

PAPER – 1 : FINANCIAL REPORTING

Question No.1 is compulsory.

Candidates are required to answer any five questions from the remaining six questions.

Working notes should form part of the respective answers.

Wherever necessary, candidates are permitted to make suitable assumptions which should be disclosed by way of a note.

Question 1

- (a) *An employee, Darshan, has joined a company PQR Ltd. in the year 2014. The annual emoluments of Darshan as decided is ₹ 15,52,303.*

The company also has a policy of giving a lump sum payment of 25% of the last drawn salary of the employee for each completed year of service, if the employee retires after completing minimum 5 years of service. The salary of the Darshan is expected to grow @ 10% per annum.

The company has inducted Darshan in the beginning of the year and it is expected that he will complete the minimum five-year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined-Benefit Obligation? Also calculate service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

- (b) *Sun Ltd. has fabricated special equipment (solar power panel) during 2014-15 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.*

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-2016 are as follows:

Solar power panel (WIP) ₹ 85 lakhs

Solar power panel (finished products) ₹ 55 lakhs

Sundry Debtor (solar power panel) ₹ 65 lakhs

The petition for winding up against the customer has been filed during 2015-16 by Sun Ltd.

Comment with explanation on provision to be made of ₹ 205 lakh included in Sundry Debtors, Finished Goods and Work-in-progress in the financial statements of 2015-16.

- (c) *A construction contractor has a fixed price contract for ₹ 13,500 lakhs to build a railway tunnel. The contractor's initial estimate of contract costs is ₹ 12,000 lakhs. It will take 3 years to build the tunnel.*

By the end of year, 1, the contractor's estimate of contract costs has increased to ₹ 12,075 lakhs.

In year 2, the Railway Authority approves a variation resulting in an increase in contract revenue of ₹ 300 lakhs and estimated additional contract costs of ₹ 225 lakhs. At the end of year 2, costs incurred include ₹ 200 lakhs for materials at site to be used fully in year 3, to complete the work.

Contract costs incurred up to the reporting date of

Year 1	₹ 3,139 lakhs
Year 2	₹ 9,102 lakhs
Year 3	₹ 12,300 lakhs

You are required to find out the amount of revenue, expenses and profit to be recognised in the Statement of Profit and Loss in all the three years.

- (d) From the following summary of cash account for the year ended 31st March, 2016 of X Ltd., calculate cash flow from Operating Activities using direct method.

Particulars	₹	Particulars	₹
To Balance b/d	1,25,000	By Cash purchases	1,30,000
To Cash sales	1,50,000	By Trade payables	1,44,000
To Trade receivables	1,60,000	By Rent paid	50,000
To Interest & dividend	2,000	By Office expenses	25,000
To Loan from Bank	1,50,000	By Income tax	30,000
To Sale of investment	80,000	By Investment	90,000
To Trade commission	40,000	By Repayment of loan	1,00,000
		By Interest on loan	7,000
		By Balance c/d	<u>1,31,000</u>
	<u>7,07,000</u>		<u>7,07,000</u>

(4 x 5 = 20 Marks)

Answer

- (a) Calculation of Defined Benefit Obligation

If Darshan will complete minimum 5 year term, then it is assumed that he will retire in the 6th year.

Accordingly, Expected last drawn salary in the 6th year

$$= ₹ 15,52,303 \times 110\% \times 110\% \times 110\% \times 110\% \times 110\% = ₹ 25,00,000$$

$$\text{Defined Benefit Obligation (DBO)} = ₹ 25,00,000 \times 25\% \times 5 = ₹ 31,25,000$$

Amount of ₹ 6,25,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost to be charged per year

Year	Equal apportioned amount of DBO [i.e. ₹ 31,25,000/5 years]	PV factor Discounting @ 8%	Current service cost (Present Value)
a	b	c	d = b x c
1	6,25,000	0.735 (4 Years)	4,59,375
2	6,25,000	0.794 (3 Years)	4,96,250
3	6,25,000	0.857 (2 Years)	5,35,625
4	6,25,000	0.926 (1 Year)	5,78,750
5	6,25,000	1 (0 Year)	6,25,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	B	c = b x 8%	d	e = b + c + d
1	0	0	4,59,375	4,59,375
2	4,59,375	36,750	4,96,250	9,92,375
3	9,92,375	79,390	5,35,625	16,07,390
4	16,07,390	1,28,591	5,78,750	23,14,731
5	23,14,731	1,85,269*	6,25,000	31,25,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

Note:

1. The question states that Darshan will complete minimum 5 year term. Accordingly, in the above solution, it is assumed that his retirement from service will be in the 6th year.
2. The above solution has been given assuming that the last drawn salary implies in the question is the annual emolument. However, alternatively one may assume last drawn salary as monthly salary. In such a situation the answer will be as follows:

Calculation of Defined Benefit Obligation

If Darshan will complete minimum 5 year term, then it is assumed that he will retire in the 6th year.

Accordingly, Expected last drawn salary in the 6th year

$$= ₹ 15,52,303 \times 110\% \times 110\% \times 110\% \times 110\% \times 110\% = ₹ 25,00,000$$

Defined Benefit Obligation (DBO) = (₹ 25,00,000/12) x 25% x 5 = ₹ 2,60,417

Amount of ₹ 52,083 (2,60,417 / 5) will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost to be charged per year

Year	Equal apportioned amount of DBO [i.e. ₹ 2,60,417 / 5 years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	C	d = b x c
1	52,083	0.735 (4 Years)	38,281
2	52,083	0.794 (3 Years)	41,354
3	52,083	0.857 (2 Years)	44,635
4	52,083	0.926 (1 Year)	48,229
5	52,083	1 (0 Year)	52,083

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	b	c = b x 8%	D	e = b + c + d
1	0	0	38,281	38,281
2	38,281	3,063	41,354	82,698
3	82,698	6,616	44,635	1,33,949
4	1,33,949	10,716	48,229	1,92,894
5	1,92,894	15,440*	52,083	2,60,417

*Due to approximations used in calculation, this figure is adjusted accordingly.

- (b) From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per AS 2 'Valuation of Inventories', inventories are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods

accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per AS 2 for ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

Note: Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 2015-16, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹ 65 lakhs shall be made in the books against the debtors amount.

(c) Statement showing stage of completion in percentage (₹ in lakhs)

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	13,500	13,500	13,500
Variation	—	300	300
Total contract revenue	<u>13,500</u>	<u>13,800</u>	<u>13,800</u>
Contract costs incurred upto the reporting date	3,139	9,102	12,300
Contract costs to complete	<u>8,936</u>	<u>3,198</u>	—
Total estimated contract costs	<u>12,075</u>	<u>12,300</u>	<u>12,300</u>
Estimated Profit	1,425	1,500	1,500
Stage of completion (rounded off)	26%	72.37%	100%

Note: The stage of completion for year 2 i.e. 72.37% is determined by excluding from contract costs incurred for work performed upto the reporting date, ₹ 200 lakhs of materials stored at the site for use in year 3.

The amounts of revenue, expenses and profit recognised in the statement of profit and loss in the three years are as follows:

(₹ in lakhs)

	Recognised in prior years	Recognised in current year
Year 1		
Revenue (13,500 x 26%)	-	3,510
Expenses	—	<u>3,139</u>
Profit	—	<u>371</u>

Year 2	Total		
Revenue (13,800 x 72.37%)	9,987	3,510	6,477
Expenses	<u>8,902</u>	<u>3,139</u>	<u>5,763</u>
Profit	<u>1,085</u>	<u>371</u>	<u>714</u>
Year 3			
Revenue	13,800	9,987	3,813
Expenses	<u>12,300</u>	<u>8,902</u>	<u>3,398</u>
Profit	<u>1,500</u>	<u>1,085</u>	<u>415</u>

(d) **Cash Flow Statement of X Ltd.**
for the year ended 31st March, 2016 (Direct Method)

Particulars	₹	₹
Cash flow from Operating Activities:		
Cash received from sale of goods	1,50,000	
Cash received from trade receivables	1,60,000	
Trade commission received	<u>40,000</u>	3,50,000
Less: Payment for cash purchases	1,30,000	
Payment to trade payables	1,44,000	
Office expenses	25,000	
Rent	50,000	
Payment of Income-tax	<u>30,000</u>	<u>(3,79,000)</u>
Net cash used in Operating Activities		<u>(29,000)</u>

Question 2

The following was the abridged Balance Sheet of Shiva Ltd. as at 31st March, 2016:

Liabilities	₹	Assets	₹
Authorized Capital:		Fixed Assets:	
15,000 Equity Shares of ₹ 100 each	15,00,000	Plant and Machinery at depreciated value	12,90,000
Issued and paid up:		Land	10,50,000
12,000 Equity Shares of ₹ 100 each, fully paid up	12,00,000	Current Assets	
		Trade Receivables	12,00,000

Reserves and Surplus:			Patent, Trademarks and Copyrights	
General Reserve	7,50,000			9,00,000
Securities Premium	6,00,000			
Profit and Loss	<u>5,40,000</u>	18,90,000		
Non-current Liabilities:				
11% Debentures secured against the assets of the company		7,50,000		
Current Liabilities:				
Trade Payables		<u>6,00,000</u>		
		<u>44,40,000</u>		<u>44,40,000</u>

The Company ran two distinct departments utilizing the trademarks and copyrights owned and generated by it. The assets and liabilities of one of the departments as on the date of the Balance Sheet were:

	₹
Plant and Machinery	6,00,000
Land (used for business)	3,00,000
Trade Receivables	3,00,000
Patent, Trademarks and Copyrights	<u>5,25,000</u>
	17,25,000
Trade Payables	<u>3,75,000</u>
	<u>13,50,000</u>

Due to managerial constraints, Shiva Ltd. is unable to develop this department. An overseas buyer is interested to acquire this department and after due diligence, offers a consideration of ₹ 30,00,000 to the company for transfer of business. The buyer offered to discharge the purchase consideration immediately after 31st March, 2016 in the following manner:

- (i) Issue of Equity Shares of the buyer's company for ₹ 15,00,000 nominal value at a premium of 20% over the face value; and
- (ii) Payment of the balance consideration in Singapore \$. The exchange rate agreed upon is ₹ 50 per Singapore \$. This amount will be retained in Singapore, till the actual takeover of the business is done by the buyer.
 - (a) Expenses to put through the transaction come to ₹ 12,00,000 initially to be incurred by Shiva Ltd. but to be shared equally by the parties.
 - (b) The balance value of Patent, Trademarks and Copyrights left with Shiva Ltd. does not enjoy any market value and has to be written off.

- (c) The value of the balance of Land in Shiva Ltd.'s possession will be taken at its market value in the books of account. Such a value, determined by an approved valuer, is 200 percent of the book value.
- (d) The parties agree that the date of legal ownership of the transferred business shall be 31st March, 2016 though certain formalities may have to be gone through and agree that the actual transfer to the buyer will be effected before 30th April, 2016.

Shiva Ltd. to carry on the business in the normal course and account for the profit of the transferred department to the foreign buyer. Shiva Ltd. made a net profit (cash profit) of ₹ 3,60,000 from the whole business for April, 2016; 40% of the net profit related to the business of the transferred department. The amount of Current Assets and Current Liabilities of Shiva Ltd. has been same as on 31.03.2016.

- (e) The shares of the overseas buyer's company were quoted on the Singapore Stock Exchange and on 30th April, 2016 were quoted at 95 percent of their face value. Shiva Ltd. holds investment in shares of overseas buyer as temporary investment.

Draw the Balance Sheet of Shiva Ltd. as at 30th April, 2016, after the transfer of the business to the overseas buyer. (16 Marks)

Answer

Balance Sheet of Shiva Ltd. as at 30th April, 2016 (after demerger)

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,00,000
(b) Reserves and Surplus	2	31,56,000
(2) Non-current Liabilities		
Long-term borrowings	3	7,50,000
(3) Current Liabilities		
Trade payables		<u>2,25,000</u>
Total		<u>53,31,000</u>
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	4	21,90,000
(2) Current assets		
(a) Trade receivables (12,00,000-3,00,000)		9,00,000

(b) Current investment	5	14,25,000
(c) Cash and cash equivalents (W.N.2)		<u>8,16,000</u>
Total		<u>53,31,000</u>

Notes to Accounts

		₹	₹
1.	Share Capital		
	<i>Authorised share capital:</i>		
	15,000 Equity shares of ₹ 100 each		<u>15,00,000</u>
	<i>Issued share capital:</i>		
	12,000 Equity shares of ₹ 100 each		12,00,000
2.	Reserves and surplus		
	Revaluation reserve (W.N.6)	7,50,000	
	General reserve	7,50,000	
	Capital reserve (W.N.3)	16,50,000	
	Securities Premium	6,00,000	
	Profit and Loss Account (W.N.1)	<u>(5,94,000)</u>	31,56,000
3.	Long-term Borrowings		
	<i>Secured borrowings</i>		
	11% Debentures secured against the assets of the Company		7,50,000
4.	Tangible Assets		
	Plant & Machinery at depreciated value (12,90,000-6,00,000)	6,90,000	
	Land (W.N.6)	<u>15,00,000</u>	21,90,000
5.	Current Investment		
	Equity shares of overseas buyer at nominal value of ₹ 15,00,000 (W.N.7)		14,25,000

Working Notes:

1. Computation of Profit and Loss Account as on 30th April, 2016

	₹
Balance as on 31 st March, 2016	5,40,000
Add: Profit earned during the month of April, 2016 (W.N.4)	<u>2,16,000</u>
	7,56,000

Less: Expenses on sale of department (share of Shiva Ltd.) (₹12,00,000 x 50%)	6,00,000	
Patents, trademarks and copyrights written off (W.N.5)	3,75,000	
Diminution in the value of investment (W.N.7)	<u>3,75,000</u>	<u>(13,50,000)</u>
		<u>(5,94,000)</u>

2. Cash and bank balances as on 30th April, 2016 of Shiva Ltd.

		₹
Cash received from Overseas buyer on 30 th April, 2016 (Singapore \$24,000 x ₹ 50*)		12,00,000
Add: Cash reimbursed by Overseas buyer (₹12,00,000 x 50%)		6,00,000
Cash profit earned during the month of April, 2016 by Shiva Ltd. (See Note)		<u>3,60,000</u>
		21,60,000
Less: Expenses on sale of department to overseas buyer	12,00,000	
Share of profit (for April, 2016) paid to Overseas buyer (W.N.4)	<u>1,44,000</u>	<u>(13,44,000)</u>
Cash and bank balances as on 30 th April, 2016 of Shiva Ltd.		<u>8,16,000</u>

*Note: In the absence of the information in the question regarding exchange rate of Singapore \$ as on 30th April, 2016, it is assumed that the exchange rate on 30th April, 2016 is same as the exchange rate as on 31st March, 2016 (as given in the question).

3. Calculation of gain on sale of department and discharge of purchase consideration

	₹
Purchase consideration	30,00,000
Less: Net assets sold	<u>(13,50,000)</u>
Gain on sale of department transferred to capital reserve	<u>16,50,000</u>
Purchase consideration	30,00,000
Less: Discharged by issue of Overseas Buyer's Equity shares of ₹ 15,00,000 at 20% premium	<u>(18,00,000)</u>
Balance discharged in cash i.e. (12,00,000/50) = Singapore \$ 24,000	<u>12,00,000</u>

4. Profit earned during the month of April, 2016

	₹
Total profit earned by Shiva Ltd. during the month of April, 2016	3,60,000

Less: 40% Profit of the sold department	<u>(1,44,000)</u>
Profit of Shiva Ltd. on the retained department	<u>2,16,000</u>

5. Patents, trademarks and copyrights written off

	₹
Patents, trademarks and copyrights as per balance sheet of Shiva Ltd.	9,00,000
Less: Patents, trademarks and copyrights taken over by Overseas buyer	<u>(5,25,000)</u>
Patents, trademarks and copyrights written off (charged to Profit and Loss Account)	<u>3,75,000</u>

6. Land

	₹
Land as per balance sheet of Shiva Ltd.	10,50,000
Less: Land taken over by Overseas buyer	<u>(3,00,000)</u>
Book value of land retained by Shiva Ltd.	<u>7,50,000</u>
Revalued value (200% of book value)	<u>15,00,000</u>
Revaluation reserve (15,00,000-7,50,000)	7,50,000

7. Diminution in the market value of equity shares of Overseas Buyer

	₹
Nominal value of shares	<u>15,00,000</u>
Issued at 20% Premium	18,00,000
Market value of shares on 30 th April, 2016 is 95% of nominal value (15,00,000 x 95%)	<u>14,25,000</u>
Diminution charged to Profit and Loss Account	<u>3,75,000</u>

Question 3

On 31st March, 2016 the balance sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Liabilities	H Ltd.	S Ltd.
	(₹ in lakhs)	(₹ in lakhs)
Share capital:		
Authorized	<u>15,000</u>	<u>6,000</u>
Issued and subscribed:		
Equity shares of ₹ 10 each fully paid up	12,000	4,800
General reserve	2,784	1,380

Profit and loss account	2,715	1,620
Bills payable	372	160
Sundry creditors	1,461	854
Provision for taxation	855	394
Proposed dividend	<u>1,200</u>	<u>-</u>
	<u>21,387</u>	<u>9,208</u>
Assets:	H Ltd.	S Ltd.
	(₹ in lakhs)	(₹ in lakhs)
Land and buildings	2,718	-
Plant and machinery	4,905	4,900
Furniture and fittings	1,845	586
Investment in shares in S Ltd.	3,000	-
Stock	3,949	1,956
Debtors	2,600	1,363
Cash and Bank Balances	1,490	204
Bills Receivables	360	199
Sundry Advances	<u>520</u>	<u>-</u>
	<u>21,387</u>	<u>9,208</u>

The following information is also provided to you:

- H Ltd. purchased 180 lakhs shares in S Ltd. on 1st April, 2015 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakhs and ₹ 1,200 lakhs respectively.
- On 4th July, 2015, S Ltd. declared a dividend of @ 20% for the year ended 31st March, 2015. H Ltd. credited the dividend received to its profit and loss account.
- On 1st November, 2015, S Ltd. issued, 3 fully paid-up shares for every 5 shares held, as bonus shares, out of balances to its General Reserve as on 31st March, 2015.
- On 31st March, 2016 all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakhs of these acceptances in hand, the rest having been endorsed in favour of its creditors.
- On 31st March, 2016, S Ltd.'s stock included goods which it had purchased for ₹ 100 lakhs from H Ltd. which made a profit @ 25% on cost.

Prepare a consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2016. Workings should form part of your answer. (16 Marks)

Answer

**Consolidated Balance Sheet of H Ltd.
and its subsidiary S Ltd. as on 31st March, 2016**

Particulars	Note No.	(₹ in lakhs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159
(2) Minority Interest [W.N.6]		3,120
(3) Current Liabilities		
(a) Trade payables (1,461 + 854)		2,315
(b) Short term provisions	3	2,449
(c) Other current liabilities	4	487
Total		27,530
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	5	14,954
(2) Current assets		
(a) Inventories	6	5,885
(b) Trade receivables (2,600 + 1,363)		3,963
(c) Cash and cash equivalents (1,490 + 204)		1,694
(d) Short term loans and advances		520
(e) Other current assets	7	514
Total		27,530

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	Authorised		<u>15,000</u>
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up		12,000

2.	Reserves and surplus			
	Capital Reserve (Note 5)		1,320	
	Consolidated General Reserve (W.N. 8)		2,892	
	Consolidated Profit and Loss Account:		<u>2,947</u>	7,159
3.	Short term provisions			
	Provision for Taxation			
	H Ltd.	855		
	S Ltd.	<u>394</u>	1,249	
	Proposed Dividend			
	H Ltd.		<u>1,200</u>	2,449
4.	Other current liabilities			
	Bills Payable			
	H Ltd.		372	
	S Ltd.		<u>160</u>	
			532	
	Less: Mutual owing		<u>(45)</u>	487
5.	Tangible assets			
	Land and Buildings			
	H Ltd.		2,718	
	Plant and Machinery			
	H Ltd.	4,905		
	S Ltd.	<u>4,900</u>	9,805	
	Furniture and Fittings			
	H Ltd.	1,845		
	S Ltd.	<u>586</u>	<u>2,431</u>	14,954
6.	Inventories			
	Stock			
	H Ltd.		3,949	
	S Ltd.		<u>1,956</u>	
			5,905	
	Less: Unrealised profit		<u>(20)</u>	5,885
7.	Other current assets			
	Bills Receivable			

H Ltd.	360		
S Ltd.	<u>199</u>		
	559		
Less: Mutual Owing	<u>(45)</u>		<u>514</u>

Working Notes:**Share holding pattern of S Ltd.**

Shares as on 31.03.2016 (Includes bonus shares issued on 01.11.2015)	480 lakh shares (4,800 lakhs / ₹ 10)
H Ltd's holding as on 01.04.2015	180 lakhs
Add: Bonus received on 01.11.2015	108 lakhs (180 / 5 × 3)
Total H Ltd's holding as on 31.03.2016	288 lakhs i.e. 60 % [288 / 480 × 100]
Minority Shareholding	40%

1. S Ltd.'s General Reserve Account

₹ in lakhs		₹ in lakhs	
To Bonus to Equity Shareholders	1,800	By Balance b/d	3,000
To Balance c/d	1,380	By Profit and Loss A/c	180
		(Balancing figure)	
	<u>3,180</u>		<u>3,180</u>

2. S Ltd.'s Profit and Loss Account

	₹ in lakhs		₹ in lakhs
To General Reserve [WN 1]	180	By Balance b/d	1,200
To Dividend paid (20% on ₹ 3,000 lakhs)	600	By Net Profit for the year*	1,200
To Balance c/d	<u>1,620</u>	(Balancing figure)	
	<u>2,400</u>		<u>2,400</u>

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs have been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60% (General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	<u>(720)</u>
Share of Minority Shareholders (40%)	<u>480</u>

Note: The question can also be solved by taking ₹ 1,080 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 – ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (₹ 1,200 – ₹ 600)	<u>600</u>
	<u>1,800</u>

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

	₹ in lakhs
Paid up value of shares held (60% of ₹ 4,800)	2,880
Add: Share in capital profits [WN 4]	<u>1,080</u>
	3,960
Less: Cost of shares less dividend received (₹ 3,000 – ₹ 360)	<u>(2,640)</u>
Capital reserve	<u>1,320</u>

6. Calculation of Minority Interest

	₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	<u>720</u>
	<u>3,120</u>

7. Unrealised profit in respect of inventory

$$₹ 100 \text{ lakhs} \times \frac{25}{125} = ₹ 20 \text{ lakhs}$$

8. Consolidated General Reserve Account

	₹ in lakhs
H Ltd.	2,784
Add: Share in post-acquisition General Reserve of S Ltd.	<u>108</u>
	<u>2,892</u>

9. Consolidated Profit and Loss Account

	₹ in lakhs
H Ltd.	2,715
Less: Dividend wrongly credited	<u>(360)</u>
Add: Share in post-acquisition General Reserve of S Ltd.	612
Less: Unrealised Profit $\frac{100}{125} \times 25$	<u>(20)</u>
	<u>2,947</u>

Question 4

- (a) PIR Ltd. and its subsidiary MAS Ltd. get their supply of some essential raw material from DSS Ltd. To coordinate their production on a more profitable basis PIR Ltd and MAS Ltd* agree between themselves each to acquire a quarter of shares in others Authorised Capital by means of exchange of shares. The terms are as follows:
- PIR Ltd. shares are quoted in the stock exchange at ₹ 10. The value to be taken for this purpose was either the quoted price or on the basis of balance sheet valuation, whichever is higher.
 - DSS Ltd. shares which are not quoted in stock exchange are to be considered on the yield basis or Balance Sheet basis, whichever is higher.
 - The future profits are estimated @ ₹ 2,10,000 subject to one third to be retained for the development purposes. The shares of the similar company yield 8%.
 - Freehold properties of DSS Ltd. are to be valued @ ₹ 8,60,000.
 - No cash is to pass and the balance due on settlement is to be treated as loan between the two companies.

* P.S. : Read MAS Ltd. as DSS Ltd.

The summarised Balance Sheets of the companies at the relevant date stood as follows:

PARTICULARS	PIR Ltd.	MAS Ltd.	DSS Ltd.
EQUITY & LIABILITIES			
Share Capital			
Authorised Equity Share Capital	24,00,000	10,00,000	20,00,000
Issued & Paid up Equity Share Capital @ 10 each	16,00,000	10,00,000	15,00,000
Reserves & Surplus			
Security Premium	1,60,000		
Profit & Loss	4,40,000	4,20,000	4,00,000
Non-Current Liabilities			
7% Debentures	6,00,000		
Current Liabilities			
Current Liabilities	5,60,000	3,60,000	4,20,000
Proposed Dividend	2,00,000	1,00,000	
	35,60,000	18,80,000	23,20,000
ASSETS			
Non-current Assets			
Freehold properties	13,20,000	5,80,000	6,60,000
Plant & Machinery	9,00,000	8,20,000	8,80,000
Investments	9,20,000		
80,000 shares in MAS Ltd.			
Current Assets			
Current Assets	4,20,000	4,80,000	7,80,000
	35,60,000	18,80,000	23,20,000

You are required to compute the value of the shares according to the terms of the agreement and to present the final settlement showing all the necessary workings.

(12 Marks)

- (b) Glory Finance Ltd. is non-banking finance company. The extracts of its balance sheet are given below:

Liabilities	₹ in '000	Assets	₹ in '000
Paid-up equity capital	100	Leased out assets	800

Free reserve	500	Investments:	
Loans	400	In shares of subsidiaries	100
Deposits	400	In debentures of subsidiaries	100
		Cash and bank balances	200
		Deferred expenditure	200
	1,400		1,400

Compute "Net Owned Fund" of Glory Ltd. as per NBFC (Deposit Accepting or Holding) Companies Prudential Norms (RBI) Directions, 2007. (4 Marks)

Answer

(a) Statement showing value of a share on Balance Sheet basis

Particulars	PIR Ltd. ₹	MAS Ltd. ₹	DSS Ltd. ₹
A. Total Assets i.e. at Current Values:			
Freehold properties	13,20,000	5,80,000	8,60,000
Plant & Machinery	9,00,000	8,20,000	8,80,000
Investment in MAS Ltd. (4/5 of its Net Assets i.e. ₹ 14,20,000)	11,36,000	-	-
Current Assets	4,20,000	4,80,000	7,80,000
	37,76,000	18,80,000	25,20,000
B. Outside liabilities:			
7% Debentures	6,00,000	-	-
Current Liabilities	5,60,000	3,60,000	4,20,000
Proposed Dividend	2,00,000	1,00,000	-
	13,60,000	4,60,000	4,20,000
C. Net Assets [A - B]	24,16,000	14,20,000	21,00,000
D. No. of Shares	1,60,000	1,00,000	1,50,000
E. Balance sheet Value per share	15.10	14.20	14.00

Valuation of DSS Ltd.'s shares on yield basis

Estimated annual future profits (Assumed to be of DSS Ltd.)	2,10,000
Less: 1/3 retained for development purposes	(70,000)
Distributable Profits	1,40,000
Earning Rate [(₹ 1,40,000 / ₹ 15,00,000) x 100]	9.33%
Normal Rate of Yield	8%

$$\text{Value per share on yield basis} = \left[\frac{\text{Earning Rate}}{\text{Normal Rate}} \times \text{Paid up Value} \right] = \frac{9.33\%}{8\%} \times 10 = ₹ 11.67$$

Value taken as per agreement for exchange of shares between PIR Ltd. and DSS Ltd.

PIR Ltd.:

₹ 15.10 per share, being the amount of Balance Sheet value, higher than the quoted value of ₹ 10.00 per share.

DSS Ltd.:

₹ 14.00 per share being the amount of Balance Sheet value, higher than the yield value of ₹ 11.67 per share.

Statement of Settlement

	₹
Shares issued by PIR Ltd. to DSS Ltd. - 60,000 shares @ ₹ 15.10 per share	9,06,000
Shares issued by DSS Ltd. to PIR Ltd. - 50,000 shares @ ₹ 14.00 per share	<u>7,00,000</u>
Loan by PIR Ltd. to DSS Ltd.	<u>2,06,000</u>

Note: In the absence of the information, shares of MAS Ltd. has been valued on net asset basis for the purpose of valuation of investment of PIR Ltd. Alternatively, the investment of PIR Ltd. in the shares of MAS Ltd. may be valued on cost basis i.e. at ₹ 9,20,000. In such a case, the Balance sheet value of PIR Ltd. will be ₹ 13.75 per share and exchange of shares for settlement and amount of loan will be as follows:

Statement of Settlement

	₹
Shares issued by PIR Ltd. to DSS Ltd. - 60,000 shares @ ₹ 13.75 per share	8,25,000
Shares issued by DSS Ltd. to PIR Ltd. - 50,000 shares @ ₹ 14.00 per share	7,00,000
Loan by PIR Ltd. to DSS Ltd.	1,25,000

(b) Statement showing computation of 'Net Owned Fund'

		₹ in 000
Paid up Equity Capital		100
Free Reserves		<u>500</u>
		600
Less: Deferred expenditure		<u>(200)</u>
	A	<u>400</u>
Investments		
In shares of subsidiaries and group companies		100
In debentures of subsidiaries and group companies		<u>100</u>
	B	<u>200</u>
10% of A		40
Excess of Investment over 10% of A (200 – 40)	C	160
Net Owned Fund [(A) - (C)] (400 – 160)		240

Question 5

- (a) From the following Value Added Statement prepare the Statement of Profit & Loss of Value Ltd. for the year ending 31/03/2016:

Statement of Gross Value Added of the Value Ltd. for the year ending 31/03/2016

Particulars	Amount (₹)	Amount (₹)
Sales		30,56,000
Less: Bought in cost for Material & Services:		
Decrease in stock	16,000	
Purchases	15,20,000	
Manufacturing & Other expenses	75,000	
Electricity	56,500	
Interest on working capital loan	25,600	(16,93,100)
		13,62,900
Add: Other Income		23,100
Gross Value Added		13,86,000
Gross Value Applied		
To Employees		
Wages & Salaries	4,35,000	

Director sitting fee & remuneration	<u>25,000</u>	4,60,000
To Government		
Cess & Taxes	5,000	
Provision for Income Tax	<u>35,000</u>	40,000
To Capital Provider		
Finance charges	3,75,000	
Proposed Dividend	<u>1,00,000</u>	4,75,000
Towards Renewals & Replacements		
Depreciation	1,22,000	
Debenture Redemption Reserve	2,00,000	
General Reserve	1,00,000	
Retained Profit	<u>(11,000)</u>	4,11,000
Gross Value Applied		<u>13,86,000</u>

Closing Stock as on Balance Sheet date was ₹ 40,000

Profit & Loss account at the beginning of the financial year was ₹ 1,25,000 (8 Marks)

- (b) Explain major changes in Ind AS 24 (Related Party Disclosures) vis-a-vis Notified Accounting Standard (AS 18). (8 Marks)

Answer

- (a) Statement of Profit and Loss of Value Ltd. for the year ended 31st March, 2016

Income	Notes	Amount (₹)	Amount (₹)
Sales			30,56,000
Other Income			<u>23,100</u>
			30,79,100
Expenditure			
Production and Operational Expenses	1	21,07,500	
Administration Expenses	2	25,000	
Interest and Other Charges	3	4,00,600	
Depreciation		<u>1,22,000</u>	<u>26,55,100</u>
Profit before Income Tax			4,24,000
Provision for taxes			<u>(35,000)</u>
			3,89,000

Balance as per Last Balance Sheet		<u>1 25,000</u>
		5,14,000
Transferred to:		
General Reserve	1,00,000	
Debenture Redemption Reserve	2,00,000	
Proposed Dividend	<u>1,00,000</u>	4,00,000
Surplus Carried to Balance Sheet (1,25,000 – 11,000)		<u>1,14,000</u>
		<u>5,14,000</u>

Notes:

(1)	Production and Operational Expenses	(₹)
	Decrease in Stock	16,000
	Purchase of Materials	15,20,000
	Manufacturing and other expenses	75,000
	Electricity	56,500
	Cess and Taxes	5,000
	Wages and Salaries	<u>4,35,000</u>
		<u>21,07,500</u>
(2)	Administration expenses include Director's sitting fee and remuneration of ₹ 25,000.	
(3)	Interest and Other Charges:	(₹)
	Finance charges	3,75,000
	Interest on Working Capital Loans	<u>25,600</u>
		<u>4,00,600</u>

Note: Since Decrease in stock has been given, closing stock is not required to be shown in the Statement of Profit and Loss.

(b) Major Changes in Ind AS 24 vis-à-vis Notified AS 18

- (i) **Definition of Relative:** Existing AS 18 uses the term "relatives of an individual", whereas Ind AS 24 uses the term "a close member of the family of a person".

Existing AS 18 covers the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

However, definition of close members of family as per Ind AS 24 includes those family members, who may be expected to influence, or be influenced by, that person in their dealings with the entity, including:

- (a) that person's children, spouse or domestic partner, brother, sister, father and mother;
- (b) children of that person's spouse or domestic partner; and
- (c) dependents of that person or that person's spouse or domestic partner.

Hence, the definition as per Ind AS 24 is much wider.

- (ii) **State Controlled Enterprise:** Existing AS-18 defines state-controlled enterprise as "an enterprise which is under the control of the Central Government and/or any State Government(s)". However, in Ind AS 24, there is extended coverage of Government Enterprises, as it defines a government-related entity as "an entity that is controlled, jointly controlled or significantly influenced by a government." Further, "Government refers to government, government agencies and similar bodies whether local, national or international."
- (iii) **Key Management Personnel:** Existing AS 18 covers key management personnel (KMP) of the entity only, whereas, Ind AS 24 covers KMP of the parent as well. Ind AS 24 also covers the entity, or any member of a group of which it is a part, providing key management personnel services to the reporting entity or to the parent of the reporting entity
- (iv) **Related Parties in case of Joint Venture:** Under Ind AS 24 there is extended coverage in case of joint ventures. Two entities are related to each other in both their financial statements, if they are either co-venturers or one is a venturer and the other is an associate. Whereas as per existing AS 18, co-venturers or co-associates are not related to each other.
- (v) **Effect of influences which do not lead to transactions:** Existing AS 18 mentions that where there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required whereas Ind AS 24 does not specifically mention this.
- (vi) **Post-employment Benefits:** Existing AS 18 does not specifically cover entities that are post-employment benefit plans, as related parties. However, Ind AS 24 specifically includes post-employment benefit plans for the benefit of employees of an entity or its related entity as related parties.
- (vii) **Next Most Senior Parent:** Ind AS 24 requires an additional disclosure as to the name of the next most senior parent which produces consolidated financial statements for public use, whereas the existing AS 18 has no such requirement.

- (viii) *Disclosure for Compensation:* Ind AS 24 requires extended disclosures for compensation of KMP under different categories, whereas the existing AS 18 does not specifically require.
- (ix) *Disclosure of 'Amount of the Transactions' vs 'Volume of the Transactions:* Ind AS 24 requires "the amount of the transactions" need to be disclosed, whereas existing AS 18 gives an option to disclose the "Volume of the transactions either as an amount or as an appropriate proportion".
- (x) *Government Related Entities:* Ind AS 24 requires disclosures of certain information by the government related entities, whereas the existing AS 18 presently exempts the disclosure of such information.
- (xi) *Clarification of Control, Substantial Interest and Significant Influence:* Existing AS 18 includes definition and clarificatory text, primarily with regard to control, substantial interest (including 20% threshold), significant influence (including 20% threshold). However, Ind AS 24 neither defines these terms nor it includes such clarificatory text and allows respective standards to deal with the same.

Note: Any eight points out of the above eleven points may be answered for 8 Marks.

Question 6

- (a) *At the beginning of year 1, an enterprise grants 300 options to each of its 1,000 employees. The contractual life of option granted is 6 years.*

Other relevant information is as follows:

<i>Vesting Period</i>	<i>3 years</i>
<i>Exercise Period</i>	<i>3 years</i>
<i>Expected Life</i>	<i>5 years</i>
<i>Exercise Price</i>	<i>₹ 50</i>
<i>Market Price</i>	<i>₹ 50</i>
<i>Expected forfeitures per year</i>	<i>3%</i>

The option granted vest according to a graded schedule of 25% at the end of the year 1, 25% at the end of the year 2, and the remaining 50% at the end of the year 3.

You are required to calculate total compensation expenses for the options expected to vest and cost and cumulative cost to be recognised at the end of all the 3 years assuming that expected forfeiture rate does not change during the vesting period when,

- (i) *The fair value of these options, computed based on their respective expected lives, are ₹ 10, ₹ 13, ₹ 15 per options, respectively.*
- (ii) *The intrinsic value of the options at the grant date is ₹ 6 per options.* (10 Marks)

- (b) You are required to calculate the Economic Value Added by using the following information of Balak Ltd.

Equity shares of ₹ 100 each	₹ 45, 00,000	
Reserves and Surplus	₹ 35, 00,000	
10% Debentures of ₹ 100 each	₹ 60,00,000	
Dividend Expectations of equity shareholders	16%	
Prevailing corporate tax rate	30%	
Financial Leverage	1.2 times	(6 Marks)

Answer

- (a) (i) Based on Fair Value Method

- Since the options granted have a graded vesting schedule, the enterprise segregates the total plan into different groups, depending upon the vesting dates and treats each of these groups as a separate plan.
- The enterprise determines the number of options expected to vest under each group as below:

Vesting Date (Year-end)		Options expected to vest
1	300 options x 1,000 employees x 25% x 0.97	72,750 options
2	300 options x 1,000 employees x 25% x 0.97 x .97	70,568 options
3	300 options x 1,000 employees x 50% x 0.97x .97 x .97	<u>1,36,901 options</u>
Total options expected to vest		<u>2,80,219 options</u>

- Total compensation expense for the options expected to vest is determined as follows:

Vesting Date (Year-end)	Expected Vesting (No. of Options)	Fair Value per Option (₹)	Compensation Expense (₹)
1	72,750	10	7,27,500
2	70,568	13	9,17,384
3	<u>1,36,901</u>	15	<u>20,53,515</u>
	<u>2,80,219</u>		<u>36,98,399</u>

- Compensation expense, determined as above, is recognised over the respective vesting periods. Total compensation expense of ₹ 36,98,399, determined at the grant date, is attributed to the years 1, 2 and 3 as below:

Vesting Date (End of year)	Cost to be recognized		
	Year 1	Year 2	Year 3
1	7,27,500		
2	4,58,692	4,58,692	
3	<u>6,84,505</u>	<u>6,84,505</u>	<u>6,84,505</u>
Cost for the year	<u>18,70,697</u>	<u>11,43,197</u>	<u>6,84,505</u>
Cumulative cost	18,70,697	30,13,894	36,98,399

(ii) Based on Intrinsic Value Method

In case of intrinsic value method, total compensation expense for the options expected to vest would be

Vesting Date (End of year)	Expected Vesting (No. of Options)	Value per Option (₹)	Compensation Expense (₹)
1	72,750	6	4,36,500
2	70,568	6	4,23,408
3	<u>1,36,901</u>	6	<u>8,21,406</u>
	<u>2,80,219</u>		<u>16,81,314</u>

Total compensation expense of ₹ 16,81,314, determined at the grant date, would be attributed to the years 1, 2 and 3 as below:

Vesting Date (End of year)	Cost to be recognized		
	Year 1	Year 2	Year 3
1	4,36,500		
2	2,11,704	2,11,704	
3	<u>2,73,802</u>	<u>2,73,802</u>	<u>2,73,802</u>
Cost for the year	<u>9,22,006</u>	<u>4,85,506</u>	<u>2,73,802</u>
Cumulative cost	9,22,006	14,07,512	16,81,314

(b) Computation of EVA

	(₹ in lakhs)
Net profit after tax (Refer Working Note 1)	21.00
Add: Interest adjusted for tax effect ($60 \times 10\% \times 0.70$)	<u>4.20</u>
Return to Providers of Funds	25.20
Less: Cost of Capital (Refer Working Note 2)	<u>(17.00)</u>
Economic Value Added (EVA)	<u>8.20</u>

Working Notes:**1. Interest and Net Profit**

$$\text{Financial Leverage} = \frac{\text{Profit before Interest \& Taxes (PBIT)}}{\text{Profit before Tax (PBT)}}$$

$$\text{Interest on Borrowings} = ₹ 60,00,000 \times 10\% = ₹ 6 \text{ lakhs}$$

$$\text{Therefore, } 1.20 = \frac{\text{PBIT}}{\text{PBIT} - \text{Interest}}$$

$$1.20 = \frac{\text{PBIT}}{\text{PBIT} - 6}$$

$$1.20 (\text{PBIT} - 6) = \text{PBIT}$$

$$1.20 \text{ PBIT} - 7.2 = \text{PBIT}$$

$$1.20 \text{ PBIT} - \text{PBIT} = 7.2$$

$$0.20 \text{ PBIT} = 7.2$$

$$\text{PBIT} = 7.2 / 0.20$$

$$\text{PBIT} = ₹ 36 \text{ Lakhs}$$

$$\text{PBT} = \text{PBIT} - \text{I} = 36 - 6 = ₹ 30 \text{ lakhs}$$

$$\text{Less: Tax (30\%)} = ₹ 9 \text{ lakhs}$$

$$\text{Net profit after tax} = ₹ 21 \text{ lakhs}$$

2. Cost of Capital

	(₹ in lakhs)
Equity Shareholders' funds (45 + 35)	80
10% Debenture holders' funds	<u>60</u>
Total	<u>140</u>
Weights assigned to Equity shareholders fund = $\frac{80}{140} = 0.5714$	
Weights assigned to Debenture holders = $\frac{60}{140} = 0.4286$	

Source of Funds (1)	Amount ₹ (in lakhs) (2)	Weight (3)	Cost % (4)	WACC % (5) = (3 × 4)%
Equity share holders' funds	80	0.5714	16.00	9.14

Debenture holders' funds	<u>60</u>	<u>0.4286</u>	<u>7.00*</u>	<u>3.00</u>
Total	<u>140</u>	<u>1.0000</u>	<u>----</u>	<u>12.14</u>

Cost of Capital = Average Capital Employed × Weighted Average cost of Capital (WACC)

= ₹ 140 lakhs × 12.14% = ₹ 16.996 lakhs or ₹ 17 lakhs.

Question 7

Answer any *four* parts out of five:

- (a) Explain the conditions required to be met for a Financial Asset to be measured at Amortized Cost (applicable to Debt Instruments only).

X Company invested in Equity Shares of another entity on 15th March, 2016 for ₹ 1,00,000. Transaction Cost = ₹ 2,000 (not included in ₹ 1,00,000). Fair value on Balance Sheet date i.e. 31st March 2016 = ₹ 1,20,000.

Pass necessary Journal entries (narration not required) if Financial Asset to be accounted as Fair Value Through Other Comprehensive Income (FVTOCI).

- (b) From the following details of Jubilee Ltd. for the year ended 31.3.2016, calculate the deferred tax asset / liability as per AS 22 and amount of tax to be debited to Profit and Loss Account for the year ended 31.3.2016.

Particulars	₹
Accounting profit	15,00,000
Book profit as per MAT	8,75,000
Profit as per Income-tax Act	1,50,000
Tax rate	30%
MAT rate	7.50%

(4 Marks)

- (c) Look-Like Investments Ltd. deals in Equity Derivatives. Their current portfolio comprises of the following instruments:

K-Tech ₹ 2800 Call Expiry June 2016, 1000 unit bought at ₹ 167 each (cost)

K- Tech ₹ 2900 Call Expiry June 2016, 1800 unit bought at ₹ 103 each (cost)

K-Tech ₹ 2700 Put Expiry June 2016, 2000 unit bought at ₹ 68 each (cost).

What will be the profit or loss to Look-Like Investments Ltd. in the following situations?

*Rate of interest net of corporate tax of 30%.

(i) K-Tech closes on the expiry day at ₹ 3,020

(ii) K-Tech closes on the expiry day at ₹ 2,900

(iii) K-Tech closes on the expiry day at ₹ 2,540

(4 Marks)

(d) Astro Corporation is dealing in seasonal products. The following is the quarterly sales pattern of the product:

Quarter 1	II	III	IV
Ending 31 st March 20%	30 th June 20%	30 th September 50%	31 st December 25%*

For the first quarter ending 31st March, 2016, Astro Corporation gives you the following information:

	₹ in crores
Sales	100
Salary and other expenses	60
Advertisement expenses (routine)	4
Administrative and selling expenses	8

While preparing interim financial report for the first quarter, Astro Corporation wants to defer ₹ 42 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure, considering the seasonal nature of business. The expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per AS 25 and comment on the Astro Corporation view.

(4 Marks)

(e) Nirman Solutions incurred costs to develop and produce a routine, low risk computer software product, as follows, as on 31st March, 2016:

Completion of detailed program design	₹15,00,000
Costs incurred for coding and testing to establish technological feasibility	₹ 8,00,000
Other coding and testing costs after establishment of technological feasibility	₹ 6,50,000
Cost of producing product masters for training materials	₹ 4,20,000

* P.S. : Read 25% as 10%.

Duplication of computer software and training materials from Product masters (5000 units)	₹ 2,50,000
Packaging product (2500 units)	₹ 1,50,000

- (i) What amount should be capitalized as software cost, subject to amortization of Nirman Solutions as on 31st March, 2016.
- (ii) What amount should be reported in Inventory of Nirman Solutions as on 31st March, 2016. (4 x 4 = 16 Marks)

Answer

- (a) A financial asset shall be measured at amortised cost if both of the following conditions are met:

- A. The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows;
- B. The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

Journal Entries

Date	Particulars		₹	₹
15/3/2016	Investment A/c Dr. To Bank		1,02,000	1,02,000
31/3/2016	Investment A/c Dr. To Fair Value Gain A/c		18,000	18,000
31/3/2016	Fair Value Gain A/c Dr. To OCI A/c		18,000	18,000
31/3/2016	OCI A/c Dr. To Fair Value Reserve A/c		18,000	18,000

- (b) Tax as per accounting profit $15,00,000 \times 30\% = ₹ 4,50,000$

Tax as per Income-tax Profit $1,50,000 \times 30\% = ₹ 45,000$

Tax as per MAT $8,75,000 \times 7.50\% = ₹ 65,625$

Tax expense = Current Tax + Deferred Tax

₹ 4,50,000 = ₹ 45,000 + Deferred tax

Therefore, Deferred Tax liability as on 31.03.2016 = ₹ 4,50,000 – ₹ 45,000 = ₹ 4,05,000

Amount of tax to be debited in Profit and Loss account for the year 31.03.2016

Current Tax + Deferred Tax liability + Excess of MAT over current tax

$$= ₹ 45,000 + ₹ 4,05,000 + (₹ 65,625 - ₹ 45,000) = ₹ 4,70,625$$

Note: Since payment of tax under MAT is a current tax, alternatively, amount of tax to be debited in Profit and Loss account for the year 31.03.2016 may be calculated as follows:

$$= \text{Current Tax (MAT) + Deferred Tax liability}$$

$$= ₹ 65,625 + ₹ 4,05,000 = ₹ 4,70,625.$$

(c) Calculation of Profit or Loss to Look – Like Investments Ltd.

When the market price at the end of expiry day is more than the exercise price under the call option, the call option will be exercised. However, put option will not be exercised.

When the market price at the end of expiry day is less than the exercise price under the call option, the call option will not be exercised. However, put option will be exercised.

Instrument	Units	Premium per unit (₹)	Price Strike (₹)	Gross Profit at Closing Prices		
				(i) At ₹ 3,020	(ii) At ₹ 2,900	(iii) At ₹ 2,540
2,800 Call	1,000	167	2,800	220	100	NIL
2,900 Call	1,800	103	2,900	120	NIL	NIL
2,700 Put	2,000	68	2,700	NIL	NIL	160
Instrument	Profit/ (Loss) per unit			Profit / (Loss) in Amount		
	Closing Prices			Closing Prices		
	(i) At ₹ 3,020	(ii) At ₹ 2,900	(iii) At ₹ 2,540	(i) At ₹ 3,020	(ii) At ₹ 2,900	(iii) At ₹ 2,540
2,800 Call	53	(67)	(167)	53,000	(67,000)	(1,67,000)
2,900 Call	17	(103)	(103)	30,600	(1,85,400)	(1,85,400)
2,700 Put	(68)	(68)	92	<u>(1,36,000)</u>	<u>(1,36,000)</u>	<u>1,84,000</u>
				<u>(52,400)</u>	<u>(3,84,400)</u>	<u>(1,68,400)</u>

(d) Calculation of the result of first quarter as per AS 25

Particulars	(₹ in crores)	
Result of first quarter ending 31 st March, 2016		
Turnover		100

Other Income		<u>Nil</u>
Total (a)		<u>100</u>
Less: Changes in inventories		Nil
Salaries and other expenses		60
Administrative and selling expenses (4 + 8)		<u>12</u>
Total (b)		<u>72</u>
Profit (a)-(b)		28

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

- (i) it is appropriate to anticipate that type of cost at the end of the financial year, and
- (ii) costs are incurred unevenly during the financial year of an enterprise.

The expenditure of ₹ 42 crores made in the first quarter shall be charge in that quarter only i.e. when they are earned and incurred. Therefore, the argument given by Astro Corporation relating to deferment of ₹ 42 crore is not tenable as expenditures are uniform throughout all quarters.

- (e) (i) As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility has been established for the product. Technological feasibility has been established upon completion of detailed program design or working model. In this case, ₹ 23,00,000 would be recorded as an expense (₹ 15,00,000 for completion of detailed program design and ₹ 8,00,000 for coding and testing to establish technological feasibility). Cost incurred from the point of technological feasibility until the time when products costs are incurred are capitalized as software cost. In this situation, ₹ 10,70,000 (i.e. ₹ 6,50,000 + ₹ 4,20,000) will be capitalized as the cost of the software.
- (ii) The cost of duplication of computer software and training materials from product masters (5,000 units) amounting ₹ 2,50,000 and packaging product (2,500 units) amounting ₹ 1,50,000 should be reported as inventory cost as on 31st March, 2016 i.e. inventory value is total of ₹ 4,00,000.