

Gurukripa's Guideline Answers for May 2011 CA Final Examination

PAPER 1 – FINANCIAL REPORTING

Q.No. 1 is Compulsory. Answer any Five Questions from the remaining Six Questions

Question No.1(a) – AS 15 – Employee Benefits – 5 Marks

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 01.04.2009. On 30.09.2009 the plan out pension plan paid out benefits of ₹ 25,000 and inward contributions of ₹ 55,000. On 31st March, 2010 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2009 the company made the following estimates, based on its market studies and prevailing prices.

Particulars	%
Interest and dividend income (after tax) payable by fund	10.25
Realised gains on plan assets (after tax)	3.00
Fund Administrative Costs	(3.00)
Expected rate of return	10.25

Calculate the expected and actual returns on plan assets as on 31st March, 2010, as per AS-15.

Solution: Also See Page 15.25, Pt 4 of Padhuka's "Students' Referencer on Accounting Standards"

1. Expected Return

As given in the Question = 10.25% p.a. at simple interest. Alternatively, it can be considered as 10% p.a. return compounded on half yearly basis.

Return Computed as follows —

Description	₹
Return at 10.25% on Opening Investment [₹2,00,000 × 10.25%]	20,500
Return at 5% on incremental investment [₹30,000 × 10% × 6/12]	1,500
Total Expected Return	22,000

Note: Computation of Incremental Investment: Additional Contribution ₹55,000 Less Plan Payouts ₹25,000 = ₹30,000

2. Actual Return

Particulars	₹
Closing Fair Value of Plan Assets	3,00,000
Less: Opening Fair Value of Plan Assets	(2,00,000)
Less: Contributions Received	(55,000)
Add: Benefits paid during the year	25,000
Actual Return on Plan Assets	70,000

Question No.1(b) – AS 31 – Presentation of Callable Convertible Debentures – 5 Marks

Certain callable convertible debentures are issued at ₹60. The value of similar debentures without call or equity conversion option is ₹57. The value of call as determined using Black and Scholes model for option pricing is ₹2. Determine the values of liability and equity component.

Answer: Also Refer to Question 7, Page 5.8 of Padhuka's "Students' Guide on Financial Reporting"

Note: In this case, the Debt instrument has two Derivative features – (a) Convertible; and (b) Callable.

Fair Value of Liability (after Call Option) = Fair Value of Liability without Option ₹57 Less Fair Value of Call Option ₹2 ₹55	Nominal Value Raised ₹60	Equity (Balancing Figure) ₹5
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Alternatively, Nominal Value can be given as follows = (Amount in ₹)

	Fair Value of Instrument without any option (Receivable by the Entity) (Financial Liability)	57
Add	Fair Value of Option to Convert to Equity (Receivable by the Entity) (Equity)	"x"
Less	Fair Value of Call Option to Buy Back (Payable by the Entity) (Financial Asset)	(2)
	Nominal Value [Given]	60

- From the above, Value of Option to Convert into Equity = $X = ₹5$
- Value of Option to Buy Back to be adjusted against the Fair Value of Liability i.e. $57 - 2 = ₹55$ carrying amount of Liability

Question No.1(c) – GN on Accounting Treatment for Excise Duty – 5 Marks

HSL Ltd is manufacturing goods for local sale and exports. As on 31.03.2010, it has the following finished stock in the factory warehouse —

- Goods meant for local sales ₹100 Lakhs (Cost ₹75 Lakhs)
- Goods meant for exports ₹50 Lakhs (cost ₹20 Lakhs)

Excise duty is payable at the rate of 12%. The Company's Managing Director says that Excise Duty is payable only on clearance of goods and hence not a cost. Please advise HSL using guidance note, if any issued on this, including valuation of stock.

Solution: Also See Illustration in Page 8.22 of Padhuka's "Students' Guide on Financial Reporting"

1. Principle:

- Guideline:** As per the Guidance Note on Accounting Treatment for Excise Duty, Excise Duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation.
- Principle:** Excise Duty is an indirect tax, arising as a consequence of manufacture of excisable goods, irrespective of the manner of use / disposal of goods thereafter i.e. sale, destruction or captive consumption. Once manufactured, levy of excise duty is attracted, but its eventual discharge is deferred till the date of removal.

2. Analysis and Conclusion:

- Levy of excise duty is and remains upon the manufacture or production alone. Only collection part of it is shifted to the stage of removal.
- Hence, the Managing Director's contention that "Excise Duty is payable only on clearance of goods and hence is not a cost" is incorrect.

3. Inventory Valuation as per Guidance Note:

- General:** As per the GN, provision for the unpaid liability should be made. Therefore, in the above case, excise duty on the goods meant for local sales should be provided for at the rate of 12% on the Selling Price, of ₹100 Lakhs for valuation of stock.
- Export Goods:** Assuming that all the conditions specified in the Central Excise Rules, regarding export of excisable goods without payment of duty are fulfilled by the Company, Excise Duty may not be provided for the goods meant for exports, even though the manufacture thereof is completed.

Question No.1(d) – AS 22 – Accounting for Taxes on Income – 5 Marks

Rama Ltd has provided the following information —

- Depreciation as per Accounting Records ₹2,00,000
- Depreciation as per Income Tax Records ₹5,00,000
- Unamortized Preliminary Expenses as per Tax Record ₹30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset / liability should be recognized as transition adjustment? Tax rate 50%

Solution:

Details	₹	₹	Nature	DTA / DTL	Amount of DTA / DTL
Depreciation as per Accounting Records	2,00,000				
Depreciation as per Income Tax Records	(5,00,000)	(3,00,000)	Timing Difference	Create DTL	$3,00,000 \times 50\% = ₹1,50,000$

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Details	₹	₹	Nature	DTA / DTL	Amount of DTA / DTL
Unamortized Preliminary Expenses as per Tax Record		30,000	Timing Difference	Create DTA	30,000 × 50% = ₹15,000

Deferred Tax Liability towards Timing Difference on Depreciation = ₹1,50,000

Deferred Tax Asset towards Timing Difference on Preliminary Expenses = ₹15,000

Question No.2 – Consolidation of Financial Statements – Chain Holding – 16 Marks

The Balance Sheets of three companies Sun Ltd., Moon Ltd. And Light Ltd. As at 31st March, 2010 are given below:

Liabilities	Sun Ltd	Moon Ltd	Light Ltd	Assets	Sun Ltd	Moon Ltd	Light Ltd
	₹	₹	₹		₹	₹	₹
Share Capital (Shares of ₹ 10 each)	1,50,000	1,00,000	60,000	Fixed Assets	70,000	1,20,000	1,03,000
Reserves	50,000	40,000	30,000	Investments (At cost)			
Profit and Loss A/c.	60,000	50,000	40,000	Shares in : Moon Ltd.	90,000	–	–
Sundry Creditors	30,000	35,000	25,000	Light Ltd.	40,000	–	–
				Light Ltd.	–	50,000	–
Sun Ltd.	–	10,000	8,000	Stock-in-Trade	40,000	30,000	20,000
				Debtors	20,000	25,000	30,000
				Due from Moon Ltd.	12,000		
				Light Ltd.	8,000		
				Cash in Hand	10,000	10,000	10,000
Total	2,90,000	2,35,000	1,63,000	Total	2,90,000	2,35,000	1,63,000

(a) Sun Ltd. Held 8,000 shares of Moon Ltd, and 1800 shares of Light Ltd.

(b) Moon Ltd. held 3600 shares of Light Ltd.

(c) All Investments were made on 1st July, 2009.

(d) The following balances were there on 1st July, 2009 —

	Moon Ltd. ₹	Light Ltd. ₹
Reserves	25,000	15,000
Profit and Loss A/c	20,000	25,000

(e) Moon Ltd. Invoiced goods to Sun Ltd. For ₹4,000 at a cost plus 25% in December, 2009. The closing stock of Sun Ltd. includes such goods valued at ₹5,000.

(f) Light Ltd. Sold to Moon Ltd. An equipment costing ₹24,000 at a profit of 25% on selling price on 1st January, 2010. Depreciation at 10% per annum was provided by Moon Ltd. On this equipment.

(g) Sun Ltd. Proposes dividend at 10%.

Prepare the Consolidated Balance Sheet of the group as at 31st March, 2010. Working should be part of the answer.

Solution: Also See Question 40, Pg.3.88 & Question 42, Pg. 3.92

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = Sun	Acquisition: 01.07.2009	Moon
Subsidiary = Moon	Consolidation: 31.03.2010	(Sun) 80%
Sub-Subsidiary = Light	(a) Holding Co.	(Sun) 30%
	(b) Minority Int.	(Moon) 60%
		20%
		10%

Note: Shareholding Pattern is as under –

Company	Held by Sun	Held by Moon	Total Holdings	Minority Interest	Total No. of Shares
Moon	8,000 (80%)	N.A.	8,000 (80%)	2000 (20%)	10,000 (100%)
Light	1,800 (30%)	3,600 (60 %)	5,400 (90%)	600 (10%)	6,000 (100%)

2. Analysis of Reserves and Surplus of Subsidiary Companies

(a) General Reserve

Moon	Light
On B/s date ₹40,000	On B/s date ₹30,000
1.7.09 ₹25,000 DoA to DoC ₹15,000 Pre Acquisition Post Acquisition	1.7.09 ₹15,000 DoA to DoC ₹15,000 Pre Acquisition Post Acquisition

(b) Profit & Loss Account

Moon		Light	
On B/s date ₹50,000		On B/s date ₹40,000	
1.7.09 ₹20,000 Pre Acquisition	DoA to DoC ₹30,000 Post Acquisition	1.7.09 ₹25,000 Pre Acquisition	Pft in 2009 ₹15,000 Post Acquisition

3. Consolidation of Balances

Particulars	Total	Minority Interest	Pre-Acqn.	Post Acquisition	
				Reserves	P&L A/c
Light Ltd (Holding – 90% Minority – 10%)					
Equity Capital	60,000	6,000	54,000	—	—
Reserves	30,000	3,000	13,500 (15,000×90%)	13,500 (15,000×90%)	—
P&L A/c	40,000	4,000	22,500 (25,000×90%)	—	13,500 (15,000×90%)
Unrealized Profit on Sale of Asset	(7,800)	(780)	—	—	(7,020) (7,800×90%)
Sub-Total		12,220	90,000	13,500	6,480
Moon Ltd (Holding – 80%, Minority – 20%)					
Equity Capital	1,00,000	20,000	80,000	—	—
Reserves	40,000	8,000	20,000 (25,000×80%)	12,000 (15,000×80%)	—
P&L A/c	50,000	10,000	16,000 (20,000×80%)	—	24,000 (30,000×80%)
Stock Reserve [Upstream]	(800)	(200)	—	—	(600)
Minority's Share in Post Acquisition Reserves of Light Ltd					
Gen Reserve (13,500 × Moon's Share $\frac{60\%}{90\%} \times 20\%$)		1,800	—	(1,800)	—
P&L A/c (6,480 × Moon's Share $\frac{60\%}{90\%} \times 20\%$)		864	—	—	(864)
Sub Total		40,464	1,16,000	10,200	22,536
Total [Cr]					
Cost of Investment [Dr.] [90,000 + 40,000 + 50,000]		—	(1,80,000)	—	—
Parent's Balances in Reserves		—	—	50,000	60,000
Reversal of Unrealized Profits booked in Sun Ltd's books		—	—	—	(1,000)
Proposed Dividend (10% × ₹1,50,000)		—	—	—	(15,000)
For Consolidated Balance Sheet [Direct Method]		52,684	26,000	73,700	73,016
Share in Pre Acquisition Reserves of Light Ltd			Cap.Res.		
(36,000 × Moon's Share $\frac{60\%}{90\%} \times 20\%$)		4,800	(4,800)		
For Consolidated Balance Sheet [Indirect Method]		57,484	21,200	73,700	73,016
			Cap.Res.		

Notes:

- Sale by Moon Ltd to Sun Ltd:** Moon Ltd has sold goods at ₹4,000 at Cost Plus 25%. Therefore, the unrealized profit on upstream transaction is ₹800 [₹4,000 × 25/125]. The unrealized profits should be adjusted against Group Reserves and Minority Interest. In addition, Sun Ltd has valued at such goods at ₹5,000. The additional unrealized profit of ₹1,000 should also be adjusted against Group Reserves.
- Sale of Fixed Assets by Light Ltd to Moon Ltd:**

Profit on Sale [₹24,000 × 25 / 75]	8,000
Less: Proportionate Depreciation [₹24,000 × 10% × 3/12]	(200)
Unrealized Profit	7,800

The above unrealized profit is in the nature of upstream transaction, and hence should be adjusted against Group Reserves and Minority Interest.

4. Consolidated Balance Sheet of Sun and its subsidiaries Moon and Light as at 31.12.2009

Liabilities	Direct	Indirect	Assets	Direct	Indirect
Equity Share Capital	1,50,000	1,50,000	Fixed Assets (70 + 120 + 103 – 7.8)	2,85,200	2,85,200
Reserves & Surplus					
Capital Reserve	26,000	21,200			

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Liabilities	Direct	Indirect	Assets	Direct	Indirect
Reserves	73,700	73,700	Current Assets		
Profit & Loss Account	73,016	73,016	Stock (40 + 30 + 20 – 1.8)	88,200	88,200
Minority Interest	52,684	57,484	Debtors (20 + 25 + 30)	75,000	75,000
Current Liabilities:			Cheque in Transit (12 + 8 – 10 – 8)	2,000	2,000
Creditors (30 + 35 + 25)	90,000	90,000	Cash in Hand (10 + 10 + 10)	30,000	30,000
Proposed Dividend	15,000	15,000			
Total	4,80,400	4,80,400	Total	4,80,400	4,80,400

Note: Inter Company Owings have been eliminated in full.

Question No.3 – Amalgamation – Purchase – 16 Marks

A Ltd. And B Ltd. were amalgamated on and from 1st April, 2010. A new company C Ltd., was formed to take over the business of the existing companies. The Balance Sheets of A Ltd., and B Ltd., as on 31st March, 2010 are given below – (₹ In Lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share Capital			Fixed Assets		
Equity shares of ₹ 100 each	800	750	Land and Building	550	400
12% Preference Shares of ₹ 100 each	300	200	Plant and Machinery	350	250
Reserves and surplus			Investments	150	50
Revaluation Reserve	150	100	Current Assets		
General Reserve	170	150	Loans and Advances		
Investment Allowance reserve	50	50	Stock	350	250
Profit and Loss account	50	30	Sundry Debtors	250	300
Secured loans			Bills Receivable	50	50
10% Debentures (₹ 100 each)	60	30	Cash and Bank	300	200
Current Liabilities and Provisions					
Sundry Creditors	270	120			
Bills Payable	150	70			
	2,000	1,500		2,000	1,500

Additional Information:

- (1) 10% Debentureholders of A Ltd., and B Ltd., are discharged by C Ltd., issuing such number of its 15% Debentures of ₹ 100 each, so as to maintain the same amount of interest.
- (2) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of C Ltd., at a price at ₹ 150 per share (face value of ₹ 100).
- (3) C Ltd. Will issue 5 equity shares for each equity share of A Ltd., and 4 equity shares for each share of B Ltd. The shares are to be issued @ ₹ 30 each, having a face value of ₹ 10 per shares.
- (4) Investment allowances reserve to be maintained for 4 more years.

Prepare the Balance Sheet of C Ltd., as on 1st April, 2010 after the amalgamation has been carried out on the basis of amalgamation has been carried out on the basis of amalgamation in the nature of purchase.

Solution: Also See Exercise 3 / Pg. 2.168 (M 96) and Illustration 15, Pg.2.40

1. Basic Information:

Companies	Dates	Nature of Amalgamation
Buying Company: C Ltd	Balance Sheet Date (as given): 31.03.2010	Purchase, since Debenture Liability is taken over at a value different from book value.
Selling Company: A Ltd and B Ltd	Amalgamation Date: 01.04.2010	

2. Purchase Consideration [₹Lakhs]

Particulars	A Ltd	B Ltd	Securities Premium
(a) In 15% Preference Shares of C Ltd – To Preference Shareholders:			
3 Lakhs 15% Preference Shares of C Ltd of ₹100 each, issued at ₹150, as fully paid	450.00		150.00
2 Lakhs 15% Preference Shares of C Ltd of ₹100 each, issued at ₹150, as fully paid		300.00	100.00
(b) In Equity Shares of C Ltd – To Equity Shareholders:			
8 × 5/1 = 40 Lakh Equity Shares of C Ltd of ₹10 each, issued at ₹30, as fully paid	1,200.00		800.00
7.5 × 4/1 = 30 Lakh Equity Shares of C Ltd of ₹10 each, issued at ₹30, as fully paid		900.00	600.00
Total Purchase Consideration	1,650.00	1,200.00	1,650.00

3. Computation of Goodwill / Capital Reserve on Amalgamation

Particulars	A Ltd	B Ltd
Total of Assets (as per Balance Sheet)	2,000.00	1,500.00
Less: Liabilities other than Debentures (150 + 270) / (70 + 120)	(420.00)	(190.00)
Value of Debentures Taken Over (agreed value)	(40.00)	(20.00)
Net Assets Taken Over	1,540.00	1,290.00
Purchase Consideration	1,650.00	1,200.00
Goodwill / (Capital Reserve) on Amalgamation	110.00	(90.00)

Value of Debenture Liabilities Takenover:

Particulars	A Ltd	B Ltd	Total
15% Fresh Issue for 10% Old Debentures	$60 \times 10\% \div 15\% = 40.00$	$30 \times 10\% \div 15\% = 20.00$	$40.00 + 20.00 = 60.00$

4. Balance Sheet of C Ltd as at 01.04.2010 (after Amalgamation)

Liabilities	₹ Lakhs	Assets	₹ Lakhs
Share Capital:		Fixed Assets	
70 Lakhs Equity shares of ₹ 10 each	700.00	Goodwill (110 – 90)	20.00
5 Lakhs 12% Preference Shares of ₹ 100 each	500.00	Land & Buildings (550 + 400)	950.00
Reserves & Surplus:		Plant & Machinery (350 + 250)	600.00
Securities Premium	1,650.00	Investments (150 + 50)	200.00
Investment Allowance Reserve (50 + 50)	100.00	Current Assets, Loans & Advances	
Secured Loans		Stock (350 + 250)	600.00
15% Debentures (₹ 100 each)	60.00	Sundry Debtors (250 + 300)	550.00
Current Liabilities & Provisions		Bills Receivable (50 + 50)	100.00
Sundry Creditors (270 + 120)	390.00	Cash & Bank (300 + 200)	500.00
Bills Payable (150 + 70)	220.00	Miscellaneous Expenditure	
		Amalgamation Adjustment Account	100.00
Total	3,620.00	Total	3,620.00

Question No.4(a) – Statement of Purchase Consideration – Fractional Shares – 8 MarksA Ltd., agreed to absorb B Ltd., on 31st march 2010, whose Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Share Capital		Fixed Assets	7,00,000
80,000 equity shares of ₹ 10 each fully paid-up	8,00,000	Investments	–
Reserves & Surplus		Current Assets	
General Reserve	1,00,000	Loans and Advances	–
Secured Loan	–	Stock-in-trade	1,00,000
Unsecured Loan	–	Sundry Debtor	2,00,000
Current Liabilities and provisions			
Sundry Creditors	1,00,000		
	10,00,000		10,00,000

The consideration was agreed to be paid as follows:

- (a) A payment in cash of ₹ 5 per share in B Ltd., and
 (b) The issue of shares of rs.10 each in A Ltd., on the basis of 2 equity shares (valued at ₹ 15) and one 10% cum. Preference share (valued at ₹ 10) for every five shares held in B Ltd.

The whole of the share capital consists of shareholdings in exact multiple of five except the following holding:

A	116	
B	76	
C	72	
D	28	
Other individual	8	(each member holding one share each)
	<u>300</u>	

It was agreed that A Ltd. Will pay in cash for fractional shares equivalent at agreed value of shares in B Ltd., i.e. ₹ 65 for five shares of ₹ 50 paid.

Prepare a statement showing the purchase consideration receivable in shares and cash.

Solution: Also See Question 10, Page 2.31 of Padhuka's "Students' Guide on Financial Reporting"

1. Analysis of Fractional Holdings and Exchange of Shares

Name of Shareholder	Shares Held	Exchangeable in Multiples of five	Exchange in Equity Shares	Exchange in Preference Shares	Non Exchangeable
A	116	115	$115 \times 2/5 = 46$	$115 \times 1/5 = 23$	1
B	76	75	$75 \times 2/5 = 30$	$75 \times 1/5 = 15$	1
C	72	70	$70 \times 2/5 = 28$	$70 \times 1/5 = 14$	2
D	28	25	$25 \times 2/5 = 10$	$25 \times 1/5 = 5$	3
Others	8	—	—	—	8
Total	300	285	114	57	15

2. Computation of Shares Exchangeable

Particulars	Shares in B Ltd	Equity Shares of A Ltd	Pref. Shares of A Ltd
Fractional Holdings (as above)	300	114	57
Other Holdings	$80,000 - 300 = 79,700$	$79,700 \times 2/5 = 31,880$	$79,700 \times 1/5 = 15,940$
Total	80,000	31,994	15,997

3. Cash Payment for Fractional Holdings: There are 15 shares in B Ltd. which are not capable of exchange into Equity & Preference Shares of A Ltd. Hence, they will be paid cash as $15 \text{ Shares} \times ₹ 10 \text{ Paid Up Value} \times 65 / 50 = ₹ 195$

4. Settlement of Purchase Consideration:

Particulars	₹
31,994 Equity Shares at ₹ 15 each	4,79,910
15,997 Preference Shares at ₹ 10 each	1,59,970
Cash for $80,000 - 15 = 79,985$ Shares at ₹ 5 each	3,99,925
Total	10,39,805
Add: Cash for 15 Shares fractional holding non-exchangeable	195
Total Purchase Consideration	10,40,000

Question No.4(b) – Valuation of Goodwill – 8 Marks

The following are the summarized Balance Sheets of two Companies, A Ltd and B Ltd as on 31.03.2010 –

Liabilities	A Ltd ₹	B Ltd ₹	Assets	A Ltd ₹	B Ltd ₹
Equity Shares of ₹10 each	15,00,000	10,00,000	Goodwill	2,00,000	1,00,000
Reserves	3,00,000	2,00,000	Net Tangible Block	17,00,000	14,00,000
10% Debentures	6,00,000	4,00,000	Current Assets	8,00,000	6,00,000
Creditors	3,00,000	5,00,000			
Total	27,00,000	21,00,000	Total	27,00,000	21,00,000

Additional Information —

1. Assets are to be revalued as follows —

	A Ltd ₹	B Ltd ₹
Revaluation of Tangible Block	21,00,000	12,00,000
Revaluation of Current Assets	10,00,000	4,00,000

2. Average Annual Profits for three years before charging Debenture Interest = A Ltd ₹4,50,000; B Ltd ₹3,10,000
3. Goodwill is to be valued at four year's purchase of Average Super Profits for three years. Such average is to be calculated after adjustment of depreciation at 10% on the amount of increase / decrease on revaluation of fixed assets. In the case of B Ltd, a claim of ₹10,000 which was omitted, is to be adjusted against its average profit. Income tax is to be ignored.
4. Normal profit on Capital Employed is to be taken at 15%, capital employed being considered on the basis of net revalued amount of tangible assets.

Ascertain the value of Goodwill of A Ltd and B Ltd.

Solution:

1. Computation of Capital Employed

Particulars	A Ltd ₹	B Ltd ₹
Revaluation of Tangible Block	21,00,000	12,00,000
Revaluation of Current Assets	10,00,000	4,00,000
Creditors	(3,00,000)	(5,00,000)

Particulars	A Ltd ₹	B Ltd ₹
10% Debentures	(6,00,000)	(4,00,000)
Equity Capital Employed	22,00,000	7,00,000
Normal Profits (15% × Capital Employed)	3,30,000	1,05,000

Note: Equity Capital Employed and Equity Earnings are considered for the purpose of determining Goodwill, since Goodwill is monetary value of the residual business advantage, which includes, among many things, advantages of gearing as well.

2. Computation of Future Maintainable Profits

Particulars	A Ltd ₹	B Ltd ₹
Average Profits As Given	4,50,000	3,10,000
Less: Interest on Debentures $[6,00,000 \times 10\% / 4,00,000 \times 10\%]$	(60,000)	(40,000)
Less: Claim / Expenses not recorded	—	(10,000)
Less: Depreciation on Increase in Value of Fixed Assets $[(21\text{ L} - 17\text{L}) \times 10\%]$	(40,000)	—
Add: Depreciation on Decrease in Value of Fixed Assets $[(14\text{ L} - 12\text{L}) \times 10\%]$	—	20,000
Equity Earnings = Future Maintainable Profits	3,50,000	2,80,000

3. Computation of Goodwill

Particulars	A Ltd ₹	B Ltd ₹
Future Maintainable Profits	3,50,000	2,80,000
Less: Normal Profits	(3,30,000)	(1,05,000)
Super Profits	20,000	1,75,000
Goodwill (Super Profits × 4 Years)	80,000	7,00,000

Question No.5 – Valuation of Shares – Controlling Interest vs. Small Lot – 16 Marks

The Balance Sheet of PNR Limited as on 31-12-2010 is as follows;

Liabilities		Assets		(₹ In Lakhs)
	₹			₹
1,00,000 Equity shares of ₹ 10 each fully paid-up	10	Goodwill		5
1,00,000 equity shares of ₹ 6 each fully paid-up	6	Fixed Assets		15
Reserves & Surplus	4	Other Tangible Assets Intangible Assets		5
Liabilities	10	(Market Value)		3
	30	Misc. Expenditure to the extent not written off		2
				30

Fixed assets are worth ₹ 24 lakhs. Other tangible assets are valued at ₹ 3 lakhs. The company is expected to settle the disputed bonus claim of ₹ 1 lakh, not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It average of the book value and a valuation made at 3 years' purchase of average super profit for the last 4 years.

After tax profits and dividend rates were are follows:

Year	PAT (₹ In lakhs)	Dividend %
2007	3.00	11
2008	3.50	12
2009	4.00	13
2010	4.10	14

Normal expectation in the industry to which the company belongs to is 10%.

Kamlesh holds 20,000 equity shares of ₹ 10 each fully paid up and 10,000 equity shares of ₹ 6 each fully paid up. He wants to sell away his holdings.

- Determine the break-up value and market value of both kinds of shares.
- What should be the fair value of shares, if controlling interest is being sold?

Note: Make necessary assumption, wherever required.

Solution: Same as Question 22, Pg.1.92 of Padhuka's "Students' Guide on Financial Reporting"

1. Treatment of Disputed Bonus Claim:

- Disputed Bonus Claim of ₹ 1 Lakh will be provided out of Year 2010 Profits and hence Profits of that year will be reduced to that extent.

- However, for estimation of Future Maintainable Profits, this amount of Disputed Bonus will be considered extra-ordinary / non-recurring (abnormal) item and hence added back.
- Therefore, for calculating Future Maintainable Profits, the amount of profits as stated in the question will not be altered. Since Profits show an increasing trend, weighted average profits are more appropriate.

2. Computation of Future Maintainable Profits

Year	PAT (Given)	Weights	Weight × PAT
2007	3,00,000	1	3,00,000
2008	3,50,000	2	7,00,000
2009	4,00,000	3	12,00,000
2010	4,10,000	4	16,40,000
Total		10	38,40,000
Weighted Average = ₹ 38,40,000 ÷ 10			₹ 3,84,000

3. Computation of Proxy Capital Employed (based on Closing Capital Employed)

Particulars	₹
Fixed Assets (Revalued Amount)	24,00,000
Other Tangible Assets (Revalued Amount)	3,00,000
Intangible Assets (given at Market Value)	3,00,000
Total Assets	30,00,000
Less: Liabilities (as per Balance Sheet)	10,00,000
Less: Disputed Bonus Claim	1,00,000
Capital Employed as at the end of the year 2010	19,00,000

Note: Alternatively, Average Capital Employed may also be taken.

4. Computation of Super Profits and Goodwill

Particulars	₹
Future Maintainable Profits	3,84,000
Less: Expected Profit [Normal Return × Closing Capital Employed] = 10% × 19,00,000	1,90,000
Super Profit	1,94,000
a. Goodwill as per Valuation = Super Profits × 3 years purchase = ₹ 1,94,000 × 3 years	5,82,000
b. Goodwill as per Balance Sheet	5,00,000
c. Additional Goodwill to be considered = Simple Average of the above (a + b) ÷ 2	5,41,000
d. Hence Revised Value of Goodwill for Share Valuation = (b) + (c)	10,41,000

5. Computation of Value per Share under Break-Up Value / Net Assets Method

Particulars	₹
Capital Employed as at the end of the year 2010	19,00,000
Add: Goodwill (revised value for Valuation of Shares)	10,41,000
Net Assets available to Equity Shareholders	29,41,000
Total Paid up Value of Share Capital	16,00,000
Value of Equity Share of Re.1 Paid Up (₹ 29,41,500 ÷ ₹ 16,00,000)	1.838
Value of Equity Shares of the Company	
Equity Shares of Par Value ₹ 6 (₹ 6 × 1.838)	₹ 11.03
Equity Shares of Par Value ₹ 10 (₹ 10 × 1.838)	₹ 18.38

Note: When shares of different face values are involved, Value per Re.1 of Equity Capital should be computed. Value of each type of share = Relevant Par Value × Value per Re.1 of Equity Capital.

6. Computation of Value per Share under Earnings Capitalisation Method i.e. Market Value Method

Particulars	₹
Future Maintainable Profits for Equity Shareholders (as computed above)	3,84,000
Capitalised Value of FMP (Future Maintainable Profit ÷ Normal Return i.e. 10%)	38,40,000
Paid Up Capital of the Company	16,00,000
Value of Equity Share of Re.1 Paid Up (₹ 38,40,000 ÷ ₹ 16,00,000)	2.203

Particulars	₹
Value of Equity Shares of the Company	
– Equity Shares of Par Value ₹ 6 (₹ 6 × 2.203)	₹ 13.22
– Equity Shares of Par Value ₹ 10 (₹ 10 × 2.203)	₹ 22.03

Note: If there are different categories of shares with different par values, shares are to be valued proportionately. However, if calls are due on some shares, the notional call on such partly paid shares should be deemed called-up and then value of each fully and partly paid share will be ascertained separately.

7. Computation of Fair Value per Share for Majority Holdings (Controlling Interest)

Particulars	₹ 6 Share	₹ 10 Share
a. Net Assets / Break Up Value Method	₹ 11.03	₹ 18.38
b. Earnings Capitalization Method	₹ 13.22	₹ 22.03
c. Fair Value (average of the above)	$(11.03 + 13.22) \div 2 = \text{₹ } 12.13$	$(18.38 + 22.03) \div 2 = \text{₹ } 20.21$

8. Computation of Value per Share for Small Lots (Dividend Yield Method)

Year	Dividend Rate	Weights	Product
2007	11%	1	11%
2008	12%	2	24%
2009	13%	3	39%
2010	14%	4	56%
Total		10	130%
Weighted Average Dividend Rate = $(130\% \div 10)$			13%
Value of Equity Shares of the Company			
= (Paid Up Value × Company's Dividend Rate) ÷ Market Dividend Expectation			
– Equity Shares of Par Value ₹ 6 $(₹ 6 \times 13\%) \div 10\%$			₹ 7.80
– Equity Shares of Par Value ₹ 10 $(₹ 10 \times 13\%) \div 10\%$			₹ 13.00

Note: Since dividend rates show an increasing trend, weights have been assigned.

Question No.6(a) – Economic Value Added – 5 Marks

Prosperous Bank has a criterion that it will give loans to companies that have an “Economic Value Added” greater than zero for the past three years on an average. The bank is considering lending money to a small company that has the economic value characteristics shown below. The data relating to the company is as follows —

- Average operating income after tax equals ₹ 25,00,000 per year for the last three years.
- Average total assets over the last three years equals ₹ 75,00,000.
- Weighted average cost of capital appropriate for the company is 10% which is applicable for all three years.
- The company's average current liabilities over the last three years are ₹ 15,00,000.

Does the company meet the bank's criterion for a positive economic value added?

Solution:

1. Economic Value Added

Operating Profit After Taxes **Less** Long Term Capital Employed × Weighted Average Capital Employed
 = ₹25.00 Lakhs **Less** ₹60.00 Lakhs × 10% = ₹25 Lakhs **Less** ₹6 Lakhs = **₹19 Lakhs**

2. Long Term Capital Employed = Total Assets Less Current Liabilities = ₹75 Lakhs Less ₹15 Lakhs = ₹60 Lakhs

3. Analysis and Conclusion: The Company's EVA is greater than ZERO, and hence, it meets the bank's criterion for a positive EVA.

Question No.6(b) – Mutual Funds – NAV Computation – 6 Marks

Calculate the NAV of a mutual fund from the following information:

- 1-4-2009 Outstanding units 1 crore of ₹ 10 each
 ₹ 10 crores (N.V. ₹ 16 crores)
 Outstanding Liabilities ₹ 5 crores.

Other information:

- 20 Lakh units were sold during the year at ₹ 24 per unit.
- No additional investments were made during the year and as at the yearend 50% of the investments held at the beginning of the year were quoted at 80% of book value.

- (iii) 10% of the investment have declined permanently 10% below cost.
 (iv) At the year end 31-3-10 outstanding liabilities were ₹ 1 crore.
 (v) Remaining investments were quoted at ₹ 13 crores.

Solution: Also See Question 3, Page 7.58 of Padhuka's "Students' Guide on Financial Reporting"

1. Units as at the end of the year (in Crores)

Add:	Number of Units at beginning of the year	1.00
	Units sold during the year	0.20
	Units as at the end of the year (A)	1.20

2. Net Asset Value of the Scheme

Market Value of Investments	50% × ₹ 16 Crores × 80% of Book Value	6.40
	10% × ₹ 10 Crores – 10% below Cost	0.90
	Balance Investments (at Market Price)	13.00
Total Market Value		20.30
Less:	Mutual Fund Scheme Liabilities	(1.00)
	Net Asset Value of the Scheme (B)	19.30

Note: It is assumed that Investments are carried at Market Value of ₹16 Crores in the books in the year beginning.

$$\text{3. NAV per unit} = B \div A = ₹ 19.30 \text{ Crores} \div 1.20 \text{ Crore units} = ₹ 16.08$$

Question No.6(c) – HRA – 5 Marks

A company has a capital base of ₹ 3 crore and has earned profits of ₹ 33 lakhs. Return on Investment of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by ₹ 7.5 lakhs over and above the target profit. Determine the amount of maximum bid price for that particular executive and the maximum salary that could be offered to him.

	₹
Capital base	3,00,00,000
Actual profit	33,00,000
Target profit	37,50,000

Solution: Also See Question 2, Page 7.45 of Padhuka's "Student's Guide on Financial Reporting"

1. Maximum Salary Payable:

	Particulars	₹ Lakhs
	Capital Base	300.00
	Target Profits (= Capital Base × 12.50%)	37.50
Add:	Extra Profits due to induction of the Executive	7.50
	Total Profits of the Company (anticipated after induction of the Executive)	45.00
Less:	Current Profits	33.00
	Incremental Profit	12.00

Maximum Salary = Incremental Profit due to introduction = ₹12.00 Lakhs per annum.

2. Maximum Bid Price:

- = Value of Salary Payable in perpetuity
 = Maximum Salary Payable ÷ Desired Rate of Return on Investment
 = ₹ 12 Lakh ÷ 12.5% = ₹ 96 Lakhs

Question No.7(a) – AS 2 – Inventory Valuation – 4 Marks

Anil Pharma Ltd. Ordered 16,000 kg of certain material at ₹ 160 per unit. The purchase price includes excise duty ₹ 10 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted to ₹ 1,40,160. Normal transit loss is 2%. The company actually received 15,500 kg and consumed 13,600 kg of material. Compute cost of inventory under AS-2 and amount of abnormal loss.

Solution:

1. Abnormal Loss Quantity

Less:	Quantity Ordered	16,000
	Normal Loss @ 2%	(320)

Quantity Receivable	15,680
Less: Quantity Actually Received	(15,500)
Abnormal Loss	180

2. Cost Incurred

Details	₹
Purchase Price Per Unit	160
Less: Cenvatable Excise Duty Per Unit	(10)
Net Cost Per Unit	150
No. of Units Ordered	16,000
Total Purchase Cost for Quantity Receivable	24,00,000
Add: Freight Charges	1,40,160
Total Cost of Inventory	25,40,160
Units Receivable	15,680
Cost Per Unit Receivable [₹25,40,160 ÷ 15,680 Units]	₹162
No. of Units at the end (15,500 – 13,600)	1,900
Value of Inventory [1,900 Units × ₹162]	₹3,07,800

Question No.7(b) – AS 7 – Construction Contracts – 4 Marks

Jain Construction Co. Ltd. undertook a contract on 1st January, 2010 to construct a building for ₹ 80 lakhs. The company found on 31st March, 2010 that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000.

What amount should be charged to revenue and what amount of contract value to be recognized as turnover in the accounts for the year ended 31st March, 2010 as per provisions of AS-7 (revised)?

Solution: See Question 32, Page 7.14 of Padhuka's "Students' Referencer on Accounting Standards"

Estimated Total Contract Costs = Cost till date + Further Costs = ₹ 58,50,000 + ₹ 31,50,000 = **₹ 90,00,000**

Percentage of Completion = Cost incurred till date ÷ Estimated Total Costs = 58.50 ÷ 90.00 = **65 %**

Total Expected Loss to be provided for = Contract Price – Total Costs = ₹ 80 – ₹ 90 = **₹ 10,00,000.**

	Contract Revenue as per Para 21 = 60% of ₹ 80 Lakhs	= ₹ 52,00,000
Less:	Contract Costs as per Para 21	= ₹ 58,50,000
	Loss on Contract	= ₹ 6,50,000
Less:	Further provision required in respect of expected loss	= ₹ 3,50,000 (Bal.Figure)
	Expected Loss recognised as per Para 35	= ₹ 10,00,000

The relevant disclosures under AS – 7 are as follows –

	₹
(a) Contract Revenue	52,00,000
(b) Contract Expenses Charged	58,50,000
(c) Provision for Future Losses to be Charged	3,50,000

Question No.7(c) – AS 15 – Employee Benefits – Actuarial Valuation – 4 Marks

Kumar Ltd. Is an engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed as surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years.

You are required to advise the company.

Solution: Same as Question 44, Page 15.21 of Padhuka's "Students' Referencer on Accounting Standards"

- Principle:** According to Para 92 of AS – 15, any actuarial gains and losses should be recognized immediately in the Statement of Profit & Loss Account as income or expenses.
- Treatment:** In the given case, the amount of surplus from pension scheme of ₹ 6 Lakhs is an actuarial gain, which should be **recognized as income** in the Profit & Loss Account of the current year and **not** to be adjusted from the amount of annual contribution.

3. **Disclosure:** The change relating to actuarial valuation for its pension scheme should be treated as a change in an accounting policy and disclosed in accordance with AS – 5. Disclosure required by AS – 15 should also be made in the Financial Statements.

Question No.7(d) – AS 25 – Interim Financial Reporting – 4 Marks

An enterprise reports quarterly, estimates as annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expenses to be recognized in each quarter.

Solution:

1. **Para 29(c) – Treatment of Taxes:** Income Tax Expense is recognized in each interim period based on the best estimate of the weighted average annual effective income tax rate expected for the full financial year.

2. **Analysis and Computation:**

- (a) **Estimated Total Income for the year:** $75000 + 250000 + 375000 + 300000 = ₹10,00,000$
 (b) **Estimated Total Tax Liability:** Upto ₹5 Lakhs = $30\% \times ₹5,00,000 = ₹1,50,000$; Next ₹5,00,000 = $40\% \times ₹5,00,000 = ₹2,00,000$. Total Liability = $1,50,000 + 2,00,000 = ₹3,50,000$.
 (c) **Effective Annual Tax Rate:** Total Tax Liability ÷ Total Income = $₹3,50,000 \div ₹10,00,000 = 35\%$
 (d) **Quarterly Tax Expense:** Therefore, tax expense for each quarter —

Q1	Q2	Q3	Q4
$₹75,000 \times 35\% = ₹26,250$	$₹2,50,000 \times 35\% = ₹87,500$	$₹3,75,000 \times 35\% = ₹1,31,250$	$₹3,00,000 \times 35\% = ₹1,05,000$

Question No.7(e) – Valuation of Assets – Brand Valuation – 4 Marks

From the following information determine the possible value of brand under the potential earning model – ₹Lakhs

(a) Profit before tax	13.00
(b) Income tax	3.00
(c) Tangible Fixed Asset	20.00
(d) Identifiable Intangible other than brand model	10.00
(e) Expected return on tangible fixed assets	6.00

Appropriate Capitalization Factor for Intangible is 25%.

Solution: Similar May 2010 (New Syllabus) Question 6(a)

Particulars	₹ Lakhs
Profit Before Tax	13.00
Less: Income Tax	(3.00)
Profit After Tax	10.00
Less: Normal Return from Tangible Assets	(6.00)
Less: Normal Return from Other Intangible Assets ($₹ 10 \text{ Lakhs} \times 25\%$)	(2.50)
Brand Earnings	3.50
Capitalisation Factor	25%
Therefore, Value of Brand ($₹ 3.50 \text{ Lakhs} \div 25\%$)	₹ 14 Lakhs

Students' Notes

