Paper 1: Financial Reporting

Test series: September, 2012

Q.1 *is compulsory. Attempt any* ***five*** *questions from remaining* ***six*** *questions.*
Working notes should form part of your answer. Make suitable assumptions wherever required.

Marks

1. *a) A patent was acquired by a company at ` 20,00,000 for a period of 4 years and the productivity will remain for four years. The cost of patent was capitalized and the company is amortizing the asset at ` 1,50,000 per annum. After two years, the company analyzed that the productivity of patent may extent to six years. The net inflows from product during next four years are estimated to be ` 2,40,000, ` 2,55,000, ` 2,25,000 and ` 4,80,000. You are required to calculate the amortization cost of the patent for each of the year.* ***5***

b) DELTA Ltd. reports following information regarding pension plan assets. Calculate actual return on plan assets and actuarial gain or loss for the year 2011-12. ***5***

	` 000's
Benefits paid to retirees during the year	*1200*
Contribution of employer to the plan	*1350*
Change in plan assets during the year	*1500*
Expected return on plan assets	*1360*

c) From the following information, ascertain the possible value of brand as per potential earning model: ***5***

EBIT	*` 6,30,000*
Total Assets	*` 30,00,000*
6%, 40,000 debentures (Face value `10)	*` 3,80,000*

The overall cost of capital and normal spread expected on return on tangible assets is 6 % and 2 % respectively. Tangible fixed assets comprises of one-third of total assets. Intangibles are capitalized at 20%. The rate of tax applicable is 40%. It is identified that intangibles other than brand amounts to ` 10 lakhs.

d) Explain the key difference between IFRS, US GAAP and AS (applicable in India) with respect to: ***5***

(i) Revaluation of fixed assets.
(ii) Inventory valuation.

2. *The summarized balance sheets of CEE Ltd. and DEE Ltd. are as follows:* ***16***

(` '000)

Equity and Liabilities	***CEE Ltd.***	***DEE Ltd.***	***Assets***	***CEE Ltd.***	***DEE Ltd.***
Ordinary Shares	*600*	*500*	*Fixed Assets:*		
Reserves and Surplus	*180*	*105*	*Tangible*	*350*	*250*
12% Debentures	*100*	*100*	*Intangible*	*-*	*20*
Creditors	*40*	*45*	*Non-current*		
Bills Payables	*100*	*60*	*Investments*	*360*	*90*
Proposed dividend	*140*	*50*	*Inventories*	*220*	*360*
			Trade receivables	*250*	*285*
			Cash and cash equivalents	*20*	*45*
	1200	***1050***		***1200***	***1050***

P.T.O.

Marks

CEE Ltd. purchased interest in DEE Ltd. by acquiring its three – fourth shares at a premium of 20% on 1st April 2011. Further information is extracted from consolidation:

- *Profit and loss account of DEE Ltd .includes ` 20,000 brought down from previous year.*
- *Creditors of CEE Ltd. includes ` 12,000 for purchase from DEE Ltd., which are still unsold. B Ltd. sells goods at 20% above cost.*
- *DEE Ltd. remitted a cheque for ` 10,000 on 31st March, 2012 which was received by CEE Ltd. in April, 2012.*
- *Bills amounting to ` 20,000 out of total bills of ` 25,000 received from B Ltd. were discounted by CEE Ltd. and DEE Ltd. had endorsed to its creditors all the bills received from CEE Ltd. of ` 15,000.*
- *Directors of CEE Ltd. and DEE Ltd. have proposed a dividend of 10% on equity shares for the year 2012.*

Required:
(i) Calculate the cost of control.
(ii) Calculate minority shareholder's interest.
(iii) Prepare group balance sheet as on 31st March, 2012.

3. *a) ARC Ltd. has one lakh equity shares and one lakh preference shares of ` 10 each and ` 5 each. Company's outside liability is ` 8 Lakhs and a reserve balance as on 31st March, 2012 is ` 4 Lakhs.* ***8***

As on 31st March, 2012, ARC Ltd earns an average operating profit of ` 5 Lakhs and the tax rate applicable to the company is 40%.

Company's normal rate of return on equity shares similarly placed is 12% provided:

(i) Profit after tax covers fixed interest and fixed dividend at least 3 times
(ii) Capital Gearing ratio is 0.75
(iii) Yield on shares is calculated at 50% of profits and at 5% on undistributed profits.
ARC Ltd. has been regularly paying equity dividend of 10%. Preference dividend and interest on outside debt is 10% and 15% respectively.
You are required to calculate value of equity shares of ARC Ltd.

b) The capital structure of Shubh Ltd. as at 31st March, 2012 is as under: ***8***

	` in Lakhs
Equity Share Capital (` 100 per share)	*15.00*
9% Preference Share Capital (` 150 per share)	*12.00*
6% debentures	*3.00*

The market value of company's total capital is ` 20 Lakhs. Further information gathered from the company:

	%
Tax rate applicable	*30*
Risk free rate	*10*
Equity Risk Premium	*5*
Specific Risk Premium	*12.5*

Shubh ltd. earns ` 9,00,000 as operating income during the year ended 31st March, 2012. Calculate Economic value Added and Market Value Added. Also comment upon your answers.

Marks

4. a) *From the following information of NAV Mutual Fund, prepare a statement showing the movement of unit holders funds for the year 31st March, 2012 :* **4**

Net assets as on 1st April, 2011	*` 10,00,000*
Net income as per audited books	*` 45,000*
Par value per unit of fund	*` 100*
Equilisation Fund Balance	*` 15,300*

During the year, NAV Mutual Fund issued 17,000 units and out of which 90% were redeemed.

b) *Given below are the balance sheets of ABC Ltd. and PQR Ltd. as at 31st March, 2011* **12**

Summarised Position Statement as on 31st March, 2011 *(` '000)*

Equity and Liabilities	**ABC Ltd.**	**PQR Ltd.**	**Assets**	**ABC Ltd.**	**PQR Ltd.**
Equity Shares of Rs.10	*700*	*250*	*Tangible Fixed Assets*	*950*	*400*
Reserves and Surplus	*630*	*225*	*Quoted Investments*	*200*	*50*
12% Debentures	*100*	*100*	*Inventories*	*120*	*50*
Trade Payables	*40*	*45*	*Advance tax*	*80*	*20*
Tax provision	*100*	*60*	*Cash & cash eq.*	*275*	*130*
Proposed dividend	*140*	*50*	*Misc. Expenditure*	*10*	*-*
	1710	***730***		***1710***	***730***

Development Allowance Reserve balance as on 31st March, 2011 for ABC Ltd. and PQR Ltd. is ` 70,000 and ` 40,000 respectively, the same is included in reserves in the above balance sheet.

PQR Ltd. was merged with ABC Ltd. with effect from 1st March, 2011 and the merger was in the nature of purchase and it was decided that ABC Ltd. would issue 12% debentures to discharge the claims of the debenture holders of the former. Investments of ABC Ltd. and PQR Ltd. fetches 25% and 18% respectively. The profits before taxation for previous year's are as follows

		` in Lakhs	
	2009	***2010***	***2011***
ABC Ltd.	*5.00*	*6.50*	*5.75*
PQR Ltd.	*1.50*	*2.10*	*1.80*

Goodwill is to be calculated using capitalization of profits method. ABC Ltd. discharges PC on the basis intrinsic value per share. The company decided to cancel proposed dividend. The pre-tax rate of return is 20%. You are required to:

(i) Value goodwill
(ii) Calculate purchase consideration
(iii) Prepare balance sheet of ABC Ltd. after merger.

5. a) *P Ltd. announces stock option plan for its employees on 1st April, 2009, the vesting period being 3 years. As per the plan, the employees can:* **10**

(i) either claim difference between exercise price ` 150 per share and market price of the shares on vesting date in respect of 10,000 shares or
(ii) can make subscription of 12,000 shares at the exercise price of ` 150 per share, subject to lock in period of 4 years.

On 1st April, 2009, fair value of option, ignoring the restrictions on transfer was ` 30 per share and that after considering restrictions on transfers was ` 27. The fair value estimates, without considering transfer restrictions were ` 31.50, ` 32.70 and ` 34.00 for the year 2009-10, 2010-11 and 2011-12, respectively. Show important accounts in the books of the company if the employees opt for equity settlement.

Marks

b) IIFC Ltd. is a deposit taking non-banking financial company. Following are the abstracts from the books of accounts of IIFC: **6**

	` in lakhs
Liabilities:	
Ordinary share capital	2,000
7% convertible preference shares of ` 10 each	1,800
6% non – convertible preference shares of ` 15 each	1,300
Securities premium	30
Free reserves	420
Profit and loss account	900
7% Debentures	1,600
Deposit	21,000
Total Liabilities [A+B]	29,050
Assets:	
Leased out Assets	26,100
Intangibles	450
Investment in debentures of subsidiaries	1,500
Cash and Bank	1,000
Total Assets	29,050

The risk adjusted value of on balance items and off – balance sheet items is ` 28,500 Lakhs.

You are required to calculate:

(i) Tier I Capital
(ii) Tier II Capital
(iii) Capital Adequacy Ratio.

6. a) An enterprise issued 3,00,000 convertible debentures at par(face value ` 100 per debentures) in the beginning of 1st year. The term of debentures is 6 years with 9% half – yearly interest. Debenture holders have an option to convert half of the face value of debentures into two equity shares at the end of the third year. If the option is not exercised, repayment at par to the extent of ` 50 per debenture will be made at the end of 3rd year. The non – convertible portion will be repaid at 10% premium at the end of year 6. Market rate of interest for similar debt without conversion option was 10% on the date of issue. You are required to compute the value of embedded derivative. **8**

Given that PVIF (5%, n) :

Year end	P.V.F.	Year end	P.V.F.	Year end	P.V.F.	Year end	P.V.F.
1	0.9524	4	0.8227	7	0.7107	10	0.6139
2	0.9070	5	0.7835	8	0.6768	11	0.5847
3	0.8638	6	0.7462	9	0.6446	12	0.5568

b) Sahil Corp. entered into a lease agreement with Rahil corp. in respect of an equipment costing ` 1.5 lakhs with expected useful life of 4 years. Following are the terms of lease contract: **8**

A. The lease term shall be three years
B. The implicit rate of interest is 10%
C. The annual lease rentals shall be paid in such way that present value of lease rentals plus residual value equals to the cost of an asset.

The expected residual value and guaranteed residual value of equipment after 3 years is ` 40,000 and ` 20,000 respectively. Ascertain in the hands of Rahil Corp.

(i) Annual lease payment
(ii) Unearned financial income
(iii) Financial charges for each year
(iv) Extract of profit and loss account.

Marks

7. Attempt any **four** of the following: **4x4 =16**

a) Alpha Ltd. holds 5%, 7 – year convertible debentures (` 50) of Gama Ltd. Balance sheet of Gama Ltd. shows investments in 10,000 equity shares of Alpha Ltd. The total share capital of Alpha Ltd. is divided into 15,000 equity shares of ` 10 each and 9%, 8000 cumulative preference shares of ` 15 each. In order to cover the foreign currency risk, Alpha Ltd. designated debentures held in Gama Ltd. as 'held to maturity'. Comment.

b) A Ltd. acquired 25% B Ltd.'s shares on 1st April, 2011 at Rs.8,00,000 when balance sheet of B Ltd. showed following balances:

Equity Share Capital	` 10,00,000
Securities premium	` 1,00,000
Reserves and Surplus	` 5,00,000

B Ltd. has earned ` 3,00,000 during the year ending 31st March, 2012 and paid dividend of ` 1 lakh. Calculate using equity method, the carrying amount of investment to be shown in consolidated balance sheet of A Ltd. as on 31st march, 2012.

c) A company receives some amount as interest and royalties for rendering services. You are required to state when and on what basis these revenues can be recognised by the company.

d) X Ltd. finds that the stock sheets of 31st march, 2011 did not include four pages containing details of stock of ` 25 lakhs. State, how you will deal with the said matters in the books of X Ltd. for the year 31st march, 2012.

e) From the following information of STAR ltd., ascertain the correct income for the quarter ended 31st Dec, 2011:

(i) Gross profit during the period 01.10.2011 to 31.12.2011 being ` 5,00,000.

(ii) The company incurred total bad debt loss of ` 50,000 as on 31st march, 2012, one – half of which is incurred as on 30.09.2011. STAR Ltd. has deferred 40% of the above to the third quarter.

(iii) On 01.10.2011, STAR Ltd. changed the method of charging depreciation which resulted into additional depreciation Of ` 25,000. The effect of this change is not given in the books.

(iv) Extra ordinary loss incurred during the quarter Dec,2011 is ` 20,000, 50% of which is recognised in the next quarter.

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Hints/answers

1. a) Company amortizes patent at ` 1,50,000 for first two years i.e. ` 3,00,000. The remaining carrying cost `17,00,000 (20,00,000 – 3,00,000) can be amortized during next 4 years on the basis of inflows arising from the sale of product.

Calculation of amortization amount

Year	Net cash flows(`)	Amortization ratio	Amortization cost(`)
1	-	0.0750	1,50,000
2	-	0.0750	1,50,000
3	2,40,000	0.2000	3,40,000
4	2,55,000	0.2125	3,61,250
5	2,25,000	0.1825	3,18,750
6	4,80,000	0.4000	6,80,000
	12,80,000	1.0000	20.00.000

Notes:

1. It is assumed that the co. has amortized the patent at ` 1,50,000 p.a. in first 2 years on the basis of economic benefits derived from the product manufactured under the patent.
2. It is assumed that the patent is renewable and the patent is renewed after expiry of 4 years.

b) Hint :- Change in plan assets is nothing but difference between fair values in beginning and at year end.

If actual return > expected return } Actuarial gain

If it is less } Actuarial loss

Exp. Return = ` 13,60,000, Actuarial loss = ` 10,000.

c) Working notes:

(i) **EAT**

	`
EBIT	6,30,000
(-) Int. on deb.(6% x ` 4 lakhs)	24,000
EBT	6,06,000
(-) tax @ 40%	2,42,400
EAT	**3,63,600**

(ii) **Expected normal return on tangible assets**

WACC	6%
+ Normal spread	2%
	8%

(iii) **Tangible fixed assets**

	`
Total assets	30,00,000
1/3rd of above	**10,00,000**

Value of Brand

	`
EAT	3,63,600
Less: profits allocated to tangible assets (10,00,000 x 8%)	80,000
Profits allocated to intangibles incl. brand	2,83,600
Capitalized value of intangibles incl. brand (2,83,600 /0.25)	11,34,400
Less: identifiable intangibles excl. brand	10,00,000
Brand value	**1,34,400**

d)

	IFRS	**US GAAP's**	**AS**
(i) Revaluation of fixed assets	If an entity adopts the revaluation model, revaluation is reqd. to be made with regular period to ensure that the carrying amount does not differ	Similar to IFRS.	No specific requirement on frequency of revaluation.

	materially from that which would be determined using fair value at the end of the reporting period.		
(ii) Inventory valuation	Inventories are carried at the lower of cost or NRV.	Lower of cost or market price subject to upper/lower limit of NRV	Inventories are carried at the lower of cost or NRV.

2. Answers:

(iv) Cost of control: **Capital reserve ` 15,000**

(v) Minority interest: ` 1,26,250 + pref. share capital ` 1,00,000 = **` 2,26,250**

(vi) CBS total: **` 18,56,000**.

3. a) Value per equity share of ARC Ltd. : $\frac{\textbf{Actual yield}}{\textbf{Expected yield}}$ **x paid-up value** = $\frac{5.39}{13.31}$ x 10 = ` 4.05

Working notes:

i. Calculation of PAT

	`	`
PBIT		5,00,000
Less: debenture interest (8,00,000 x 15%)		1,20,000
PBT		3,80,000
Less: Tax @ 40%		1,52,000
PAT		2,28,000
Less: Preference dividend(` 5,00,000 x .10)	50,000	
Equity dividend(` 10,00,000 x .10)	1,50,000	1,50,000
Retained earnings(undistributed profits)		**78,000**

ii. Calculation of Interest and Fixed Dividend Coverage

= $\frac{\text{PAT + Deb. Interest}}{\text{Deb. Interest + Preference Dividend}}$ = $\frac{2,28,000 + 1,20,000}{1,20,000 + 50,000}$ = 2.05 times

iii. Capital Gearing Ratio = $\frac{\text{Fixed interest bearing securities}}{\text{Equity share capital + Reserves}}$ = $\frac{\text{PSC + Debentures}}{\text{ESC + Reserves}}$

= $\frac{5 + 8}{10+4}$ = 13/14 = 0.93

iv. Yield on equity shares:

	`
50% of distributed profits (1,00,000 x 50%)	50,000
5% of undistributed profits (78,000 x 5%)	3,900
	53,900

Yield = $\frac{\text{`53,900}}{\text{`10 lacs}}$ x 100 = 5.39%

v. Calculation of expected yield on equity shares:

The risk premium is assumed as:

I. 1% for every one time difference for interest and fixed dividend coverage.

Interest and fixed dividend coverage of ARC ltd. is 2.05 which is lower than the industry average (3 times). Hence, the risk premium is added to ARC ltd. shares @ 1% for every one time of difference.

Risk premium = [3.00 – 2.05] (1%) = 0.95%

II. 2% for every one time difference for capital gearing ratio.

Capital Gearing Ratio of ARC Ltd. is 0.93 but the industry average is 0.75 times. Therefore, risk premium is added to ARC Ltd. shares @ 2% for every on time of difference.

Risk premium = [0.75 – 0.93] (2%) = 0.36%

	%
Normal return expected	12.00
Add: risk premium for lower interest and dividend coverage	0.95
Add: risk premium for high capital gearing ratio	0.36
Expected yield	**13.31**

b) Economic Value Added (EVA)

EVA = NOPAT – COCE

= 6,30,000 – 4,58,100 = ` 1,71,900

Market Value Added (MVA)

MVA = Market value of capital – Capital employed

= 20,00,000 – 30,00,000 = ` (10,00,000)

Market value added (MVA) of Shubh Ltd. is negative which indicates that the value of actions and investments of management is less than the value of capital contributed to the co. by capital market, meaning wealth or value of Shubh Ltd. has been destroyed.

Working notes:

a. **Cost of debt (K_d)** = 0.06(1 – 0.30) = 0.042 or 4.20%

b. **Cost of pref. capital (K_p)**= $\frac{\text{preference dividend}}{\text{PSC}} = \frac{\text{` 1.08 lakhs}}{\text{` 12 lakhs}}$ = 0.09 or 9%

c. **Cost of equity (K_e)** = R_f + specific risk premium**

= 0.10 + 0.125 = 0.225 or 22.5%

****specific risk premium =** β x equity risk premium

equity risk premium = ($R_m - R_f$)

d. **Capital Employed(CE)** = `(15+12+3) Lakhs = ` 30 lakhs

e. **Overall cost of capital** = $K_d \times \frac{\text{Debt}}{\text{CE}} + K_p \times \frac{\text{PSC}}{\text{CE}} + K_e \times \frac{\text{ESC}}{\text{CE}} = 0.042 \times \frac{3}{30} + 0.09 \times \frac{12}{30} + 0.225 \times \frac{15}{30}$

= 0.1527 or 15.27%

f. **NOPAT (net operating profit after tax)**= ` 9,00,000 x (1 – 0.30) = ` 6,30,000

g. **Cost of capital employed(COCE)** = CE x WACC = ` 30 lakhs x 0.1527 = ` 4.581 lakhs

4. a) Statement showing the movement of unit holders funds for the year 31st March, 2012 :

Particulars	`
Opening balance of net assets	10,00,000
Add: Par value of units issued(17,000 x 100)	17,00,000
Net income during the year	45,000
Transfer from Equilisation Fund	15,300
	27,60,300
Less: Par value of units redeemed(17,000 x 90% x 100)	15,30,000
Net assets as on 31.03.2012	12,30,300

b)

(i) Valuation of Goodwill

Capital Employed:

Particulars	`	**ABC Ltd.** `	`	**PQR Ltd.** `
Tangible fixed assets as per B/S		17,10,000		7,30,000
Less: Misc. expenditure	10,000		-	
Non-trade investments	2,00,000	2,10,000	50,000	50,000
		15,00,000		6,80,000
Less: Liabilities				
12% Debentures	1,00,000		1,00,000	
Trade Payables	40,000		45,000	
Tax provision	1,00,000	2,40,000	60,000	2,05,000
		12,60,000		**4,75,000**

Average profit:

Particulars	ABC Ltd. `	PQR Ltd. `
Year: 2009	5,00,000	1,50,000
2010	6,50,000	2,10,000
2011	5,75,000	1,80,000
	17,25,000	5,40,000
Simple Average	5,75,000	1,80,000
Less: Non-trade income(interest on non-trade investments)	50,000	9,000
	5,25,000	**1,71,000**

Goodwill = Capitalized Value Average Profit – Capital Employed

	`
ABC Ltd.:	
Capitalized value [(5,25,000/20) x 100]	26,25,000
Less: CE	(12,60,000)
	13,65,000
PQR Ltd.:	
Capitalized value [(1,71,000/20) x 100]	8,55,000
Less: CE	(4,75,000)
	3,80,000

(ii) Purchase Consideration

Intrinsic value

Particulars	`	ABC Ltd. `	`	PQR Ltd. `
Goodwill		13,65,000		3,80,000
Tangible fixed assets	17,10,000		7,30,000	
Less: Misc. expenditure	(10,000)	17,10,000	-	7,30,000
		30,65,000		11,10,000
Less: Liabilities				
12% Debentures	1,00,000		1,00,000	
Trade Payables	40,000		45,000	
Tax provision	1,00,000	2,40,000	60,000	2,05,000
		28,25,000		**9,05,000**
I/V per share	28,25,000/ 70000 shares	**40.40**	9,05,000/ 25,000 shares	**36.20**

Purchase consideration

	`
25,000 shares @ ` 36.20	9,05,000
To be discharged by 22,400 $\left[25,000 \times \frac{36.20}{40.40}\right]$ = 22,400 shares @ ` 40.40	9,04,960
Cash for fraction	40

(iii)

Balance Sheet of ABC Ltd.

(after merger with PQR Ltd.)

	Note no.	`
I. Equity and Liabilities		
(1) **Shareholder's Funds**		
a) Share Capital	1	9,24,000
b) Reserves and Surplus	2	14,80,000
(2) **Non-Current Liabilities**		
Long-term borrowings	3	2,00,000
(3) **Current Liabilities**		
a) Trade payables	4	85,000
b) Other current liabilities	5	1,60,000
		28,49,960

II. Assets		
(1) **Non-current assets**		
a) Fixed Assets		
Tangible assets	6	13,50,000
Intangible assets(Goodwill)		*3,80,000
b) Non-current investments (2,00,000 + 50,000)		2,50,000
c) Other non-current liabilities	7	40,000
(2) **Current assets**		
a) Stock (1,20,000 + 50,000)		1,70,000
b) Debtors (75,000 + 80,000)		1,55,000
c) Cash and cash equivalents (2,75,000 +1,30,000 – 40)		4,04,960
d) Other current assets	8	1,00,000
		28,49,960

Notes to accounts

			`	`
1.	**Share Capital**			
	92,400 equity shares of `10 each			9,24,000
	(of the above, 22400 shares were issued for consideration other than cash)			
2.	**Reserves and Surplus**			
	General reserve		3,50,000	
	Profit and loss a/c	2,10,000		
	Add: proposed dividend w/off	1,40,000		
	Less: Preliminary exp.	(10,000)	3,40,000	
	Securities Premium		6,80,960	
	Development allowance reserve: ABC Ltd.	70,000		
	Add: balance of PQR Ltd.	40,000	1,10,000	14,80,960
3.	**Long term borrowings**			
	12% debentures		1,00,000	
	Add: 12% debentures issued at par other than cash		1,00,000	2,00,000
4.	**Trade payables**			
	Creditors of ABC Ltd.		40,000	
	Add: Taken over		45,000	85,000
5.	**Other current liabilities**			
	Provision for taxation: ABC Ltd.		1,00,000	
	Add: Balance of PQR Ltd.		60,000	1,60,000
6.	**Tangible assets**			
	Fixed Assets of ABC Ltd.		9,50,000	
	Add: Taken over		4,00,000	13,50,000
7.	**Other non-current assets**			
	Amalgamation Adjustment a/c			40,000
8.	**Other current assets**(80,000 + 20,000)			1,00,000

***As per para 56 of AS 26,** goodwill should not appear in the balance sheet.

5. a)

		`
	Fair alue under equity settlement (12,000 x `27)	3,24,000
Liability component	Less: Fair value under cash settlement (10,000 x `30)	(3,00,000)
Equity component		**24,000**

Vesting period = 3 years

2009-10:

No. of shares = 10,000

Fair value = ` 31.5 per share

Fair value of liability component = 10,000 x ` 31.5 = ` 3,15,000

Vesting period = 3 years

Expense recognised = ` 3,15,000/3 = ` 1,05,000

2010-11:
No. of shares = 10,000
Fair value = ` 32.7 per share
Fair value of liability component = 10,000 x ` 32.7 = ` 3,27,000
Vesting period = 3 years
No. of years expired = 2 years
Cumulative exp. to be recognised upto 2010-11 = (` 3,27,000/3) x 2 = ` 2,18,000
Expense recognised in 2009-10 = ` 1,05,000
Expense recognised in 2010-11 = ` 2,18,000 -- ` 1,05,000 = ` 1,13,000

2011-12:
No. of shares = 10,000
Fair value = ` 34 per share
Fair value of liability component = 10,000 x ` 34 = ` 3,40,000
Vesting period = 3 years
No. of years expired = 3 years
Cumulative exp. to be recognised upto 2011-12 = ` 3,40,000
Cumulative exp. to be recognised upto 2010-11 = ` 2,18,000
Expense recognised in 2011-12 = ` 3,40.000 -- ` 2,18,000 = ` 1,22,000

Employee's Compensation a/c

Year	Particulars	`	Year	Particulars	`
09-10	To provision for liability	1,05,000	09-10	By P & L a/c	1,13,000
	To ESOP O/s	8,000			
		1,13,000			1,13,000
10-11	To provision for liability	1,13,000	10-11	By P & L a/c	1,21,000
	To ESOP O/s	8,000			
		1,21,000			1,21,000
11-12	To provision for liability	1,22,000	11-12	By P & L a/c	1,30,000
	To ESOP O/s	8,000			
		1,30,000			1,30,000

Provision for liability component a/c

Year	Particulars	`	Year	Particulars	`
09-10	To bal. c/d	1,05,000	09-10	By Employment compensation	1,05,000
		1,05,000			1,05,000
10-11	To bal. c/d	2,18,000	10-11	By bal. c/d	1,05,000
				By Employment compensation	1,13,000
		2,18,000			2,18,000
11-12	To bal. c/d	1,22,000	11-12	By bal. c/d	2,18,000
		8,000		By Employment compensation	1,22,000
		3,40,000			3,40,000
12-13	To ESOP O/s	3,40,000	12-13	By bal. c/d	3,40,000
		3,40,000			3,40,000

ESOP O/s a/c

Year	Particulars	`	Year	Particulars	`
09-10	To bal. c/d	8,000	09-10	By Employment compensation	8,000
		8,000			8,000
10-11	To bal. c/d	16,000	10-11	By bal. c/d	8,000
				By Employment compensation	8,000
		16,000			16,000
11-12	To bal. c/d	24,000	11-12	By bal. c/d	16,000
				By Employment compensation	8,000
		24,000			24,000
12-13	To share capital	3,40,000	12-13	By bal. c/d	24,000
	To sec. premium	9,64,000		By provision for liability	3,40,000
				By bank	18,00,000
		21,64,000			21,64,000

b)

(iv) **Tier I Capital**

Particulars	**` lacs**
Equity share capital	2,000
Convertible pref. share capital	1,800
Securities premium	30
Free reserves	420
	4,250
Less: Intangibles	450
Owned Fund	**3,800** [A]
Investments in debentures of subsidiaries	1,500
Less: 10% of [A]	380
Excess of investments over 10% of [A]	1,120 [B]
Tier I Capital [A] – [B]	**2,680**

(v) **Tier II Capital :** non convertible pref.shares i.e. **` 1,300 lacs**

(vi) **Capital Adequacy Ratio** = $\dfrac{\textbf{Tier I Capital + Tier II Capital}}{\textbf{Risk adjusted assets}}$ **x 100**

$= \dfrac{\text{` (2,680 + 1,300) lacs}}{\text{` 28,500 lacs}} \times 100$

= **13.96%**

***** Since minimum capital adequacy ratio (CAR) shall not be less than 15%,** IIFC Ltd. is advised to maintain CAR as per the directions.

IMP:

- **Owned fund** = ESC + PSC (convertible into equity shares) + free reserves + sec. premium + capital reserve (surplus on sale of assets) – book value of intangibles – accumulated loss – deferred revenue expenditure.

- **Tier I Capital** means owned fund as reduced by investments in shares of other NBFC and in shares, debentures, bonds, o/s loans and advances incl. hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate**, ten percent of the owned fund.**

- **The total of Tier II Capital, at any point of time, shall not exceed 100% Tier I Capital.**

- ***** AMENDMENT: --** All deposit taking NBFC's shall maintain minimum CAR of **15% w.e.f. 31st March 2012.**

6. a) Value of liability component

Half – year	**Workings**	**Cash flow(`)**	**PVF**	**Present value(`)**
1 – 6	(` 3 crores x 9% x ½)	13,50,000	5.0756	68,52,060
7 – 12	(` 1.5 crores x 9% x ½)	6,75,000	3.7875	25,56,563
12	1,50,000 deb. x ` 110	1,65,00,000	0.5568	91,87,200
				1,85,95,823

Value of embedded derivative	`
Issue proceeds (3,00,000 debentures x ` 100)	3,00,00,000
Less: value of host	1,85,95,823
Value of embedded derivative	**1,14,04,177**

b)

(v) **Annual lease payment**(considered to be paid at the end of each accounting year)

	`
Cost of equipment	1,50,000
UGRV	20,000*
PV of residual value for 3yrs @ 10%(` 20,000 x 0.751)	15,020
Fair value to be recovered from lease payment(` 1,50,000 – ` 15,020)	1,34,980
PVIFA(10%,3) **(A)**	2.487
Annual lease payment[` 1,34,980/ (A)]	**54,275**

* Expected residual value = GRV + UGRV, hence UGRV = `(40,000 – 20,000) = ` 20,000

(vi) **Unearned financial income**

	`
Total lease payments(` 54,275 x 3)	1,62,825
Add: Residual value	20,000
Gross investments	1,82,825
Less: Present value of investments(` 1,34,980 + ` 15,020	1,50,000
Unearned financial income	**32,825**

(vii) **Financial charges for each year**

Year	Lease Rentals `	Finance charges @ 10% on O/s amt. of the year `	Repayment `	O/s amt. `
0	-	-	-	1,50,000
1	54,275	15,000	39,275	1,10,725
2	54,275	11,073	43,202	67,523
3	**74,275	6,752	67,523	-
	1,82,825	32,825	1,50,000	

Financial charges for 1st, 2nd and 3rd year are ` 15,000, ` 11,073 and ` 6,752 respectively.
**54,275 + 20,000(UGRV)

(viii) **Extract of profit and loss account.**

Incomes/gains	`
1st year By finance income	15,000
2nd year By finance income	11,073
3rd year By finance income	6,752

7.

a) The total equity share capital of Alpha Ltd. is ` 1,50,000. Beta Ltd. holds 10,000 shares out of total 15,000 equity shares of Alpha Ltd. (i.e. 66.67% shares) and hence becomes the holding company of Alpha Ltd. **Para 82** of **AS 30 "financial instruments: Recognition and Measurement"** states that for hedge accounting purposes only instruments that involves a party external to reporting entity can be designated as hedging instrument. Hence debentures issued by Beta Ltd. cannot be designated as hedging instrument for the purpose of consolidated financial statements of the group. However, it can be designated as hedging instrument for separate financial statements of Alpha Ltd.

b) Carrying amount of investments as per equity method

Particulars	`	`
Equity Share Capital	10,00,000	
Securities premium	1,00,000	
Reserves and Surplus	5,00,000	
Net Assets	**16,00,000**	
25% of net assets	4,20,000	
Add : 25% of profits for the year	75,000	
	4,95,000	
Less: dividend recd.(25%)	25,000	4,70,000
Less: cost of investment		(8,00,000)
Goodwill		**3,30,000**

Consolidated balance sheet (extract)

Assets	`
Investment in B Ltd. **(goodwill identified ` 3,30,000)**	8,00,000

c) Refer **para 13** of AS 9 "Revenue Recognition"

d) Refer para 4 of AS 5.

Rectification of error in stock valuation is a prior period item as per **para 4** of **AS 5**. ` 25 lacs must be added to opening stock of 01.4.2011. Further, ` 25 lacs shall be shown as a prior period adjustment in the P & L a/c below line. Separate disclosure of this item as a prior period item is reqd. as per para 15 of AS 5.

e) Calculation of quarterly income for quarter ended 01.10.2011 to 31.12.2011

Particulars	`
Gross profit earned during 01.10.2011 to 31.12.2011	5,00,000
Less: bad debts deferred [(50,000 x 50%) x 40%]	(10,000)
Less: additional depreciation on account of change in method	(25,000)
Less: extra ordinary loss (20,000 x 50%)	(10,000)
Income for quarter ended Dec. 2011	**4,55,000**