

CA (FINAL): MAY, 2013
PAPER – 1: FINANCIAL REPORTING
MODEL SOLUTION

General Notes to Examiners: The suggested solutions contained herein are based on certain assumptions. Therefore, due credit may be given if students have worked out the solution correctly based on any other logical alternative assumption / approach.

1. The candidates may commit errors at various stages in solving the problems and therefore, be awarded marks for each and every step.
2. Working notes may be given by the candidates in 'ledger format' or 'statement format' and also may be shown separately or within the solution.
3. For questions involving explanation (as in case of Accounting standard based questions), maximum marks should be given if the answers given by the candidates cover the key points that are expected from them.

Answer to Question 1 (a)

(i) Original cost of the machinery

	Particulars	Rs.	
1	Quoted price	2,75,00,000	
2	Less: Trade discount @ 2%	<u>(5,50,000)</u>	
		2,69,50,000	] ½ Mark
3	Add: Sales Tax @ 6% on quoted price	16,50,000	
4	Transportation charges	60,000	
5	Architect's Fees	45,000	] ½ Mark
6	Trial run expenses	29,000	
	(Material 15,000 + labour 10,000 + overheads 4,000)		1 Mark
7	Finance cost (15% on Rs. 250 lakhs for the period 01.9.12 to 15.1.13)	<u>14,06,250</u>	1 Mark
8	Total amount to be capitalised for machinery	<u>3,01,40,250</u>	1 Mark

Note to Examiners: The above solution is based on the specific requirement of the question i.e. 'Sales tax on quoted price is 6%'. However, in general practice sales tax is calculated on amount arrived after deduction of trade discount. Therefore, if any candidate has solved the question accordingly, he should not be penalised.

(ii) Cost incurred during the period between the date the machine was ready for use and the actual date the machine was put to use-

Finance cost amounting Rs. 6,25,000 i.e. 15% of Rs. 250 lakhs for the period 15.01.2013 to 15.03.2013 will be charged to profit and loss account as per AS 16 "Borrowing Costs".

(1 Mark)

(Total 5 Marks)

Answer to Question 1 (b)

Calculation of Profit / Loss on disposal of investment in subsidiary

Particulars	Rs.	Rs.	Marks
Net Assets of B Ltd. on the date of disposal		35,00,000	
Less: Minority Interest (35 lakhs x 20%)		(7,00,000)	
A Ltd.'s share in Net Assets (80%)		28,00,000	(1 Mark)
Proceeds from the sale of Investment		30,00,000	
Less: A Ltd.'s share in net assets		(28,00,000)	
		2,00,000	(1 1/2 Mark)
Add: Capital Reserve in the Consolidated Financial Statement			
A Ltd.'s share in net assets on the date of investment (22 lakhs x 80%)	17,60,000		
Less: Cost of investment	(15,00,000)	2,60,000	(1 1/2 Mark)
Profit on disposal of investment in subsidiary		4,60,000	(1 Mark)

(Total 5 Marks)

Answer to Question 1 (c)

Calculation of Profit or Loss on sale of equipment in the books of Lessee (Santa Ltd.)

1. Whether lease is an operating lease or finance lease

Annuity factor of Rs. 1 @10% for 10 years = 6.144

Present value of Minimum Lease Payments (MLP) @ 10% for 10 years

= Rs. 1,00,000 x 6.144 = Rs. 6,14,400

(1 Mark)

Some of the criterias for classification of lease as finance lease are:

a. The lease term is for the major part of the economic life of the asset even if title is not transferred i.e. Life of asset = 10 years and lease term = 10 years

b. **At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value (Sales price) of the leased asset**

Present value of MLP = Rs. 6,14,400

Fair value (Sales price) = Rs. 6,14,460

Difference between Fair value (Sales price) and Present value of MLP is negligible.

Therefore, Lease is a finance lease.

(1 Mark)

2. Calculation of profit on sale of lease to Santa Ltd.

Sales value = Rs. 6,14,460

Carrying amount = Rs. 1,00,000

Profit = Rs. 5,14,460

(1 Mark)

Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Santa Ltd.)

As per AS 19, if a sale and leaseback transaction results in a finance lease, profit of Rs. 5,14,460 will not be recognized as income in the year of sale in the books of lessee i.e. Santa Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Amortisation of profit of Rs. 5,14,460 will be in 10 years on Straight Line Method as follows:

Rs. 5,14,460 / 10 years = Rs. 51,446

(1 Mark)

Note: Assuming that Santa Ltd., has decided to charge depreciation on straight line basis, AS -19 requires Santa Ltd. to:

- Recognize depreciation of Rs. 61,446 per annum for 10 years.
- Allocate excess of Rs. 5,14,460 over the lease term at the rate of Rs. 51,446 p.a.

The net effect is a debit of (Rs. 61,446-Rs. 51,446) Rs. 10,000 p.a. to the profit and loss account for 10 years, as covered under the lease term.

Had there been no sale and lease back transaction, the profit and loss account for each year covered in the lease term would have been charged by (Rs. 1,00,000/10) of Rs. 10,000, towards depreciation. Thus, the sale and lease back transaction has no impact on profit or loss to be reported by the lessee (vendor in the sale transaction) over the lease period."

(1 Mark)

(Total 5 Marks)

Answer to Question 1 (d)

1. Calculation of Carrying amount of the fixed asset at the end of the fourth year on revaluation-

	(Rs. in lakhs)
Purchase price of a fixed asset	150.00
Less: Depreciation for four years [(150 lakhs/10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

(2 Marks)

2. Computation of Impairment Loss

Net Selling Price = Market Price – Expected disposal cost

= Rs. 67.50 lakhs – Rs. 3 lakhs = Rs. 64.50 lakhs

Value in use = Rs. 60 lakhs

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As per AS 28, recoverable amount is higher of asset's net selling price and its value in use.

Therefore, recoverable amount will be Rs. 64.50 lakhs

(1 Mark)

Impairment loss = Carrying Amount after revaluation – Recoverable Amount

= Rs. 75 lakhs – Rs. 64.50 lakhs = Rs. 10.50 lakhs

(1 Mark)

3. Treatment of Impairment Loss

An impairment loss should be recognised as an expense in the statement of profit and loss immediately since there was downward revaluation of asset which was charged to Profit and loss account.

The carrying amount of the asset i.e. Rs.75 lakhs should be further reduced by amount of impairment loss i.e. Rs.10.5 lakhs. Accordingly, asset will be shown in the books at recoverable amount i.e. at Rs. 64.50 lakhs only.

(1 Mark)

(Total 5 Marks)

Answer to Question 2

Consolidated Balance Sheet of Major Ltd., and its subsidiary Minor Ltd., as on 31st December, 2012

Particulars		Note No.	Rs.
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1		6,20,000
(b) Reserves and Surplus	2		1,69,610
(2) Minority Interest	3		2,05,090
(3) Current Liabilities			
(a) Trade Payables (1,06,000 + 1,22,000)			2,28,000
(b) Other current liabilities (Pref. dividend of Major Ltd.)			22,500
Total			12,45,200
II. Assets			
(1) Non-current assets			
(a) Fixed assets			
s Tangible assets	4		5,51,200
(2) Current assets			
(a) Inventories Rs. (96,000+2,28,000)			3,24,000
(b) Trade receivables Rs. (1,40,000+1,70,000)			3,10,000
(c) Cash & Cash equivalents (Rs. 34,000+26,000)			60,000
Total			12,45,200

(21/2 Marks for items not covered by Notes to Accounts and ½ mark for format of Revised Sch. VI.)

Notes to Accounts-

				Rs.
1. Share Capital				
36,000 Equity shares of Rs. 10 each of Major Ltd.		3,60,000		
Less : Shares held by Minor Ltd.		<u>(40,000)</u>		
		3,20,000		
30,000 Preference shares of Rs. 10 each fully paid of Major Ltd.		<u>3,00,000</u>	6,20,000	
			(1/2 Mark)	
2. Reserves and Surplus				
(a) Reserves	52,000			
Less: Share of Minor Ltd.	<u>(17,042)</u>	34,958		
(b) Profit & Loss account	1,20,000			
Less: Preference dividend	<u>(22,500)</u>			
	97,500			
Less : Share of Minor Ltd.	<u>(12,659)</u>			
	84,841			
Add: Share of Revenue Profit of Minor Ltd.	<u>16,433</u>	1,01,274		
(c) Capital Reserve of Major Ltd.	41,378			
Less: Goodwill of Minor Ltd.	<u>(8,000)</u>	<u>33,378</u>	1,69,610	
			(1 Mark)	
3. Minority Interest				
Preference shares of Minor Ltd.		1,60,000		
Preference dividend paid by Minor Ltd.		12,000		
Equity shares (10%)		20,000		
Capital profit (W.N. ii)		11,264		
Revenue profit (W.N. v)		<u>1,826</u>	2,05,090	
			(1 Mark)	

4. Tangible Assets			
Plant & Machinery			
Major Ltd.	4,14,000		
Minor Ltd. (1,00,800+13,600-400)	<u>1,14,000</u>	5,28,000	
Furniture (14,000+9,200)		<u>23,200</u>	5,51,200
			(1/2 Mark)

Working Notes:

(i) (a) Analysis of profits of Minor Ltd. (Pre-allocation of inter-companies' share)

	<i>Capital Profit Rs.</i>	<i>Revenue Profit Rs.</i>
Reserves	60,000	
Profit and Loss as on 1.1.2012	16,000	
Profit for the year after payment of Preference Dividend (24,000 – 12,000)	6,000	6,000
Profit on upward revaluation (1,20,000 – 1,06,400)	13,600	
Additional depreciation on upward revaluation [6,000-5,600]		<u>(400)</u>
	<u>95,600</u>	<u>5,600</u>

(1 Mark)

(b) Analysis of Profits of Major Ltd.

	<i>Capital Profit Rs.</i>	<i>Revenue Profit Rs.</i>
Reserves	26,000	26,000
Profit and Loss as on 1.1.2012	(45,500)	
Profit for the year after payment of preference dividend [(1,20,000 + 45,500) - 22,500] = 1,43,000	<u>71,500</u>	<u>71,500</u>
	<u>52,000</u>	<u>97,500</u>

(1 Mark)

(ii) Capital profits of Major Ltd. & Minor Ltd. (post allocation of inter-companies' share)

Suppose capital profits of Major Ltd. = a and capital profits of Minor Ltd. = b

$$\text{Total Capital profits of Major Ltd.} = 52,000 + \frac{9}{10}b \quad (1)$$

$$\text{Total Capital profits of Minor Ltd.} = 95,600 + \frac{1}{9}a \quad (2)$$

Putting values of equation (2) in (1), we get

$$a = 52,000 + \frac{9}{10} \left[95,600 + \frac{1}{9}a \right] \quad \text{i.e.} \quad a = 52,000 + \frac{9}{10} \times \frac{8,60,400 + a}{9}$$

$$a = 52,000 + 86,040 + \frac{a}{10} \quad \text{i.e.} \quad a - \frac{a}{10} = 1,38,040$$

$$9a = 13,80,400 \quad \text{i.e.} \quad a = \frac{13,80,400}{9}$$

$$a = 1,53,378 \quad \text{Then} \quad b = 95,600 + \frac{1}{9}(1,53,378)$$

$$b = 1,12,642$$

Rs.

Minority Interest in Capital profits of Minor Ltd.	11,264
Share of Major Ltd.	<u>1,01,378</u>
	<u>1,12,642</u>

(1 Mark)

(iii) Revenue profits of Major Ltd. and Minor Ltd. (post allocation)

Assume revenue profits of Major Ltd. = x

and revenue profits of Minor Ltd. = y

$$\text{Total Revenue profits of Major Ltd.} = 97,500 + \frac{9}{10}y \quad (3)$$

$$\text{Total Revenue profits of Minor Ltd.} = 5,600 + \frac{1}{9}x \quad (4)$$

Putting values of equation (4) in (3), we get

$$x = 97,500 + \frac{9}{10} \left(5,600 + \frac{1}{9}x \right) \quad \text{i.e.} \quad x = 97,500 + \frac{9}{10} \times \frac{50,400 + x}{9}$$

$$x = 97,500 + 5,040 + \frac{x}{10} \quad \text{i.e.} \quad x - \frac{x}{10} = 1,02,540$$

$$10x - x = 10,25,400 \quad \text{i.e.} \quad x = \frac{10,25,400}{9}$$

$$\text{or } x = 1,13,933 \quad \text{Then } y = 5,600 + \frac{1}{9}(1,13,933) \quad y = 18,259 \quad (1 \text{ Mark})$$

		Major Ltd.	Minor Ltd.
(iv)	Capital Profits	Rs.	Rs.
	As per Working Note (ia) & (ib)	52,000	95,600
	Adjustment as per equation (ii)	<u>(17,042)</u>	<u>17,042</u>
		<u>34,958</u>	1,12,642
	Minority Interest (10%)		<u>(11,264)</u>
	Share of Major Ltd.		<u>1,01,378</u>
			(1 ½ Mark)
(v)	Revenue Profits		
	(1,20,000 - 22,500 Preference dividend)	97,500	5,600
	Adjustment as per equation (iii)	<u>(12,659)</u>	<u>12,659</u>
		84,841	18,259
	Minority interest of Minor Ltd.	<u>16,433</u>	<u>(1,826)</u>
	Share of Major Ltd. in Minor Ltd.	<u>1,01,274</u>	<u>16,433</u>
			(1 ½ Mark)
(vi)	Cost of Control		
(a)	Cost of Investments of Major Ltd. in Minor Ltd.		2,40,000
	Less: Paid up value of shares	1,80,000	
	Capital Profits	<u>1,01,378</u>	<u>(2,81,378)</u>
	Capital Reserve		<u>41,378</u>
(b)	Cost of Investments of Minor Ltd. in Major Ltd.		48,000
	Less: Paid up value of shares held		<u>(40,000)</u>
	Goodwill		<u>8,000</u>
			(1 Mark)
(vii)	Plant & Machinery as on 1.1.2012		1,12,000
	Less: Dep. upto 30 th June, 2012 (1,12,000 x 10% x 6/12)		<u>(5,600)</u>
	Value as on 1.7.2012		1,06,400
	Revaluation of Plant & Machinery on 1.7.2012		<u>1,20,000</u>
	Upward Revaluation		<u>13,600</u>
			(1 ½ Mark)

(viii)	Additional depreciation on upward Revaluation of Plant & Machinery Depreciation for remaining 6 months $(1,20,000 \times 10\% \times 6/12)$ Less: Depreciation already charged $(1,12,000 \times 10\% \times 6/12)$			6,000 <u>(5,600)</u> 400 (1/2 Mark)
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Note to Examiners: Alternatively, excess depreciation can be calculated as follows:

Upward revaluation = Rs. 13,600

Additional depreciation on upward revaluation = $13,600 \times 10\% \times 6/12 = \text{Rs. } 680$.

Due credit may be given if the candidates have solved the question accordingly.

(Total 16 Marks)

Answer to Question 3

(a) Schedule showing determination of Fractional shares

	Holding of Shares (A)	Exchange able in nearest multiple of five (B)	Exchange in equity shares (C) = $(B)/5 \times 2$	Exchange in Preference shares (D) = $(B)/5 \times 1$	Non (E) = (A) – (B)
P	174	170	68	34	4
Q	114	110	44	22	4
R	108	105	42	21	3
S	42	40	16	8	2
Other individuals	12	-	-	-	12
	450	425	170	85	25
		(1 Mark)	(2 Marks)	(2 Marks)	(1 Mark)

(6 Marks)

b) (i) Shares Exchangeable: In Equity Shares of Sun Ltd.

	No. of shares		No. of shares
1,20,000-450 (Total A above)	1,19,550	2/5 there of	47,820
450-25 (Total E Above)	<u>425</u>	2/5 there of	<u>170</u>
	<u>1,19,975</u>		<u>47,990</u>

(2 Marks)

(ii) Shares Exchangeable: In 10% Cumulative Preference Shares of Sun Ltd.

	No. of shares		No. of shares
Shares held as in b (i)	1,19,550	1/5 there of	23,910
as in b (i)	<u>425</u>	1/5 there of	<u>85</u>
	<u>1,19,975</u>		<u>23,995</u>

(2 Marks)

- (c) There are 25 shares in Moon Ltd. which are not capable of exchange into equity and preference shares of Sun Ltd. They will be paid = $25 \text{ shares} \times \text{Rs.} 10 \times \frac{65}{50} = \text{Rs.} 325$ (1 Mark)

(d) Statement showing calculation of Purchase Consideration Rs.

47,990, Equity Shares @ Rs.15 each	7,19,850	(1 Mark)
23,995, 10% Cumulative Preference shares @ Rs.10 each	2,39,950	(1 Mark)
Cash on 1,19,975 shares @ Rs. 5 each	5,99,875	(1 Mark)
Add: Cash for 25 fractional shares	<u>325</u>	(1 Mark)
	<u>15,60,000</u>	(1 Mark)

(5 Marks)

(Total 16 Marks)

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Answer to Question 4(a)

1. Calculation of profit after tax (PAT)

	Rs.	Rs.	Marks
Profit before interest & tax (PBIT)		18,00,000	
Less: Debenture interest (Rs. 12,50,000 × 12/100)		<u>(1,50,000)</u>	(1/2 Mark)
Profit before tax (PBT)		16,50,000	(1/2 Mark)
Less: Tax @ 40%		<u>(6,60,000)</u>	(1/2 Mark)
Profit after tax (PAT)		9,90,000	(1/2 Mark)
Less: Preference dividend $\left(12,50,000 \times \frac{12}{100} \right)$	1,50,000		(1/2 Mark)
Equity dividend $\left(45,00,000 \times \frac{15}{100} \right)$	<u>6,75,000</u>	<u>(8,25,000)</u>	(1/2 Mark)
Retained earnings (undistributed profit)		<u>1,65,000</u>	(1 Mark)

(4 Marks)

2. Calculation of Interest and Fixed Dividend Coverage

$$= \frac{\text{PAT} + \text{Debenture interest}}{\text{Debenture interest} + \text{Preference dividend}} = \frac{9,90,000 + 1,50,000}{1,50,000 + 1,50,000} = 3.8$$

(1½ Mark)

This ratio is less than the prescribed ratio i.e. 4.

3. Calculation of Debt Equity Ratio

$$\begin{aligned} \text{Debt Equity Ratio} &= \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}} \\ &= \frac{\text{Debentures}}{\text{Preference share capital} + \text{Equity share capital} + \text{Reserves}} \\ &= \frac{12,50,000}{12,50,000 + 45,00,000 + 12,50,000} \quad \text{i.e.} \quad \frac{12,50,000}{70,00,000} = 0.179 \end{aligned}$$

The ratio is less than the prescribed ratio i.e. 2.

(1½ Mark)

4. Calculation of actual Yield on Equity Shares

Yield on equity shares is calculated at 60% of distributed profits and 10% of undistributed profits as follows:

60% of distributed profits (60% of Rs. 6,75,000) [See (1)]	4,05,000
10% of undistributed profits (10% of Rs. 1,65,000) [See (1)]	<u>16,500</u>
	<u>4,21,500</u>
	(1 Mark)

$$\text{Yield on equity shares} = \frac{\text{Yield on shares}}{\text{Equity share capital}} \times 100 = \frac{4,21,500}{45,00,000} \times 100 = 9.37\% \quad (1 \text{ Mark})$$

5. Calculation of Expected Yield on Equity Shares	
Normal return expected	15%
Add: Risk premium for low interest and fixed dividend coverage (3.8 < 4)	1%*
Risk adjustment for debt equity ratio not required	Nil**
	16%
(1 Mark)	
6. Value of an Equity Share	
$= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid up value of a share} = \frac{9.37}{16} \times 100 = 58.56$	
(1 Mark)	

* When interest and fixed dividend coverage is lower than the prescribed norm, the riskiness of equity investors is high. Therefore, they should claim additional risk premium over and above the normal rate of return. (1/2 Mark)

** The debt equity ratio is lower than the prescribed ratio that means outside funds (Debts) are lower as compared to shareholders' funds. Therefore, the risk is less for equity shareholders. Therefore, no risk premium is required to be added in such a case.

(1/2 Mark)

(Total 12 Marks)

Answer to Question 4 (b)

Fair value of an ESPP = Rs. 48 – Rs. 40 = Rs. 8

Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares (1 Mark)

Fair value of ESPP which will be recognized as expense in the year 2012-13

= 40,000 shares x Rs. 8 = Rs. 3,20,000 (1 Mark)

Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
30.04.2012	Bank A/c (40,000 shares x Rs. 40) Dr.	16,00,000	
	Employees compensation expense A/c Dr.	3,20,000	
	To Share Capital A/c (40,000 shares x Rs.10)		4,00,000
	To Securities Premium (40,000 shares x Rs.38)		15,20,000
	(Being shares issued under ESPP @ Rs. 40)		

(2 Marks)

(Total 4 Marks)

Answer to Question 5 (a)

1. Rectification of current year's profit i.e. 2012-13

Profit After Tax = Rs. 1,100 lacs

Provision for taxation = Rs. 300 lacs

Profit Before Tax = PAT + Provision for taxation = Rs. 1,100 lacs + Rs. 300 lacs = Rs. 1,400 lacs

$$\text{Rate of tax} = \frac{\text{Provision for tax}}{\text{Profit before tax}} \times 100 = \frac{300}{1,400} \times 100 = 21.43\% \text{ (approx.)} \quad (1/2 \text{ Mark})$$

Note to Examiners: It is assumed that 'Provision for Taxation' included in reserves is made in the current year only.

	Rs. in lacs
Profit for the year after tax	1,100
Less: Depreciation net of tax on motor vehicles (Rs. 40 lacs x 20% x 6/12) x (100-21.43)%	(3.1428)
Depreciation net of tax on Premises and Land (Rs. 400 lacs x 2%) x (100-21.43)%	(6.2856)
Depreciation net of tax on Plant and Machinery (Rs. 3,000 lacs x 10%) x (100-21.43)%	(235.71)
Provision for doubtful debts net of tax (Rs. 400 lacs x 10%) x (100-21.43)%	(31.428)
Rectified profit of 2012-13	<u>823.43</u>

(1 1/2 Marks)

Note to Examiners: It is assumed that plant and machinery given in the balance sheet is at cost and depreciation on 'Premises and Land' and 'Plant and Machinery' is charged on Straight Line method.

2. Calculation of Capital Employed	(Rs. In lacs)	(Rs. In lacs)
Premises and land		1,200
Plant and machinery		2,400
Motor vehicles (book value less depreciation for ½ year)		36
Raw materials		920
Work-in-progress		130
Finished goods		180
Book debts (400 x 90%)		360
Investments (market value)		1,500
Cash at bank and in hand		<u>192</u>
		6,918

Less: Liabilities:			
Provision for taxation		300	
5% Debentures		2,000	
Secured loans		200	
Sundry creditors		<u>300</u>	<u>(2,800)</u>
Total capital employed on 31.3.2013			4,118
Less: Half of current year's rectified profit (823.43 x 1/2)			<u>(411.72)</u>
Average Capital Employed			<u>3,706.28</u>

(2 Marks)

Note to Examiners: It is assumed that resale value of 'Premises and Land' and 'Plant and Machinery' given in the question is for depreciated value of respective assets. Therefore, no adjustment for depreciation has been made in such assets while calculating capital employed.

3. Calculation of Future Maintainable Profits

		2009-10	2010-11	2011-12	2012-13
Profit after tax		469	546	405	823.43
Less: Depreciation net of tax on Premises and (Rs. 400 lacs x 2%) x (100-21.43)%	Land	6.29	6.29	6.29	
Depreciation net of tax on Plant and Machinery (Rs. 3,000 lacs x 10%) x (100- 21.43)%		<u>235.71</u>	<u>235.71</u>	<u>235.71</u>	
Adjusted Profit		<u>227</u>	<u>304</u>	<u>163</u>	<u>823.43</u>

(2Marks)

Average adjusted profit (227+304+163+823.43)/4	379.36
Less: Excess depreciation (net of tax) due to upward revaluation of premises and land [(1,200-400) x 2%] x (100 - 21.43)%	(12.57)
Depreciation on motor vehicle (net of tax) for remaining six months (in future depreciation on motor vehicle will be charged for full year) (Rs. 40 lacs x 20% x 6/12) x (100- 21.43)%	(3.14)
Add: Short depreciation (net of tax) due to downward revaluation of plant and machinery [(3,000 - 2,400) x 10%] x (100 - 21.43)%	<u>47.14</u>
Future Maintainable Profit	<u>410.79</u>

(2 Marks)

Note to Examiners: It is assumed that profit for the year 2009-10, 2010-11 and 2011-12 given in the questions is after tax and no depreciation was charged in the earlier years also.

4. Calculation of General Expectation

Similar Company pays Rs. 2.5 as dividend (25%) for each share of Rs. 10.

Market value of an equity share of the same denomination is Rs. 25 which fetches dividend of 25%.

Therefore, share of Rs. 10 (Face value of shares of Domestic Ltd.) is expected to fetch $(2.5/25) \times 100 = 10\%$ return.

A nominal rate of 1% or 2% may be added as Risk premium, to the normal rate of return for uncertainty associated with dividend distribution.

Since, Domestic Ltd. is not having a stable record in payment of dividend, in its case the expectation may be assumed to be slightly higher, say 11%.

(1 Mark)

Note to Examiners: In the above point 4, 1% has been added to market expectation, for calculation of general expectation from Domestic Ltd. If candidates assume more or less than 1% to be added to market expectation, for calculation of general expectation from Domestic Ltd. and solve the question accordingly, they should also be awarded due marks.

5. Calculation of value of goodwill of Domestic Ltd.	(Rs. in lakhs)
Future maintainable profit	410.79
Less: Normal profit i.e. 11% of average capital employed (3,706.28 x 11%)	<u>(407.69)</u>
Super Profit	<u>3.1</u>
Goodwill at 4 years' purchase of Super Profit (3.1 x 4)	<u>12.4</u>

(1 Mark)

Notes: (1) Average Capital employed has been taken for valuation of goodwill. However, candidates may compute the value of goodwill on the basis of terminal or closing capital employed also.

(2) While considering past profits for determining average profit, the years 2007-08 and 2008-09 have been left out, as during these years normal business was hampered. (Total 10 Marks)

Note to Examiners: The above solution is based on the assumption that the depreciation was not charged in the previous years in addition to the current year. The impact of tax has also been considered in the given solution by computing the tax rate from the facts given in the question. Alternatively candidates may solve the question assuming that depreciation on fixed assets has not been charged in the current year but the same has been charged in the earlier years. Also, candidates may ignore tax effect since no tax rate has been given in the question. In such a case, the solution will be as follows:

1. Profit available for shareholders for the year 2012-13	Rs. In lacs	Rs. In lacs
Profit for the year as per Balance Sheet		1,100
Less: Depreciation to be considered		
Premises and land (400 x 2%)	8	
Plant & machinery (3,000 x 10%)	300	
Motor vehicles (40 x 20% x 6/12)	<u>4</u>	<u>(312)</u>
		788
Less: Bad debts		<u>(40)</u>
Rectified Profit for the year 2012-13		<u>748</u>

(2 Marks)

Note to examiners: It is assumed that plant and machinery given in the balance sheet is at cost and depreciation on 'Premises and Land' and 'Plant and Machinery' is charged on Straight Line method.

2. Calculation of capital employed	Rs. In lacs	Rs. In lacs
Premises and land		1,200
Plant and machinery		2,400
Motor vehicles (book value less depreciation for ½ year)		36
Raw materials		920
Work-in-progress		130
Finished goods		180
Book debts (400 x 90%)		360
Investments		1,500
Cash at bank and in hand		<u>192</u>
		6,918
Less: Liabilities:		
Provision for taxation	300	
5% Debentures	2,000	
Secured loans	200	
Sundry creditors	<u>300</u>	<u>2,800</u>
Total capital employed on 31.3.2013		4,118
Less: Half of current year's rectified profit (748 x 1/2)		<u>(374)</u>
Average Capital Employed		<u>3,744</u>

(2 Marks)

3. Calculation of Future Maintainable Profits

	Rs. In lacs	Rs. In lacs
Profit for the year 2012-13	748	
Profit for the year 2011-12	405	
Profit for the year 2010-11	546	
Profit for the year 2009-10	469	
	<u>2,168 / 4</u>	542
		(2 Marks)
Less: Excess depreciation due to upward revaluation of premises and land $[(1,200-400) \times 2\%]$		(16)
Depreciation on motor vehicle for remaining six months (in future depreciation on motor vehicle will be charged for full year) (Rs. 40 lacs $\times$ 20% $\times$ 6/12)		(4)
Add: Short depreciation due to downward revaluation of plant and machinery $[(3,000 - 2,400) \times 10\%]$		<u>60</u>
		<u>582</u>
		(2 Marks)

Note to Examiners: Depreciation on premises and land and plant and machinery have been provided on the basis of assumption that the same has not been provided for in the year 2012-13 but has been provided for in the earlier years.

4. Calculation of General Expectation

Similar company pays Rs. 2.5 as dividend (25%) for each share of Rs. 10.

Market value of an equity share of the same denomination is Rs. 25 which fetches dividend of 25%.

Therefore, share of Rs. 10 (Face value of shares of Domestic Ltd.) is expected to fetch $(2.5/25) \times 100 = 10\%$ return

A nominal rate of 1% or 2% may be added as Risk premium, to the normal rate of return for uncertainty associated with dividend distribution.

Since, Domestic Ltd. is not having a stable record in payment of dividend, in its case the expectation may be assumed to be slightly higher, say 11%. (1 Mark)

Note to Examiners: In the above point 4, 1% has been added to market expectation, for calculation of general expectation from Domestic Ltd. If candidates assume more or less than 1% to be added to market expectation, for calculation of general expectation from Domestic Ltd. and solve the question accordingly, they should also be awarded due marks.

5. Valuation of Goodwill

Rs. In lacs

Future maintainable profit	582.00
Less: Normal profit (11% of average capital employed)	<u>(411.84)</u>
Super Profit	<u>170.16</u>
Goodwill at 4 years' purchase of Super Profit (170.16 × 4)	680.64

(1 Mark)

Notes: (1) Average Capital employed has been taken for valuation of goodwill. However, candidates may compute the value of goodwill on the basis of terminal or closing capital employed also.

- (2) While considering past profits for determining average profit, the years 2007-08 and 2008-09 have been left out, as during these years normal business was hampered.
- (3) If any candidate has considered the tax rate of 30% applicable to a domestic company (instead of taking the tax rate of 21.43% arrived at from the information given in the question) for computing the tax impact, he /she may also be given due credit as per alternative solution.
- (4) In case depreciation has been calculated on revalued figures in determining the profit for the year, the same may be accepted and given requisite marks.

(Total 10 Marks)

Answer to Question 5 (b)

Computation of Expected and Unexpected Returns on Plan Assets

Rupees

Return on Rs. 2,50,000 held for 12 months at 10.25%	25,625
Return on Rs. 75,000 (1,22,500-47,500) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	<u>3,750</u>
Expected return on plan assets for 2011-12	<u>29,375</u>
	(2 Marks)
Fair value of plan assets as on 31 March, 2012	3,75,000
Less: Fair value of plan assets as on 1 April, 2011	2,50,000
Contributions received	<u>1,22,500</u>
	<u>(3,72,500)</u>
	2,500
Add: Benefits paid	<u>47,500</u>
Actual return on plan assets	<u>50,000</u>
	(3 Marks)

$$\begin{aligned}\text{Unexpected Return on Plan Asset} &= \text{Actual return} - \text{Expected return} \\ &= 50,000 - 29,375 = \text{Rs. } 20,625\end{aligned}$$

(1 Mark)

(Total 6 Marks)

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Answer to Question 6 (a)

B Co. Ltd

Gross Value Added Statement

For the year ended 31st December, 2012

	Rs. '000	Rs. '000
Sales		6,240
Less: Cost of bought in material and services:		
Production and operational expenses		
Rs. (4,320 – 8 – 620)	3,692	
Administration expenses Rs. (180 – 5)	175	
Interest on bank overdraft	109	
Interest on working capital loan	20	
Excise duties (Refer to working note)	180	
Other/miscellaneous charges Rs. (444 – 180)	<u>264</u>	<u>(4,440)</u>
Value added by manufacturing and trading activities		1,800
Add: Other income		<u>55</u>
Total Value Added		<u>1,855</u>
		(2 Marks)
Application of Value Added:		
To Pay Employees :		
Salaries to Administrative staff		620
To Pay Directors:		
Salaries and Commission		5
To Pay Government:		
Local Tax	8	
Income Tax	<u>55</u>	63
To Pay Providers of Capital :		
Interest on Fixed Loan	51	
Dividend	<u>160</u>	211

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To Provide for Maintenance and Expansion of the Company:		
Depreciation	16	
Fixed Assets Replacement Reserve	400	
Retained Profit Rs. (600 - 60)	<u>540</u>	<u>956</u>
		<u>1,855</u>
		(2 Marks)

Reconciliation between Total Value Added and Profit Before Taxation: Rs. '000 Rs. '000

Profit before Tax		1,155
Add back:		
Depreciation	16	
Salaries to Administrative Staff	620	
Director's Remuneration	5	
Interest on Fixed Loan	51	
Local Tax	<u>8</u>	<u>700</u>
Total Value Added		<u>1,855</u>
		(2 Marks)

Working Note:

Calculation of Excise Duty

Rs. '000

Rs. '000

Interest and other charges		624
Less : Interest on bank overdraft	109	
Interest on loan from ICICI	51	
Interest on loan from IFCI	<u>20</u>	<u>(180)</u>
Excise duties and other/miscellaneous charges		<u>444</u>

It is assumed that these miscellaneous charges of Rs.444 thousands have been taken for arriving at Value Added by manufacturing and trading activities.

On the basis of this assumption, the excise duty will be computed as follows.

Let excise duty be x, thus miscellaneous/ other charges =Rs. 444 -x

Thus $x = \frac{1}{10} \times [\text{Rs. } 6,240 - \{\text{Rs. } 3,692 + \text{Rs. } 175 + \text{Rs. } 109 + \text{Rs. } 20 + x + (\text{Rs. } 444 - x)\}]$

$= \frac{1}{10} \times [\text{Rs. } 6,240 - \text{Rs. } 4,440] = \text{Rs. } 180;$

Other/ miscellaneous charges = Rs. 444 - Rs. 180 = Rs. 264.

(2 Marks)

Note to Examiners: In the above solution, it is assumed that miscellaneous charges (including excise duty) are considered for computation of value added by manufacturing and trading activities. However, it may be taken otherwise and miscellaneous charges may be taken as application of Value Added (i.e. to be taken in the application part), then excise duty (x) will be computed as follows:

$$x = 1/10 \times [\text{Rs. } 6,240 - \text{Rs. } (3,692 + 175 + 109 + 20 + x)]$$

$$x = 1/10 \times [\text{Rs. } 2,244 - x]$$

$$11x = \text{Rs. } 2,244$$

$$x = \text{Rs. } 204$$

And thus total value added will be Rs. 2,040 + Rs. 55 (other income) = Rs. 2,095

And accordingly, application part will be prepared, taking miscellaneous charges.

Rs. ('000) 240 [i.e. Rs. 444 - Rs. 204] as the application of value added.

(Total 8 Marks)

Answer to Question 6(b)

Accounting Entries in the books of fund		Rs.	Rs.
31.12.2010	Investment in X Ltd.'s shares A/c (5,000 x Rs. 40)	Dr. 2,00,000	
	Investment in Y Ltd.'s shares A/c (4,000 x Rs. 60)	Dr. 2,40,000	
	To Bank A/c		4,40,000
	(Being investment made in X Ltd. and Y Ltd.)		(1 Mark)
31.3.2011	Revenue A/c [5,000 x Rs. (40-38)]	Dr. 10,000	
	To Provision for Depreciation A/c		10,000
	(Being provision created for the reduction in the value of X Ltd.'s shares)		(1 Mark)
31.3.2011	Investment in Y Ltd.'s shares A/c [4,000 x Rs. (64-60)]	Dr. 16,000	
	To Unrealised Appreciation Reserve A/c		16,000
	(Being appreciation in the market value of Y Ltd.'s shares transferred to Unrealised Appreciation Reserve A/c)		(1 Mark)
01.04.2011	Unrealised Appreciation Reserve A/c	Dr. 16,000	
	To Investment in Y Ltd.'s shares A/c		16,000
	(Being last year's unrealised appreciation reserve balance reversed at the beginning of the current year)		(1 Mark)
30.6.2011	Bank A/c (5,000 x Rs. 37)	Dr. 1,85,000	
	Loss on disposal of Investment A/c	Dr. 15,000	
	To Investment in X Ltd.'s shares A/c (5,000 x Rs. 40)		2,00,000
	(Being shares of X Ltd. disposed off at a loss of Rs. 15,000)		(1 Mark)

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30.6.2011	Provision for Depreciation A/c	Dr.	10,000	
	Revenue A/c	Dr.	5,000	
	To Loss on disposal of Investment A/c (Being net loss on disposal of X Ltd.'s shares charged to revenue account)			15,000 (1 1/2 Marks)
30.6.2011	Bank A/c (4,000 x Rs. 67)	Dr.	2,68,000	
	To Investment in Y Ltd.'s shares A/c (4,000 x Rs. 60)			2,40,000
	To Revenue A/c			28,000
	(Being shares of Y Ltd. disposed off at a profit of Rs. 28,000)			(1 1/2 Marks)

Note to Examiners: Overall 1 mark may be deducted for not giving narrations. (Total 8 Marks)

Answer to Question 7(a)

Calculation of Provision required on Advances as on 31st March, 2012

	Amount Rs. in lakhs	Percentage of provision	Provision Rs. in lakhs	Marks
Standard assets	16,800	0.25	42	(1/2 Mark)
Sub-standard assets	1,340	10	134	(1/2 Mark)
Secured portion of doubtful debts				
—upto one year	320	20	64	(1/2 Mark)
— one year to three years	90	30	27	(1/2 Mark)
—more than three years	30	50	15	(1/2 Mark)
Unsecured portion of doubtful debts	97	100	97	(1/2 Mark)
Loss assets	48	100	48	(1/2 Mark)
			<u>427</u>	(1/2 Mark)

(Total 4 Marks)

Answer to Question 7 (b)

Adjusted net profit for the current year

	Rs.
Net profit for the current year (assumed to be after tax)	5,00,00,000
Add: Interest expense for the current year	13,75,000
Less: Tax relating to interest expense (30% of Rs. 13,75,000)	<u>(4,12,500)</u>
Adjusted net profit for the current year	<u>5,09,62,500</u> (1 1/2 Marks)

Number of equity shares resulting from conversion of debentures:

10,00,000 shares (i.e. 1,25,000 x 8)

Number of equity shares for computation of diluted EPS:

$(1,00,00,000 + 10,00,000) = 1,10,00,000$ shares

(1 Mark)

Computation of diluted earnings per share

Diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

$= (5,09,62,500 / 1,10,00,000) = \text{Rs. 4.63 (approx.)}$

(1 1/2 Marks)

(Total 4 Marks)

Answer to Question 7 (c)

Journal Entries

			Rs. in lakhs	
(a)	Machinery A/c	Dr.	72	
	Cenvat credit receivable on capital goods A/c	Dr.	8	
	To Bank A/c or Creditors A/c			80
	(Being capitalization of machinery)			(2 Marks)
(b)	Excise duty A/c	Dr.	7.2	
	To Cenvat credit receivable on capital goods A/c			4.0
	To Bank A/c			3.2
	(Being excise duty set off to the extent of 50% of excise duty paid in the first year on acquisition of capital asset)			(2 Marks)

(Total 4 Marks)

Note: In case bank entry in (b) is not given, full marks shall be given.

If explanation by way of narration or note is not given, one mark shall be deducted.

Answer to Question 7. (d) "Disclosure of Carrying amounts of financial assets and financial liabilities in Balance Sheet".

The carrying amounts of financial assets and financial liabilities should be disclosed either on the face of the balance sheet or in the notes as follows:

(1 Mark)

Financial Assets

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading,

(1/2 Mark)

(b) held-to-maturity investments;

(1/2 Mark)

(c) loans and receivables;

(1/2 Mark)

(d) available-for-sale financial assets;

(1/2 Mark)

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Financial Liabilities

- (a) financial liabilities at fair value through profit or loss, showing separately
(i) those designated as such upon initial recognition and
(ii) those classified as held for trading, and

(1/2 Mark)

- (b) financial liabilities measured at amortised cost.

(1/2 Mark)

(Total 4 Marks)

Answer to question 7 (e)

In the given case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing 10 cases is 40% and 50% respectively. **According to AS 29, where it is not probable that a present obligation exists, an enterprise discloses a contingent liability.** Since in the given case chances of winning the case is more and losing the case is less, no provision will be recognized. In fact, it is a contingent loss / liability.

(1 Mark)

The amount of contingent loss may be calculated as under:

Expected contingent loss in first ten cases = [Rs. 90,000 x 0.3 + Rs. 1,60,000 x 0.1] x 10 cases

= [Rs. 27,000 + Rs. 16,000] x 10 cases

= Rs. 43,000 x 10 cases = Rs. 4,30,000

(1 Mark)

Expected contingent loss in remaining five cases = [Rs. 60,000 x 0.3 + Rs. 95,000 x 0.2] x 5 cases

= [Rs. 18,000 + Rs. 19,000] x 5 cases

= Rs. 37,000 x 5 cases = Rs. 1,85,000

(1 Mark)

Total contingent liability

= Rs. 4,30,000 + Rs. 1,85,000

= Rs. 6,15,000.

(1/2 Mark)

An enterprise should not recognise a contingent liability. An enterprise should disclose, by way of a note, for each class of contingent loss / liability at the balance sheet date a brief description of the nature of the contingent liability.

(1/2 Mark)

(Total 4 Marks)

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