounting policies and conventions used by Balaji Ltd. Subhalakshana would then issue securities to the shareholders in Abhilash Ltd and Balaji Ltd on the following basis –

1. Rs. 10 of 9% Loan Stock 2004 for every Rs. 10 of net asset owned by each Company.
2. Rs. 10 Equity Shares based on a two-year purchase of the Profits after Taxation profits are to be the average profits of two years, with second year weighted on the basis of 2 : 1 basis.

The accounts of the two years ended 30.6.2004 showed –

Particulars	**Abhilash Ltd**		**Balaji Ltd**	
ASSETS	**2003**	**2004**	**2003**	**2004**
Fixed Assets : Furniture, Fixtures etc. Gross Block	1,20,000	1,20,000	1,60,000	1,60,000
Less : Accumulated Depreciation	12,000	24,000	24,000	48,000
Net Book Value	1,08,000	96,000	1,36,000	1,12,000
Trade Investments	-	-	-	3,00,000
Current Assets : Stock at cost	2,60,000	3,45,000	2,90,000	3,52,000
Debtors	2,92,500	4,24,000	3,24,000	4,32,000
Quoted Investments at Cost (Market Value Rs. 1,40,000)	-	1,00,000	-	-
Cash at Bank	10,000	-	35,000	-
Total	6,70,500	9,65,000	7,85,000	8,96,000

LIABILITIES				
Share Capital : Equity Shares of Rs. 10 each	2,00,000	2,00,000	2,50,000	2,50,000
Profit & Loss account	1,28,000	2,70,000	1,39,000	3,02,000
Unrealised Appreciation in investment	-	-	-	80,000
Creditors	2,60,500	3,07,000	3,00,000	3,42,000
Bank Overdraft	-	80,000	-	1,05,000
Taxation	82,000	1,08,000	96,000	1,17,000
Total	6,70,500	9,65,000	7,85,000	11,96,000

The following information is obtained :

1. **Purchases:** Both Abhilash and Balaji purchase the Steel Rods from the same supplier, who sells on a fixed price list. Abhilash Ltd and Balaji Ltd themselves apply a 50% uplift on cost, to calculate their own selling Prices. The Suppliers Price List showed –
   - 1st July 2002 Rs. 100 each
   - 1st June 2003 Rs. 110 each
   - 1st May 2004 Rs. 120 each

The number of rods purchased and sold in the periods after the price increased were:

Particulars	**Abhilash Ltd**		**Balaji Ltd**	
	Purchase	**Sales**	**Purchase**	**Sales**
1st June – 30th June 2003	1,000	800	1,200	900
1st May – 30th June 2004	1,500	1,000	2,900	2,500

2. **Stock :** Abhilash Ltd calculates the cost price of stock on FIFO basis, while Balaji Ltd uses LIFO basis.

3. **Depreciation**: Depreciation in both the Companies is provided on the Straight-Line Method. There had been no material change in the Fixed Assets since 1.7.2002 when the Companies commenced trading. The Fixed Assets of the two Companies are of similar nature.

4. **Bad Debts:** Abhilash Ltd deducts 1% from Gross Trade Debtors, as a general provision against doubtful debts.

5. **Debtors:** Debtors comprise the following -

Particulars	**Abhilash Ltd**		**BalaJi Ltd**	
	2002	**2003**	**2002**	**2003**
Trade Debtors	2,47,500	3,96,000	3,20,000	4,25,000
Prepaid Expenses Advertising (Note)	5,000 40,000	8,000 20,000	4,000 -	7,000 -

Note: Abhilash Ltd carried out an extensive advertising campaign when commencing to trade, and decided to write off this expense equally over three years. Balaji Ltd incurred similar expenditure, which was however written off as incurred.

6. **Managerial Remuneration:** It was agreed by all parties that the Directors' Remuneration paid by Balaji Ltd is strictly on commercial basis, whereas that paid by Abhilash Ltd contains a "distribution of profit" element of Rs. 30,000 in each year.

7. **Profits**: Net Profits including investment income, after Provision for Corporate Tax were :-

Year ending 30th June...	Abhilash Ltd	Balaji Ltd
2003	1,28,000	1,39,000
2004	1,42,000	1,63,000

Required –

a) Calculate the terms of the offer to be made to Abhilash Ltd and Balaji Ltd by Subhalakshana Ltd.

b) Prepare the Balance Sheet of Subhalakshana Ltd after the transactions are given effect to.

(20 Marks)

Answer.

1. DEPRECIATION ANALYSIS - Balaji's Depreciation Rate to be used by both Companies

(a) Computation of Rate of Depreciation charged by both Companies

Particulars	**Abhilash**	**Balaji**
Original Cost	Rs. 1,20,000	Rs. 1,60,000
Accumulated Depreciation	Rs. 24,000	Rs. 48,000
Depreciation per annum = Accumulated Depreciation ÷ 2 years	Rs. 12,000	Rs. 24,000
Rate of Depreciation = Depreciation per annum ÷ Original Cost	10%	15%

(b) Computation of Revised Depreciation for Abhilash Ltd based on Balaji Depreciation Rate

Particulars	**Rs.**
Revised Depreciation for two years (Rs.1,20,000 × 15% × 2 years)	36,000
Less: Depreciation already charged for two years	24,000
Extra Depreciation to be provided	12,000

2. STOCK VALUATION ANALYSIS -LIFO to be used by both Companies

Particulars for the financial year	**2003**	**2004**
a. purchase Quantity of Rods (units) by Abhilash Ltd	1,000	1,500
b. Sales Quantity of Rods (units) by Abhilash Ltd	(800)	(1,000)
c. Stock held out of Purchases after price increase (units) (a - b)	200	500
d. Price per unit of Stock under FIFO (FIFO Stock Price = Latest Prices)	110	120
e. **Value of Rods in Stock under FIFO Method** (c × d)	**22,000**	**60,000**
f. Price per unit of Stock under FIFO (FIFO Stock Price = Earliest Prices)	100	110
g. **Value of Rods in Stock under LIFO Method** (c × f)	20,000	55,000
h. Difference in Stock Valuation (e - g) i.e. reduction in value of Stock	**2,000**	**5,000**

3. DEBTORS AND PROVISION FOR DOUBTFUL DEBTS ANALYSIS

Particulars	**2003**	**2004**
Balance as per Balance Sheet of Abhilash Ltd (after 1% deduction)	2,47,500	3,96,000
Add : Provision provided in the books [(Rs.2,47,500 - 99%) × 1%]	2,500	4,000
Gross Value of Debtors (i.e. balance before deducting provision)	**2,50,000**	**4,00,000**

4. COMPUTATION OF WEIGHTED AVERAGE PROFITS

(a) Abhilash Ltd :

Particulars	**2003**	**2004**
Net Profit before Adjustments (given)	1,28,000	1,42,000
Add : Adjustment in Value of Opening Stock	—	2,000

Managerial Remuneration in the nature of Distribution of Profits	30,000	30,000
Provision for Bad Debts	2,500	4,000
Amortisation of Advertisement Costs	20,000	20,000
	1,80,500	**1,98,000**
Less : Extra Depreciation to be provided	(6,000)	(6,000)
Adjustment in Value of Closing Stock	(2,000)	(5,000)
Total Advertisement amortised in the year of occurrence as per B Ltd	(60,000)	-
Profits after adjustments of accounting policies	**1,12,500**	**1,87,000**
Weights	1	2
Weighted Adjusted Profits	1,12,500	3,74,000
Weighted Average Profits (Rs.1 ,12,500 + Rs.3,74,000) ÷ 3		**Rs.1,62,167**

(b) Balaji Ltd:

Particulars	**2003**	**2004**
Net Profit (given)	1,39,000	1,63,000
Weights	1	2
Weighted Profits	1,39,000	3,26,000
Weighted Average Profits (Rs.l,39,000 + Rs.3,26,000) ÷ 3		**1,55,000**

5. COMPUTATION OF NET ASSETS

Particulars	**Abhilash (Rs.)**		**Balaji (Rs.)**
Fixed Assets	96,000	84,000	1,12,000
Less: Extra Depreciation on Fixed Assets	(12,000)		
Trade Investments	-	-	3,00,000
Stock (3,45,000-difference in valuation 5,000)	3,45,000	-	-
Less: Adjustment for change in method of valuation	(5,000)	3,40,000	3,52,000
Debtors	4,24,000	-	-
Add: Provision no longer required	4,000	-	-
Less: Advertisement Expenses fully amortized	(20,000)	4,08,000	4,32,000
Quoted Investments		1,40,000	—
Total Assets		**9,72,000**	**11,96,000**
Less: Provision for Tax		(1,08,000)	(1,17,000)
Bank Overdraft Creditors		(80,000)	(1,05,000)
Creditors		(3,07,000)	(3,42,000)
Net Assets		**4,77,000**	**6,32,000**

6. CALCULATION OF CONSIDERATION (Rs.)

Particulars	**Abhilash**	**Balaji**	**Total**
Consideration in Rs. 10 Shares = 2 × Weighted Average Profits			
Weighted Average Profit	1,62,167	1,55,000	
Consideration in Shares of Rs.10 (A)	**3,24,330**	**3,10,000**	**6,34,330**
Consideration in Rs.10 - 9% Loan Stock = Net Assets Consideration in Loan Stock (= Net Assets) (B)	**4,77,000**	**6,32,000**	**11,09,000**
TOTAL (A + B)	**8,01,330**	**9,42,000**	**17,43,330**

7. BALANCE SHEET OF SUBHALAKSHANA LTD (Holding Company)

Liabilities	Rs.	Assets	Rs.
Share Capital		**Investments:**	
Equity Shares of Rs. 10 each	6,34,330	- in shares of Abhilash Ltd	8,01,330
Secured Loans:		- in Shares of Balaji Ltd	9,42,000
Rs. 10 -9% Loan Stock	11,09,000		
Total	**17,43,330**	**Total**	**17,43,330**

Question 3. X Ltd. plans to take over B Ltd. Independent Cash Flow forecasts of both companies are as follows:

Year	X ltd (Rs in lakhs)	B ltd (Rs in lakhs)
1	200	50
2	225	65
3	250	80
4	270	95
5	285	110
6	310	120
7	350	130
8	600	150
9	610	170
10	650	180
	3750	**1150**

Following further information is available from the latest Balance Sheet of Beta Ltd.

Assets:		**Rs. in lakhs**
Fixed Assets		5,00
Stock		1,15
Debtors		50
		6,65
Less: Liabilities		
Sundry creditors	1,65	
Long term loan	2,00	(3,65)
Net assets		**3,00**

X Ltd. finds that fixed assets of book value Rs.75 lakhs will not be used which will fetch Rs.50 lakhs on immediate disposal. Moreover, stock will fetch Rs.140 lakhs and debtors Rs.48 lakhs immediately. But X Ltd. has to pay off the liabilities immediately. Also it has to pay Rs.110 lakhs to workers of B Ltd. whose service cannot be used. It appears that after merger X Ltd. has to invest Rs.210 lakhs for renovation of the plant and machinery at the end of 1st year and Rs.50 lakhs for modernization at the end of 2^{nd} year after merger.

Forecast of cash flows of X Ltd. after merger :

Year	X ltd (Rs in lakhs)
1	240
2	280
3	350
4	400

5	410
6	480
7	550
8	800
9	880
10	950
	5340

Determine the maximum value of B Ltd. which its management should ask from X Ltd. You may use 20% discount rate.

Answer. Maximum value to be quoted

Particulars	**Rs. in Lakhs**	**Rs. in Lakhs**
Value of merged entities as per discounted cash flows (W.N.1)		502.38
Add: Cash to be collected immediately on disposal of assets		
i. Fixed assets	50.00	
ii. Stock	140.00	
iii. Debtors	48.00	238.00
Less:		
i. Sundry creditors	165.00	
ii. Long term loan	200.00	
iii. Compensation to workers	110.00	
iv. Renovation of plant and machinery (210×0.8333) [PV]	174.99	
v. Modernisation of Plant and machinery (50 x 0.6944)	34.72	(684.71)
Maximum value to be quoted (a+ b-c)		55.67

So, Beta Ltd. can quote as high as Rs.55,67,000 for takeover.

Working Note:

Valuation of X Ltd. in case of merger

Year	Cash flow after merger	Cash flow of X Ltd. before merger	Incremental cash flow	Discount factor @ 20%	Discounted cash flow
(1)	**(2)**	**(3)**	**(4)= (2)-(3)**	**(5)**	**(6) = (4) ×(5)**
1	240	200	40	0.8333	33.33
2	280	225	55	0.6944	38.19
3	350	250	100	0.5787	57.87
4	400	270	130	0.4823	62.70
5	410	285	125	0.4019	50.24
6	480	310	170	0.3349	56.93
7	550	350	200	0.2791	55.82
8	800	600	200	0.2326	46.52
9	880	610	270	0.1938	52.33
10	950	650	300	0.1615	48.45
Total					**502.38**

(b) While closing its books of account 31st March, a NBFC has its advances classified as follows-

Particulars		**Rs. In lakhs**
Standard Assets		16,800
Sub-Standard Assets		1,340
Secured Portions of Doubtful Debts:	- up to one year	320
	- one year to three years	90
	- more than three years	30
Unsecured Portion of Doubtful Debts		97
Loss Assets		48

Calculate the amount of provision which must be made against the advances.

(10+4=14 Marks)

Answer.

Particulars	**Loan Rs. Lakhs**	**Provision %**	**Provision Rs. Lakhs**
Standard Assets	16,800	Nil	Nil
Sub-standard Assets	1,340	10%	134
Secured Portions of Doubtful Debts: - up to one year	320	20%	64
- 1 year to 2 years	90	30%	27
- more than three years	30	50%	15
Unsecured Portion of Doubtful Debts	97	100%	97
Loss Assets	48	100%	48
Total			**385**

Question 4.

(a) AIPL imported a machine on 01.01.2009 for GBP 24000 on deferred payment basis being payable in six annual installments at the end of the financial year, commencing from 31.03.2009. Determine the exchange difference and the carrying amounts of the liability at the end of each financial year as per Revised AS 11 on the basis of the following exchange rates :

Date	01.01.2009	31.03.2009	31.03.2010	31.03.2011	31.03.2012	31.03.2013	31.03.2014
Rate	81.00	80.50	80.25	80.75	82.00	84.50	86.25

Answer.

Calculation of Carrying Amount of Liability

Financial Year Ending	**GBP Amount Due**	**Closing Rate**	**Carrying amount (Rs.)**
31-Mar-2009	20000	80.50	1610000
31-Mar-2010	16000	80.25	1284000
31-Mar-2011	12000	80.75	969000
31-Mar-2012	8000	82.00	656000
31-Mar-2013	4000	84.50	338000
31-Mar-2014	Nil	86.25	Nil

Calculation of Exchange Difference :

Financial Year Ending	**Exchange difference due to settlement**	**Exchange difference due to reporting**
31-Mar-2009	4000 (81.00-80.50) = 2000 Gain	20000(81-80.5)= 10000 Gain
31-Mar-2010	4000 (80.50-80.25)= 1000 Gain	16000(80.5-80.25)= 4000 Gain

31-Mar-2011	4000 (80.25-80.75)= 2000 Loss	12000(80.25-80.75)= 6000 Loss
31-Mar-2012	4000 (80.75-82.00)= 5000 Loss	8000(80.75-82)= 10000 Loss
31-Mar-2013	4000 (82.00-84.50)= 10000 Loss	4000(82-84.5) = 10000 Loss
31-Mar-2014	4000 (84.50-86.25)= 7000 Loss	Nil

Gain /Loss is transferred to Profit & Loss Account.

(b) Arihant Industries has taken a loan of Euro 200,000 on 1st April, 2009, for a specific project at an interest rate of 5% per annum, payable annually. On 1st April, 2009, the exchange rate between the currencies was Rs. 54 per Euro. The exchange rate, as at 31st March, 2010, is Rs. 57 per Euro. The corresponding amount could have been borrowed by Arihant Industries in local currency at an interest rate of 11% per annum as on 1st April, 2009. Compute the amount of borrowing costs as per para 4(e) of AS-16.

(10+4=14 Marks)

Answer. The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS-16:

(a) Interest for the period = € 200,000 X 5% X Rs. 57 per € = Rs. 5,70,000
(b) Increase in the liability towards the principal amount = € 2,00,000 X (57 - 54) = Rs. 6,00,000
(c) Interest that would have resulted if the loan was taken in Indian currency = € 2,00,000 X 54 X 11% = Rs. 11,88,000
(d) Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 11,88,000 - Rs. 5,70,000 = Rs. 6,18,000

As per para 4(e) if the difference between the interest on local currency and interest on foreign currency borrowing is equal to or more than the exchange difference amount of principal foreign currency borrowing then the **ENTIRE AMOUNT** of exchange difference is covered by para 4(e). Hence, in the above case entire amount of Rs 6,00,000 would be considered as borrowing cost.

Question 5.

(a) Zero Limited commenced its business on 1st April, 1996. 2,00,000 equity shares of Rs. 10 each at par and 12.5% debentures of aggregate value of Rs. 2,00,000 were issued and fully taken up. The proceeds utilised as under,:

	Rs.
Fixtures and Equipments	16,00,000
(Estimated Life 10 years, no Scrap Value)	
Goods Purchased for Resale at Rs. 200 per unit	6,00,000

The goods were entirely sold by 31st January, 1997 at a profit of 40% on selling price.

Collections from debtors outstanding on 31st March amounted to Rs. 60,000, goods sold were replaced at a cost of Rs. 7,20,000, the number of units purchased being the same as before. A payment of Rs. 40,000 to a supplier was outstanding as on 31st March, 1997.

The replaced goods remained entirely in stock on 31st March, 1997.

Replacement cost as at 31st March 1997 was considered to be Rs 280 per unit.

Replacement cost of fixtures and equipments (depreciation on straight line basis) was Rs. 20,00,000 as at 31st March, 1997.

Draft the Profit and Loss Account and the Balance Sheet on replacement cost (entry value) basis and on historical cost basis.

Answer.

Profit & Loss Account for the year ended 31st march 1997

Particulars	**Historical Cost Basis**	**Replacement Cost Basis**
Sales	10,000,000.00	1,000,000.00
Less : Cost of Sales	600,000.00	720,000.00
Gross Profit	400,000.00	280,000.00
Less : Depreciation	160,000.00	180,000.00
Profit before interest	240,000.00	100,000.00
Less : Debenture Interest	25,000.00	25,000.00
Net Profit	**215,000.00**	**75,000.00**

Balance sheet of Zero Ltd as at 31 st march 1997

Particulars	**Historical Cost Basis**	**Replacement Cost Basis**
LIABILITIES		
Equity share capital	2,000,000.00	2,000,000.00
P & L Account	215,000.00	75,000.00
Replacement Reserve	-	620,000.00
12.5 % Debentures	200,000.00	200,000.00
Creditors	40,000.00	40,000.00
Total	**2,455,000.00**	**2,935,000.00**
ASSETS		
Furnitures & Equipment	1,440,000.00	1,800,000.00
Stock	720,000.00	840,000.00
Debtors	60,000.00	60,000.00
Cash & Bank	235,000.00	235,000.00
Total	**2,455,000.00**	**2,935,000.00**

Working Notes:

(i)Replacement cost of sales on the basis of replacement cost on the date of sale = Rs. 240 x 3,000 = Rs.7,20,000.

(ii) Under replacement cost basis, depreciation, calculated on the average basis
= 10% of (1,60,000+2,00,000) / 2 = Rs. 1,80,000

(iii) Fixtures and equipments at net current replacement cost.

	Rs.
Gross replacement cost	20,00,000

Less: Depreciation, 10% of Rs.20,00,000	2,00,000
Net current replacement cost	18,00,000

Replacement Reserve = Realised holding gains + unrealised holding gains

Particulars	**Realised Holding Gains**	**Unrealised holding gains**
Stocks: Sold [replacement cost on the date of sale-historical cost] [7,20,000 - 6,00,000]	120,000.00	
Unsold [closing stock X (closing rate - rate on the date of purchase) [3000 (280 - 240)		120,000.00
Fixtures & Equipments : Depreciation Rs (1,80,000 -1,60,000) Net Book value at year end [18,00,000-14,40,000]	20,000.00	360,000.00
Total	**140,000.00**	**480,000.00**

Replacement + Reserve = Rs.1,40,000 + Rs.4,80,000 = Rs.6,20,000.

(b)AIPL taken on lease an equipment costing Rs.3,00,000 with expected useful life of 4 years for three years. The asset would revert to AIPL under the lease agreement. The other information available in respect of lease agreement is:

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs.40,000.

(ii) The implicit rate of interest is 10%.

(iii)The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of AIPL:

a) The annual lease payment.
b) The unearned finance income.
c) The segregation of finance income, and also,
d) Show how necessary items will appear in its profit and loss account and balance sheet in the FIRST year.

Solution. (a) (i) Calculation of Annual Lease Payment assuming to be paid at the end of the year.

	Rs.
Cost of the equipment	3,00,000
Unguaranteed Residual Value	40,000
PV of residual value for 3 years @ 10% (Rs.40,000 x 0.751)	30,040
Fair Value to be recovered from lease payment (Rs.3,00,000 – Rs.30,040)	2,69,960
PV Factor for 3 years @ 10%	2.487
Annual Lease Payment (Rs.2,69,960 / PV Factor for 3 years @ 10% i.e. 2.487)	1,08,548

(ii)Unearned Financial Income

Total lease payments [Rs. 1,08,548 x 3]	3,25,644
Add: Residual value	40,000
Gross Investments	3,65,644
Less: Present value of Investments (Rs.2,69,960 + Rs.30,040)	3,00,000
Unearned Financial Income	**65,644**

(iii) Segregation of Finance Income

Year	Lease Rentals	Finance charges @ 10% on Outstanding amount	Repayment	Outstanding amount
0	-	-	-	300,000.00
1	108,548.00	30,000.00	78,548.00	221,452.00
2	108,548.00	22,145.00	86,403.00	135,049.00
3	148,548.00**	13,499.00	135,049.00	-

** Rs. 1,48,548 includes unguaranteed residual value of equipment amounting Rs. 40,000.

(iv) **Profit and Loss Account (Relevant Extracts)**

Credit side		**Rs.**
I Year	By Finance Income	30,000

Balance Sheet (Relevant Extracts)

Assets side	**Rs.**	**Rs.**
I year Lease Receivable	3,00,000	
Less: Amount Received	78,548	2,21,452

(8+8=16 Marks)

Question 6

(i)R Ltd acquired 4000 equity shares of P Ltd. at Rs 150 cum right per share. Later on P Ltd. made right issue of 1:1 at Rs. 120 per share. Calculate the cost of the investment if:

(a) R Ltd exercised 100% of right issue.
(b) R Ltd exercised 90% of right issue.

Answer.

(a)

Cost of Shares bought cum Right (4000 X 150)	600000
Add : Cost of Right shares subscribed (4000 X120)	480000
Total cost of Investment	**1080000**

(b)

Cost of Shares bought cum Right (4000 X 150)	600000
Add : Cost of Right shares subscribed (4000 X90%X120)	432000
Less : Proceeds of Right sold (4000 XX 10% X 30**)	108000
Total cost of Investment	**924000**

****** Assumed that rights are sold in the market at Rs 30 per share.

(ii) "Company invested 100 lakhs in April, 2009 for the acquisition of ABC Ltd doing similar business, the negotiations for which had started during the year.

State with reasons, how you would deal with this in the financial statements:

Solution. As per revised AS 4 the acquisition of ABC Ltd. is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2009. Therefore, the investment of Rs. 100 lakhs in April, 2009 in the acquisition of ABC Ltd. should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

(iii)ABC Limited Company has been including interest in the valuation of closing stock. In 2009-10 the management of the company decided to follow AS 2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by Rs. 4,50,000. Is a disclosure necessary? If so, draft the same.

Solution. As per AS 5 (Revised), change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the given case, the company has changed its accounting policy in order to conform to the AS 2 (Revised) on Valuation of Inventories. Therefore, a disclosure is necessary by way of notes to the annual accounts for the year 2009-10.

"In conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock unlike preceding years. Had the same principle been followed in previous years, profit for the year and its corresponding effect on the year end net assets would have been higher by Rs. 4,50,000."

(6+5+5=16 Marks)