PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.
Working notes should form part of the answer.
Wherever necessary, suitable assumptions may be made by the candidates.

Question 1

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

(Rs. in 000's)

Liabilities	Astha Ltd.	Birat Ltd.	Assets	Astha Ltd.	Birat 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 Birat Ltd.	1,920	-
Profit and loss account	1,600	720	in preference shares of Birat Ltd.	320	-
Creditors	300	320	Stock	680	404
			Debtors	560	316
			Cash at bank	660	220
	6,800	2,080		6,800	2,080

Note:

Contingent liability – Astha 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 Birat Ltd. was the same as on 1.4.2007.

(ii) The balance in Profit and Loss A/c of Birat 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 Birat Ltd. for the year 2007-08 was still payable as on 31.3.2008.

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

(v) Sundry creditors of Astha Ltd. included an amount of Rs.1,20,000 for purchases from Birat 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 Astha Ltd. as at 31.3.2008.

(vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat 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 Astha 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. (16 Marks)

Answer

Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd.

as at 31st March 2008

(Rs. in '000s)

Liabilities		Amount	Assets		Amount
Share capital:			Goodwill (W.N.5)		1,088.0
3,00,000 Equity shares of			Plant and machinery		
Rs. 10 each fully paid up		3,000.0	Astha Ltd.	2,060.0	
Minority interest (W.N.4)		360.4	Birat Ltd. (W.N.7)	750.0	2,810.0
General reserves		1,900.0	Furniture and fixtures		
Profit and loss A/c (W.N.6)		1,894.6	Astha Ltd.	600.0	
Creditors			Birat Ltd. (W.N. 8)	432.0	1,032.0
Astha Ltd.	300.0		Stock		
Birat Ltd.	320.0		Astha Ltd.	680.0	
	620.0		Birat Ltd.	404.0	
Less: Mutual owings	120.0	500.0		1,084.0	
			Add: Unrealised loss	5.0	1,089.0

	Debtors		
	Astha Ltd.	560.0	
	Birat Ltd.	316.0	
		876.0	
	Less: Mutual owings	120.0	756.0
	Cash at Bank		
	Astha Ltd.	660.0	
	Birat Ltd.	220.0	880.0
7,655.0			7,655.0

Contingent liability: Claim against damages lodged by a contractor against Astha 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		40.0
Profit and loss account balance as on 1-04-2007	320.0	
Less: Dividend at 16% p.a. on Rs. 6,00,000 for the year 2006-07	96.0	224.0
		264.0
Add: Profit on revaluation of plant and machinery (W.N.7)		200.0
		464.0
Less: Loss on revaluation of furniture and fixtures (W.N.8)		120.0
		344.0
Share of Astha Ltd. (80%)		275.2
Share of Minority Interest (20%)		68.8

2. Calculation of revenue profits (post-acquisition)

	(Rs. in '000s)
Profits during the year 2007-08 (720.0 – 224.0)	496.0
Less: Preference dividend for the year 2007-08 @ 14% on Rs.4,00,000	56.0
	440.0
Less: Under charging of depreciation on plant and machinery due to upward revaluation (Rs.2,00,000 x 25%)	50.0
	390.0

Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%)	12.0
	402.0
Share of Astha Ltd. (80%)	321.6
Share of Minority Interest (20%)	80.4

3. Calculation of dividend on preference shares of Birat Ltd.

		(Rs. in '000s)
Dividend on preference shares (Rs. 4,00,000 x 14%)		56.0
Share of Astha Ltd.	(80%)	44.8
Share of Minority Interest	(20%)	11.2
		56.0

4. Calculation of Minority Interest

	(Rs. in '000s)
Equity share capital (20%)	120.0
Preference share capital (20%)	80.0
Share of capital profits (W.N. 1)	68.8
Share of Revenue profit (W.N.2)	80.4
Share of preference dividend (W.N.3)	11.2
	360.4

5. Calculation of Cost of Control - Goodwill

		(Rs. in '000s)
Investment by Astha Ltd. in		
Equity shares of Birat Ltd.	1,920.0	
Less: Dividend received for 2006-07 (600 x 80% 16%)	76.8	1,843.2
Preference shares		320.0
		2,163.2
Less: Paid up value of		
Equity shares (80%)	480.0	
Preference shares (80%)	320.0	
Share in Capital Profit (W.N. 1)	275.2	1,075.2
Goodwill		1,088.0

6. Calculation of Consolidated Profit and Loss A/c

			(Rs. in '000s)
Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2007			1,600.0
Add:	Revenue profit from Birat Ltd (W.N. 2)		321.6
	Preference dividend of Birat Ltd. (W.N. 3)		44.8
	Share of unrealised loss on stock (Rs. 10,000 x 50%)		5.0
			1,971.4
Less:	Dividend wrongly credited		76.8
			1,894.6

7. Value of Plant and Machinery of Birat Ltd.

			(Rs. in '000s)
Value as on 1.04.07 (600 x 100/75)			800.0
Add:	Appreciation on revaluation (25%)		200.0
Revalued figure			1,000.00
Less: Depreciation			
	Already charged (800-600)	200.0	
	Due to upward revaluation (200 x 25%)	50.0	(250.0)
			750.0

8. Value of Furniture and Fixtures of Birat 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			480.0
Less: Depreciation already charged (600 - 540)		60.0	
Less: Depreciation written back due to downward revaluation			
	(120 x 10%)	(12.0)	(48.0)
			432.0

9. Contingent liability:

As per para 68 of 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 not be correct to ignore the contingent liability.

Question 2

T. Ltd. and V. Ltd. propose to amalgamate. Their balance sheets as at 31st March, 2008 were as follows:

Liabilities	T. Ltd.	V. Ltd.	Assets	T. Ltd.	V. Ltd.
	Rs.	Rs.		Rs.	Rs.
Share capital:			Fixed assets		
Equity shares of Rs.10 each	15,00,000	6,00,000	Less: Depreciation	12,00,000	3,00,000
General reserve	6,00,000	60,000	Investments (face value of Rs.3 lakhs, 6% tax free G.P. notes)	3,00,000	-
Profit & Loss A/c	3,00,000	90,000	Stock	6,00,000	3,90,000
Creditors	3,00,000	1,50,000	Debtors	5,10,000	1,80,000
			Cash and bank balances	90,000	30,000
	27,00,000	9,00,000		27,00,000	9,00,000

Their net profits (after taxation) were as follows:

Year	T. Ltd.	V. Ltd.
2005-06	3,90,000	1,35,000
2006-07	3,75,000	1,20,000
2007-08	4,50,000	1,68,000

Normal trading profit may be considered as 15% on closing capital invested. Goodwill may be taken as 4 years' purchase of average super profits. The stock of T. Ltd. and V. Ltd. are to be taken at Rs.6,12,000 and Rs.4,26,000 respectively for the purpose of amalgamation. W. Ltd. is formed for the purpose of amalgamation of two companies.

(a) Suggest a scheme of capitalization of W. Ltd. and ratio of exchange of shares; and

(b) Draft the opening balance sheet of W. Ltd. (16 Marks)

Answer

(a) Scheme of capitalization of W. Ltd. and ratio of exchange of shares

Computation of Net Assets of amalgamating companies

	T. Ltd.	V. Ltd.
	Rs.	Rs.
Goodwill (W.N.2)	3,19,200	1,21,200

Fixed Assets	12,00,000	3,00,000
6% investments (Non-trade)	3,00,000	-
Stock	6,12,000	4,26,000
Debtors	5,10,000	1,80,000
Cash and Bank Balances	90,000	30,000
	30,31,200	10,57,200
Less: Creditors	3,00,000	1,50,000
Net Assets	27,31,200	9,07,200
No. of Equity shares	1,50,000	60,000
Intrinsic value of a share	Rs. 18.208	Rs. 15.12
No of shares to be issued by W. Ltd to		
T. Ltd 1,50,000 x 18.208/10	2,73,120 shares	
V. Ltd 60,000 x 15.12/10		90,720 shares

In total 2,73,120 + 90,720 i.e. 3,63,840 shares will be issued by W. Ltd.

Ratio of exchange of shares will be as follows:

1. Holders of 1,50,000 equity shares of T Ltd. will get 2,73,120 shares in W. Ltd.
2. Similarly, holders of 60,000 equity shares of V Ltd. will get 90,720 shares in W. Ltd.

(b) Opening Balance Sheet of W. Ltd.

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
3,63,840 Equity shares of Rs. 10 each	36,38,400	Goodwill (W.N.2) (3,19,200 + 1,21,200)	4,40,400
(Issued for consideration other than cash, pursuant to scheme of amalgamation)		Other fixed Assets (12,00,000+ 3,00,000)	15,00,000
Current Liabilities:		Investments in 6% Tax free G.P. Notes	3,00,000
Creditors	4,50,000	Current Assets:	
		Stock (6,12,000 + 4,26,000)	10,38,000
		Debtors (5,10,000 + 1,80,000)	6,90,000
		Cash and bank balance (90,000 + 30,000)	1,20,000
	40,88,400		40,88,400

Working Notes:

1. Calculation of closing trading capital employed on the basis of net assets

	T. Ltd.	V. Ltd.
	Rs.	Rs.
Fixed Assets	12,00,000	3,00,000
Stock	6,12,000	4,26,000
Debtors	5,10,000	1,80,000
Cash and Bank Balances	90,000	30,000
	24,12,000	9,36,000
Less: Creditors	3,00,000	1,50,000
Net Assets	21,12,000	7,86,000

2. Calculation of value of goodwill

(i) Average Trading Profit

	T. Ltd.	V. Ltd.
	Rs.	Rs.
2005-06	3,90,000	1,35,000
2006-07	3,75,000	1,20,000
2007-08	4,50,000	1,68,000
Profit after tax	12,15,000	4,23,000
Profit before tax (40%)*	20,25,000	7,05,000
Add : Under valuation of closing stock	12,000	36,000
	20,37,000	7,41,000
Average of 3 years' profit before tax	6,79,000	2,47,000
Less: Income from non-trade investments (3,00,000 x 6%)	18,000	-
Average profit before tax	6,61,000	2,47,000
Less: 40% tax	2,64,400	98,800
Average profit after tax	3,96,600	1,48,200

(ii) Super Profits

	T. Ltd.	V. Ltd.
Average trading profit	3,96,600	1,48,200
Less: Normal Profit		

* Tax rate of 40% has been assumed. The candidates may assume some other tax rate and give the solution accordingly.

T. Ltd. Rs. 21,12,000 x 15%	3,16,800	
V. Ltd Rs. 7,86,000 x 15%		1,17,900
	79,800	30,300
(iii) Value of goodwill at 4 years' purchase of super profits	3,19,200	1,21,200

Question 3

(a) ABC Ltd. grants 1,000 employees stock options on 1.4.2004 at Rs.40, when the market price is Rs.160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2006. 600 options are exercised on 30.6.2007. 100 vested options lapse at the end of the exercise period.

Pass Journal Entries giving suitable narrations.

(b) From the following data, compute the 'Net Assets' value of each category of equity shares of Smith Ltd.:

Shareholders funds

10,000 'A' Equity shares of Rs.100 each, fully paid

10,000 'B' Equity shares of Rs.100 each, Rs.80 paid

10,000 'C' Equity shares of Rs.100 each, Rs.50 paid

Retained Earnings Rs.9,00,000

(10+6 = 16 Marks)

Answer

(a) Journal Entries in the Books of ABC Ltd.

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.3.2005	Employees compensation expenses account	Dr.	48,000	
	To Employees stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)			

	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2006	Employees compensation expenses account	Dr.	48,000	
	To Employees stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2007	Employees stock option outstanding account (W.N.1)	Dr.	12,000	
	To General Reserve account (W.N.1)			12,000
	(Being excess of employees compensation expenses transferred to general reserve account)			
30.6.2007	Bank A/c (600 x Rs.40)	Dr.	24,000	
	Employee stock option outstanding account (600 x Rs.120)	Dr.	72,000	
	To Equity share capital account (600 x Rs. 10)			6,000
	To Securities premium account (600 x Rs.150)			90,000
	(Being 600 employees stock option exercised at an exercise price of Rs. 40 each)			

01.10.2007	Employee stock option outstanding account	Dr.	12,000	
	To General reserve account			12,000
	(Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)			

Working Note:

On 31.3.2007, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options, that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

	Rs.
No. of options actually vested (700 x Rs.120)	84,000
Less: Expenses recognized Rs.(48,000 + 48,000)	96,000
Excess expenses transferred to general reserve	12,000

(b) (i) Computation of Net assets

Worth of net assets is equal to shareholders' fund, i.e.

		Rs.
Paid up value of 'A' equity shares	10,000 x Rs.100	10,00,000
Paid up value of 'B' equity shares	10,000 x Rs. 80	8,00,000
Paid up value of 'C' equity shares	10,000 x Rs. 50	5,00,000
Retained earnings		9,00,000
Net assets		32,00,000

(ii) Net asset value of equity share of Rs.100 paid up

Notional calls of Rs. 20 and Rs.50 per share on 'B' and 'C' equity shares respectively will make all the 30,000 equity shares fully paid up at Rs. 100 each. In that case,

	Rs.
Net assets	32,00,000
Add: Notional calls (10,000 x Rs.20 + 10,000 x Rs.50)	7,00,000
	39,00,000

Value of each equity share of Rs.100 fully paid up = Rs. 39,00,000 / 30,000=Rs.130

(iii) Net asset values of each category of equity shares

	Rs.
Value of 'A' equity shares of Rs. 100 fully paid up	130
Value of 'B' equity shares of Rs. 100 each, out of which Rs. 80 paid up (130-20)	110
Value of 'C' Equity shares of Rs.100 each, out of which Rs. 50 paid up (130-50)	80

Alternatively value of an equity share may also be calculated as follows:

	Rs.
Total paid-up capital	
'A' equity shares (10,000XRs.100)	10,00,000
'B' equity shares (10,000XRs. 80)	8,00,000
'C' equity shares (10,000XRs. 50)	5,00,000
	23,00,000
Retained earnings	9,00,000
Net assets value of all shares	32,00,000

$$\text{Value per rupee of paid up capital} = \frac{\text{Net assets value of all shares}}{\text{Paid up capital}} = \frac{32,00,000}{23,00,000}$$

= Rs.1.391

Therefore,

Net assets value of Rs. 100 paid up share	Rs.1.391 x 100	Rs.139.10
Net assets value of Rs. 80 paid up share	Rs.1.391 x 80	Rs.111.28
Net assets value of Rs. 50 paid up share	Rs.1.391 x 50	Rs.69.55

Question 4

(a) X Ltd. began construction of a new building on 1st January, 2007. It obtained Rs.1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
Rs.5,00,000	11%
Rs.9,00,000	13%

The expenditure that were made on the building project were as follows:

		Rs.
January	2007	2,00,000
April	2007	2,50,000
July	2007	4,50,000
December	2007	1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in AS-16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

(b) From the following information of Steel India Ltd. for the year ended 31st March, 2008, 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. (10 + 6 = 16 Marks)

Answer

(a) (i) Computation of average accumulated expenses

		Rs.
Rs. 2,00,000 x 12 / 12	=	2,00,000
Rs. 2,50,000 x 9 / 12	=	1,87,500
Rs. 4,50,000 x 6 / 12	=	2,25,000
Rs. 1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (in Rs.)	Rate of interest		Ampount of interest (in Rs.)
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000

Weighted average rate of interest = 12.285% (approx)

$\left(\frac{1,72,000}{14,00,000} \times 100\right)$

(iii) Interest on average accumulated expenses

		Rs.
Specific borrowings (Rs. 1,00,000 X 10%)	=	10,000
Non-specific borrowings (Rs. 5,22,500* X 12.285%)	=	64,189
Amount of interest to be capitalized	=	74,189

(iv) Total expenses to be capitalized for building

	Rs.
Cost of building Rs.(2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.12.2007	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalized)			

(b) Social Balance Sheet of Steel India Ltd.

as at 31.03.2008

(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

* (Rs. 6,22,500 – Rs. 1,00,000)

(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

Question 5

(a) U.K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2007, the total expenditure incurred was Rs.50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2006. Expenditure incurred till this date was Rs.22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2008 was Rs.80 lakhs. As at 31st March, 2008, the recoverable amount of know-how embodied in the process is estimated to be Rs.72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2007 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2008.

Ignore depreciation.

(b) Sky Hospital – a non-profit seeking entity receives medicines worth Rs.5,00,000 by way of donations from a donor. During the year its issues of all medicines totals Rs.16,00,000. The closing inventory of donated medicines is Rs.1,00,000. Show relevant summary Journal Entries in the books of the Hospital in respect of the above.

(c) Mini Ltd. took a factory premises on lease on 1.4.07 for Rs.2,00,000 per month. The lease is operating lease. During March, 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.

(d) A Cosmetic articles producing company provides the following information:

	Cold Cream	Vanishing Cream
January, 2006 – September, 2006 per month	2,00,000	2,00,000
October, 2006 – December, 2006 per month	1,00,000	3,00,000
January, 2007- March, 2007 per month	0	4,00,000

The company has enforced a gradual change in product-line on the basis of an overall plan. The Board of Directors of the company has passed a resolution in March, 2006 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer.

(5+5+5+5 = 20 Marks)

Answer

(a) As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2007

(1) Carrying value of intangiblet as on 31.03.2007:

At the end of financial year 31st March 2007, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2006).

(2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2007. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2008

(1) Expenditure to be charged to Profit and Loss account:

	(Rs. in lakhs)
Carrying Amount as on 31.03.2007	28
Expenditure during 2007 – 2008	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2008.

(2) Carrying value of intangible as on 31.03.2008:

	(Rs. in lakhs)
Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2008	72

(b) Journal Entries

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
	Inventory of Medicines (Donated) A/c	Dr.	5,00,000	
	To Operating Revenue A/c			5,00,000
	(Being receipt of donated medicines during the year)			
	Operating Expenses – Medicines A/c	Dr.	16,00,000	
	To Inventory of Medicines A/c (Donated)			4,00,000
	To Inventory of Medicines (Purchased)			12,00,000
	(Being consumption / issue of medicines during the year)			

(c) In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets' and ASI 30 'Applicability of AS 29 to Onerous Contracts', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous* as the economic benefit of lease contract for next 33 months up to 31.12.2010 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of Rs. 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Therefore, provision on account of Rs.66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right.

(d) In response to the market forces, business enterprises often abandon products or even product lines and reduce the size of their work-force. These actions are not in themselves discontinuing operations unless they satisfy the definition criteria.

In the instant case the company has been gradually reducing operation in the product line of cold creams, simultaneously increasing operation in the product line of vanishing creams. The company was not disposing of any of its components. Phasing out a product line as undertaken by the company does not meet definition criteria in paragraph

* For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

3 of AS 24, namely, disposing of substantially in its entirety a component of the enterprise. Therefore, this change over is not a discontinuing operation.

Question 6

Answer the following questions:

(a) What are the advantages of preparation of Value Added (VA) statements?

(b) How are capital expenditures not represented by any specific or tangible assets dealt in financial statements?

(c) One of the important factors generally considered for awarding shields and plaques in India for 'best presented accounts' is that the information presented in the accounts make useful disclosures.

What are actually looked into in this regard? (6+5+5 = 16 Marks)

Answer

(a) The various advantages of preparation of Value Added (VA) Statements are as under:

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour–intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

(b) Sometimes circumstances force a project to incur capital expenditure which is not represented by any specific or tangible assets. For example, a project may have to pay the cost of laying pipelines in order to facilitate the supply of its products or raw materials to or from a sea port but the port trust or other similar authorities may insist that the pipelines belong to them even though the cost thereof is paid by the company. In such a case, the capital expenditure incurred by the project for the stated purpose would not be represented by any actual assets, since the pipeline would remain the property of the relevant port trust or other similar authorities even though the whole or a part of their cost may have been defrayed by the company in order to facilitate its business. In such cases the expenditure so incurred would have to be treated in the books of account as the capital expenditure.

There seems to be no valid objection to disclose the expenditure under the general heading of "Capital Expenditure" subject to two conditions. In the first place the description of the specific items on the balance sheet should be such as to indicate quite clearly that the capital expenditure is not represented by any assets owned by the company. In the second place the capital expenditure should be written off over the approximate period of its utility or over a relatively brief period not exceeding five years whichever is less.

In fact having regard to the nature of expenditure and purpose for which it is incurred, it would be more appropriate and realistic to classify such expenditure in the balance sheet under the heading of "Capital Expenditure" rather than either, write off the expenditure to revenue or classify the expenditure under the heading of "Miscellaneous Expenditure".

(c) In order to ascertain whether the nature and quality of information presented in the accounts make useful disclosures, the following features are generally looked into:

1. Statement of changes in financial position.
2. Sufficient details of revenues / expenses for financial analysis e.g. distinction between manufacturing cost, selling cost and administration cost.
3. Use of vertical form as against the conventional T form; judicious use of schedules, use of sub-totals, manner of showing comparative figures, ease of getting at figures.
4. To what extent additional financial information is provided to the readers through charts and graphs.
5. Financial highlights and ratios including earnings per share.
6. Inclusion of one or more bits of information like value added statement, break up of operations, organization chart, location of factories / branches, human resource accounting, inflation adjusted accounts, social accounts etc.