

DISCLAIMER

The Suggested Answers hosted in the website do not constitute the basis for evaluation of the students' answers in the examination. The answers are prepared by the Faculty of the Board of Studies with a view to assist the students in their education. While due care is taken in preparation of the answers, if any errors or omissions are noticed, the same may be brought to the attention of the Director of Studies. The Council of the Institute is not in anyway responsible for the correctness or otherwise of the answers published herein.

PAPER – 1 : FINANCIAL REPORTING

Question No.1 is compulsory.

Answer any **five** questions from the remaining **six** questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Question 1

- (a) J Ltd. purchased a machine from K Ltd. on 31-08-2012. Quoted price was ₹ 275 lakhs. The vendor offers 2% trade discount. Sales tax on quoted price is 6%. J Ltd. spent ₹ 60,000 for transportation and ₹ 45,000 for architect's fees. They borrowed money from HDFC Bank of ₹ 250 lakhs for acquisition of asset @ 15% p.a. They also spent ₹ 15,000 for material, ₹ 10,000 for labour and ₹ 4,000 as overheads during trial run of the machine. The machine was ready for use on 15-01-2013 but it was put to use on 15-3-2013. Find out the original cost of the machine. Also suggest the accounting treatment for the cost incurred during the period between the date the machine was ready for use and the date on which it was actually put to use.
- (b) A Ltd. had acquired 80% shares in the B Ltd. for ₹ 15 lakhs. The net assets of B Ltd. on that day are ₹ 22 lakhs. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.
- (c) On 1st January, 2011, Santa Ltd. sold equipment for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for ten years term. The economic life of the asset is estimated as 10 years. The minimum lease rents payable by the lessee has been fixed at ₹ 1,00,000 payable annually beginning from 31st December, 2011. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% p.a. Calculate the net effect on the Statement of profit and loss in the books of Santa Ltd.
- (d) X Ltd. purchased a fixed asset four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs? (4 x 5 = 20 Marks)

Answer**(a) (i) Original cost of the machinery**

<i>Particulars</i>	<i>₹</i>
Quoted price	2,75,00,000
Less: Trade discount @ 2%	<u>(5,50,000)</u>
	2,69,50,000
Add: Sales Tax @ 6% on quoted price*	16,50,000
Transportation charges	60,000
Architect's Fees	45,000
Trial run expenses	29,000
(Material ₹ 15,000 + Labour ₹ 10,000 + Overheads ₹ 4,000)	
Finance cost (15% on ₹ 250 lakhs for the 4.5 months ie. for the period 01.9.12 to 15.1.13)	<u>14,06,250</u>
Total amount to be capitalised for machine	<u>3,01,40,250</u>

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

Finance cost amounting ₹ 6,25,000 i.e. 15% of ₹ 250 lakhs for 2 months ie. for the period 15.01.2013 to 15.03.2013 will be charged to statement of profit and loss as per AS 16 "Borrowing Costs".

(b) Calculation of Profit/Loss on disposal of investment in subsidiary

<i>Particulars</i>	<i>₹</i>
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd. (W.N.1)	<u>(28,00,000)</u>
	2,00,000
Add: Capital Reserve at the time of acquisition of shares in B Ltd. (W.N.2)	2,60,000
Profit on sale of investment	<u>4,60,000</u>

* In general practice, sales tax is calculated on amount arrived at after deduction of trade discount. However, sales tax has been computed on the basis of the requirement of the question i.e. sales tax is calculated on quoted price.

Working Notes:**1. A Ltd.'s share in net assets of B Ltd.**

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

2. Capital Reserve at time of acquisition of shares in B Ltd.

	₹
A Ltd.'s share in the net assets of B Ltd. on the date of acquisition (80% of ₹ 22 lakhs)	17,60,000
Less: Cost of investment	(15,00,000)
Capital Reserve at time of acquisition of shares in B Ltd.	2,60,000

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

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is ₹ 6,14,400 [$₹ 1,00,000 \times 6.144$ (Annuity factor of ₹ 1 @10% for 10 years)] and amounts to at least substantially all of the fair value (sale price ie. ₹ 6,14,460) of the leased equipment. Thus lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 5,14,460 (Sale value ₹ 6,14,460 less carrying amount ₹1,00,000) 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.

Therefore, assuming that depreciation is charged on straight line basis, Santa Ltd. will recognize depreciation of ₹ 61,446 per annum for 10 years ($₹ 6,14,460 / 10$) and amortise profit of ₹ 5,14,460 over the lease term of 10 years, i.e. ₹ 51,446 p.a. The net effect is a debit of ($₹ 61,446 - ₹ 51,446$) ₹ 10,000 p.a. to the Statement of profit and loss, for 10 years as covered under the lease term.

Note: Had there been no sale and lease back transaction, the Statement of profit and loss for each year (covered in the lease term) would have been charged by ($₹ 1,00,000/10$) ₹ 10,000, towards depreciation. Thus, the sale and lease back

transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.

(d) Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the fixed asset at the end of the fourth year on revaluation

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

Question 2

The summarized balance sheets of two companies, Major Ltd. and Minor Ltd. as at 31st December, 2012 are given below:

Particulars	Major Ltd.	Minor Ltd.
	₹	₹
Assets:		
Plant and Machinery	4,14,000	1,00,800
Furniture	14,000	9,200
18,000, Ordinary shares in Minor Ltd.	2,40,000	-
4,000, Ordinary shares in Major Ltd.	-	48,000
Stock in Trade	96,000	2,28,000
Sundry Debtors	1,40,000	1,70,000

Cash at Bank	34,000	26,000
	9,38,000	5,82,000
Liabilities:		
Ordinary shares of ₹10 each	3,60,000	2,00,000
7.5% Preference shares of ₹10 each	3,00,000	1,60,000
Reserves	52,000	60,000
Sundry Creditors	1,06,000	1,22,000
Profit and Loss account	1,20,000	40,000
	9,38,000	5,82,000

Major Ltd. acquired the shares of Minor Ltd. on 1st July, 2012. As on 31st December, 2011, the plant and machinery stood in the books at ₹1,12,000, the reserve at ₹60,000 and the profit and loss account at ₹16,000. The plant and machinery was revalued by Major Ltd. on the date of acquisition of shares of Minor Ltd. at ₹1,20,000 but no adjustments were made in the books of Minor Ltd.

On 31st December, 2011, the debit balance of profit and loss account was ₹45,500 in the books of Major Ltd.

Both the companies have provided depreciation on all their fixed assets at 10% p.a.

You are required to prepare a Consolidated Balance Sheet as on 31st December 2012 as per Revised Schedule VI. (16 Marks)

Answer

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

Particulars	Notes No.	₹
I. Equity and Liabilities		
(1) Shareholders' 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 (Preference dividend of Major Ltd.)		22,500
Total		12,45,200

II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	4	5,51,200
(2) Current assets		
(a) Inventories ₹ (96,000+2,28,000)		3,24,000
(b) Trade receivables ₹ (1,40,000+1,70,000)		3,10,000
(c) Cash & Cash equivalents ₹ (34,000+26,000)		60,000
Total		12,45,200

Notes to Accounts

			₹
1. Share Capital			
36,000 Equity shares of ₹ 10 each of Major Ltd.		3,60,000	
Less : Shares held by Minor Ltd.		<u>(40,000)</u>	
		3,20,000	
30,000, 7.5% Preference shares of ₹ 10 each fully paid of Major Ltd.		<u>3,00,000</u>	6,20,000
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
3. Minority Interest			
Preference shares of Minor Ltd.		1,60,000	
Preference dividend paid by Minor Ltd.		12,000	
Equity shares (10%)		20,000	

4.	Capital profit (W.N. iv)		11,264	
	Revenue profit (W.N. v)		<u>1,826</u>	2,05,090
	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

Working Notes:**(i) (a) Analysis of profits of Minor Ltd. (Pre-allocation of inter-company's share)**

	Capital Profit ₹	Revenue Profit ₹
Reserves	60,000	
Profit and Loss as on 1.1.2012	16,000	
Profit for the year (40,000 – 16,000)	24,000	
Less: Preference dividend (as per para 27 of AS 21)	<u>(12,000)</u>	
	<u>12,000</u>	6,000
Profit on upward revaluation (W.N. vii)	13,600	
Additional depreciation on upward revaluation (W.N. viii)		<u>(400)</u>
	<u>95,600</u>	<u>5,600</u>

(b) Analysis of Profits of Major Ltd.

	Capital Profit ₹	Revenue Profit ₹
Reserves during the year	26,000	26,000
Profit and Loss as on 1.1.2012	(45,500)	
Profit for the year (1,20,000 + 45,500)	1,65,500	
Less: Preference dividend	<u>(22,500)</u>	
	<u>1,43,000</u>	<u>71,500</u>
	<u>52,000</u>	<u>97,500</u>

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

$$a = 52,000 + \frac{9}{10} \left[95,600 + \frac{1}{9}a \right]$$

$$a = 52,000 + \frac{9}{10} \times \frac{8,60,400 + a}{9}$$

$$a = 52,000 + 86,040 + \frac{a}{10}$$

$$a - \frac{a}{10} = 1,38,040$$

$$9a = 13,80,400$$

$$a = \frac{13,80,400}{9}$$

$$a = 1,53,378$$

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

$$b = 1,12,642$$

(iii) Revenue profits of Major Ltd. and Minor Ltd. (post allocation of inter-company's share)

Suppose revenue profits of Major Ltd. = x

and revenue profits of Minor Ltd. = y

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

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

By solving the above equations (3) and (4) in line with the equations (1) and (2) of capital profit, we will get

$$x = 1,13,933 \text{ and } y = 18,259$$

		Major Ltd. ₹	Minor Ltd. ₹
(iv) Capital Profits			
	As per W.N.(ia) & (ib)	52,000	95,600
	Adjustment as per W.N.(ii) (1,53,378/9)	<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>
(v) Revenue Profits			
	As per W.N.(ia) & (ib)	97,500	5,600
	Adjustment as per W.N.(iii)	<u>(12,659)</u>	<u>12,659</u>
		84,841	18,259
	Minority interest of Minor Ltd.	-	<u>(1,826)</u>
	Share of Major Ltd. in Minor Ltd.	<u>16,433</u>	<u>16,433</u>
		<u>1,01,274</u>	
(vi) Cost of Control			
	(a) Cost of investment of Major Ltd. in Minor Ltd.		2,40,000
	Less: Paid up value of shares (18,000 x ₹ 10)	1,80,000	
	Capital Profits	<u>1,01,378</u>	<u>(2,81,378)</u>
	Capital Reserve		<u>41,378</u>
	(b) Cost of investment of Minor Ltd. in Major Ltd.		48,000
	Less: Paid up value of shares held		<u>(40,000)</u>
	Goodwill		<u>8,000</u>
(vii) Plant and Machinery as on 1.1.2012			1,12,000
	Less: Depreciation 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 and Machinery on 1.7.2012		<u>1,20,000</u>
	Profit on upward revaluation		<u>13,600</u>

(viii)	Additional depreciation on upward Revaluation of Plant and Machinery		
	Depreciation for remaining 6 months (1,20,000 x 10% x 6/12)		6,000
	Less: Depreciation already charged (1,12,000 x 10% x 6/12)		<u>(5,600)</u>
			<u>400</u>

Question 3

Sun Limited agreed to absorb Moon Limited on 31st March 2012 whose summarized Balance Sheet stood as follows:

Equity and Liabilities	₹	Assets	₹
Share capital		Fixed Assets	10,50,000
1,20,000 Shares of ₹10 each fully paid up	12,00,000	Investments	-
Reserves & Surplus		Current Assets,	
General reserve	1,50,000	Loans and Advances	
Secured Loan	-	Stock in Trade	1,50,000
Unsecured Loan	-	Sundry Debtors	3,00,000
Current Liabilities & Provisions			
Sundry Creditors	1,50,000		
	<u>15,00,000</u>		<u>15,00,000</u>

The consideration was agreed to be paid as follows:

- A payment in cash of ₹5 per share in Moon Ltd. and
- The issue of shares of ₹10 each in Sun Ltd. on the basis of two equity shares (valued at ₹15) and one 10% cumulative preference share (valued at ₹10) for every five shares held in Moon Ltd.

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

P	174
Q	114
R	108
S	42

Other Individuals 12 (Twelve members holding one share each)

It was agreed that Sun Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in Moon Ltd. i.e. ₹65 for five shares of ₹50 paid.

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

(16 Marks)

Answer

(a) Schedule showing determination of fractional shares

	Holding of shares (A)	Exchangeable in nearest multiple of five (B)	Exchange in equity shares (C) = (B)/5 x 2	Exchange in Preference shares (D) = (B)/5 x 1	Non-exchange-able shares (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

(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>

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

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

(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 @ ₹ 65 for five shares of ₹ 50 paid.

$$= 25 \text{ shares} \times ₹ 10 \times \frac{65}{50} = ₹ 325$$

(d) Statement showing calculation of Purchase Consideration

	₹
47,990, Equity shares @ ₹ 15 each	7,19,850

23,995, 10% Cumulative Preference shares @ ₹ 10 each	2,39,950
Cash on 1,19,975 shares @ ₹ 5 each	5,99,875
Add: Cash for 25 fractional shares	<u>325</u>
	<u>15,60,000</u>

Question 4

(a) The capital structure of VWX Ltd. is as follows as on 31st March, 2012:

Particulars	₹
45,000, Equity shares of ₹ 100 each fully paid up	45,00,000
12,500, 12% Preference shares of ₹ 100 each fully paid up	12,50,000
12% Secured debentures	12,50,000
Reserves	12,50,000
Profit before interest and tax during the year	18,00,000
Tax rate	40%

Normally the return on equity shares in this type of industry is 15%.

Find out the value of the equity shares subject to the following:

- (i) Profit after tax covers fixed interest and fixed dividend, atleast 4 times.
 - (ii) Debt equity ratio is atleast 2.
 - (iii) Yield on shares is calculated at 60% of distributed profits and 10% on undistributed profits.
 - (iv) The company has been paying regularly an equity dividend of 15%.
 - (v) Risk premium for dividends is generally assumed at 1%.
- (b) On 1st April 2012, a company offered 100 shares to each of its employees at ₹ 40 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under this plan will be subject to lock in on transfer for three years from the grant date. The market price on the grant date is ₹ 50 per share. However, the fair value of shares issued under this plan is estimated at ₹ 48 per share. On 30-04-2012, 400 employees accepted the offer and paid ₹ 40 per share. Nominal value of each share is ₹ 10.

Record the issue of shares in the books of the company under the aforesaid plan.

(12 + 4 = 16 Marks)

Answer**(a) 1. Calculation of profit after tax (PAT) and retained earnings**

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

2. Calculation of Interest and Fixed Dividend Coverage

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

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

3. Calculation of Debt Equity Ratio

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

$$\text{Debt Equity Ratio} = \frac{₹ 12,50,000}{₹ 70,00,000} = 0.179$$

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

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 ₹ 6,75,000)	4,05,000
10% of undistributed profits (10% of ₹ 1,65,000)	<u>16,500</u>
	<u>4,21,500</u>

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

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	<u>Nil**</u>
	<u>16%</u>

6. Value of an Equity Share

$$= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid up value of a share} = \frac{9.37\%}{16\%} \times 100 = ₹ 58.56$$

(b)

Journal Entries

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

* 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.

** 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.

Profit and Loss A/c	Dr.	3,20,000	
To Employees compensation expense A/c (Being employees compensation expense recognized immediately to Profit and Loss Account as per para 11* of Guidance Note on Employee Share Based Payments)			3,20,000

Working Note:

Fair value of an Employee Share Purchase Plan (ESPP) = ₹ 48 – ₹ 40 = ₹ 8

Number of shares issued = 400 employees x 100 share per employee = 40,000 shares

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

= 40,000 shares x ₹ 8 = ₹ 3,20,000.

Question 5

(a) The summarised Balance Sheet of Domestic Ltd. as on 31st March, 2013 is as under:

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
Equity shares of ₹ 10 each	3,000	Goodwill	744
Reserves (including provision for taxation of ₹ 300 lakhs)	1,000	Premises and Land at cost	400
5% Debentures	2,000	Plant and Machinery	3,000
Secured loans	200	Motor vehicles	
Sundry creditors	300	(purchased on 1.10.12)	40
Profit & Loss A/c:		Raw materials at cost	920
Balance from previous year	32	Work-in-progress at cost	130
Profit for the year (after taxation)	<u>1,100</u>	Finished goods at cost	180
	1,132	Book debts	400
		Investment (meant for replacement of plant and machinery)	1,600
		Cash at bank and cash in	192

* Para 11 of Guidance Note on "Employee Share Based Payments" states that if the shares granted vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In such a case, the enterprise presumes the services rendered by the employee as consideration received for the instruments granted. Accordingly, in this case, since there is no vesting period the enterprise should recognise the expense of ₹ 3,20,000 immediately.

	hand	
	Discount on debentures	10
	Underwriting commission	16
7,632		7,632

1. The resale value of premises and land is ₹ 1,200 lakhs and that of plant and machinery is ₹ 2,400 lakhs.
2. Depreciation @ 20% is applicable to motor vehicles.
3. Applicable depreciation on premises and land is 2% and that on plant and machinery is 10%.
4. Market value of the investments is ₹ 1,500 lakhs.
5. 10% of book debts is bad.
6. The company also revealed that the depreciation was not charged to Profit and Loss account and the provision for taxation already made is sufficient.
7. In a similar company the market value of equity shares of the same denomination is ₹ 25 per share and in such company dividend is consistently paid during last 5 years @ 25%. Contrary to this, Domestic Ltd. is having a marked upward or downward trend in the case of dividend payment.
8. In 2007-08 and in 2008-09, the normal business was hampered. The profit earned during 2007-08 is ₹ 67 lakhs, but during 2008-09 the company incurred a loss of ₹ 1,305 lakhs.

Past 3 years' profits of the company were as under:

2009-10	₹ 469 lakhs
2010-11	₹ 546 lakhs
2011-12	₹ 405 lakhs

The unusual negative profitability of the company during 2008-09 was due to the lock out in the major manufacturing unit of the company which happened in the beginning of the second quarter of the year 2007-08 and continued till the last quarter of 2008-09.

Value the goodwill of the company on the basis of 4 years' purchase of the super profit.

- (b) On 1st April, 2011, the fair value of plan assets were ₹ 2,50,000 in respect of a pension plan of Q Ltd.

On 30th September, the plan paid out benefits of ₹ 47,500 and received further contribution of ₹ 1,22,500.

On 31st March, 2012, the fair value of plan asset was ₹ 3,75,000 and the present value of the benefit obligation was ₹ 3,69,800. Actuarial losses on the obligation for 2011-12 were ₹ 1,500.

On 1st April, 2011, the company had made the following estimates:

	Particulars	%
(i)	Interest and dividend income after tax payable by the fund	9.25
(ii)	Realised and unrealised gain on plan asset (after tax)	2.00
(iii)	Fund expenses	<u>(1.00)</u>
	Expected rate of return	<u>10.25</u>

Find out the expected and unexpected return on plan assets. (10 + 6 = 16 Marks)

Answer

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

Profit After Tax = ₹ 1,100 lakhs

Provision for taxation = ₹ 300 lakhs

Profit Before Tax = PAT + Provision for taxation

= ₹ 1,100 lakhs + ₹ 300 lakhs = ₹ 1,400 lakhs

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

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

2. Calculation of Capital Employed

	(₹ in lakhs)	(₹ in lakhs)
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>

3. Calculation of Future Maintainable Profits

(₹ in lakhs)				
	2009-10	2010-11	2011-12	2012-13
Profit after tax	469	546	405	823.43
Less: Depreciation net of tax on Premises and Land (₹ 400 lakhs x 2%) x (100-21.43)%	(6.29)	(6.29)	(6.29)	
Depreciation net of tax on Plant and Machinery (₹ 3,000 lakhs 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>
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) ($\text{₹ } 40 \text{ lakhs} \times 20\% \times 6/12 \times (100-21.43)\%$)				(3.14)
Add: Short depreciation (net of tax) due to downward revaluation of plant and machinery $[(3,000 - 2,400) \times 10\%] \times (100 - 21.43)\%$				<u>47.14</u>
Future Maintainable Profit				<u>410.79</u>

4. Calculation of General Expectation

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

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

Therefore, share of ₹ 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, therefore, the expectation from it may be assumed to be slightly higher, say 11% instead of 10%.

5. Calculation of value of goodwill of Domestic Ltd.

	(₹ in lakhs)
Future maintainable profit	410.79
Less: Normal profit i.e. 11% of average capital employed ($3,706.28 \times 11\%$)	<u>(407.69)</u>
Super Profit	<u>3.1</u>
Goodwill at 4 years' purchase of Super Profit (3.1×4)	<u>12.4</u>

Notes:

- (1) It is assumed that 'Provision for Taxation' included in reserves is made in the current year only.
- (2) It is assumed that plant and machinery given in the balance sheet is at cost.
- (3) It is assumed that depreciation on 'Premises and Land' and 'Plant and Machinery' is charged on Straight Line method.

- (4) 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.
- (5) 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.
- (6) Average Capital employed has been taken for valuation of goodwill.
- (7) 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.

(b) Computation of Expected and Unexpected Returns on Plan Assets

	₹
Return on ₹ 2,50,000 held for 12 months at 10.25%	25,625
Return on ₹ 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>
Fair value of plan assets as on 31 st March, 2012	3,75,000
Less: Fair value of plan assets as on 1 st April, 2011	2,50,000
Contributions received	<u>1,22,500</u>
	(3,72,500)
	2,500
Add: Benefits paid	<u>47,500</u>
Actual return on plan assets	<u>50,000</u>

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

Question 6

- (a) From the following summarised Profit and Loss account of B. Co. Ltd. prepare a gross value added statement for the year ended 31-12-2012. Show also the reconciliation between gross value added and profit before taxation.

Summarised Profit and Loss account for the year ended 31-12-2012

	Notes	(₹ in '000)	(₹ in '000)
Income:			
Sales			6,240
Other income			<u>55</u>
			6,295

<i>Expenditure:</i>			
<i>Production and operational expenses</i>	1	4,320	
<i>Administrative expenses (Factory)</i>	2	180	
<i>Interest and Other charges</i>	3	624	
<i>Depreciation</i>		<u>16</u>	
			<u>(5,140)</u>
<i>Profit before tax</i>			1,155
<i>Provision for tax</i>			<u>(55)</u>
			1,100
<i>Balance as per last Balance Sheet</i>			<u>60</u>
			1,160
<i>Transferred to Fixed Assets Replacement Reserve</i>		400	
<i>Dividend Paid</i>		<u>160</u>	<u>(560)</u>
<i>Surplus carried to Balance Sheet</i>			<u>600</u>

Notes:

1	<i>Production and Operation Expenses:</i>	
	<i>Consumption of raw materials</i>	3,210
	<i>Consumption of stores</i>	40
	<i>Local tax</i>	8
	<i>Salaries to administrative staff</i>	620
	<i>Other manufacturing expenses</i>	442
		<u>4,320</u>
2.	<i>Administration expenses include salaries and commission to directors</i>	5
3	<i>Interest and other charges include:</i>	
	<i>(a) Interest on bank overdraft (overdraft is of temporary nature)</i>	109
	<i>(b) Fixed loan from ICICI</i>	51
	<i>(c) Working capital loan from IFCI</i>	20
	<i>(d) Excise duties amounts to one-tenth of total value added by manufacturing and trading activities.</i>	

- (b) The investment portfolio of a mutual fund scheme includes 5,000 shares of X Ltd. and 4,000 shares of Y Ltd. acquired on 31-12-2010. The cost of X Ltd.'s shares is ₹ 40 while that of Y Ltd.'s shares is ₹ 60. The market value of these shares at the end of 2010-11

were ₹ 38 and ₹ 64 respectively. On 30-06-2011, shares of both the companies were disposed off realizing ₹ 37 per X Ltd. shares and ₹ 67 per Y Ltd. shares. Show important accounting entries in the books of the fund for the accounting years 2010-11 and 2011-12.

(8 + 8 = 16 Marks)

Answer

(a)

B Co. Ltd

**Gross Value Added Statement
For the year ended 31st December, 2012**

	(₹ '000)	(₹ '000)
Sales		6,240
Less: Cost of bought in material and services:		
Production and operational expenses		
₹ (4,320 – 8 – 620)	3,692	
Administration expenses ₹ (180 – 5)	175	
Interest on bank overdraft	109	
Interest on working capital loan	20	
Excise duties (Refer W.N.)	180	
Other charges (Refer W.N.)	<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>
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

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

Reconciliation between Total Value Added and Profit before Taxation:

	(₹ '000)	(₹ '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>

Working Note:**Calculation of Excise Duty**

		(₹ '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 charges		<u>444</u>

Note: It is assumed that these miscellaneous charges of ₹ 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 other charges be = ₹ 444 - x

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

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

Excise duty = ₹ 180

Other charges = ₹ 444 - ₹ 180 = ₹ 264.

(b)

Accounting Entries in the books of fund

			₹	₹
31.12.2010	Investment in X Ltd.'s shares A/c (5,000 x ₹ 40) Dr.	2,00,000		
	Investment in Y Ltd.'s shares A/c (4,000 x ₹ 60) Dr.	2,40,000		
	To Bank A/c			4,40,000
	(Being investment made in X Ltd. and Y Ltd.)			
31.3.2011	Revenue A/c [5,000 x ₹ (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)			
31.3.2011	Investment in Y Ltd.'s shares A/c [4,000 x ₹ (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)			
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)			
30.6.2011	Bank A/c (5,000 x ₹ 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 ₹ 40)			2,00,000
	(Being shares of X Ltd. disposed off at a loss of ₹ 15,000)			
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			15,000
	(Being net loss on disposal of X Ltd.'s shares charged to revenue account)			
30.6.2011	Bank A/c (4,000 x ₹ 67) Dr.	2,68,000		
	To Investment in Y Ltd.'s shares A/c (4,000 x ₹ 60)			2,40,000
	To Revenue A/c			28,000
	(Being shares of Y Ltd. disposed off at a profit of ₹ 28,000)			

Question 7

Answer any **four** of the following:

- (a) While closing its books of account on 31st March, 2012 a non-banking finance company has its advances classified as follows:

Particulars	₹ in lakhs
Standard Assets	16,800
Sub-Standard Assets	1,340
Secured portion of doubtful debts:	
- Upto one year	320
- One year to three years	90
- More than three years	30
Unsecured portion of doubtful debts	97
Loss Assets	48

Calculate the amount of provision, which must be made against the advances.

- (b) From the following information relating to W Ltd., calculate diluted earnings per share as per AS 20:

		₹
(i)	Net profit for the current year	5,00,00,000
(ii)	Number of equity shares outstanding	1,00,00,000
(iii)	11% convertible debentures of ₹100 each (Nos.)	1,25,000
(iv)	Interest expenses for current year	13,75,000
(v)	Tax saving relating to interest expense	30%
(vi)	Each debenture is convertible into eight equity shares.	

- (c) W Ltd. purchased machinery for ₹80 lakhs from X Ltd. during 2010-11 and installed the same immediately. Price includes excise duty of ₹8 lakhs. During the year 2010-11, the company produced exciseable goods on which excise duty of ₹7.20 lakhs was charged. Give necessary entries explaining the treatment of Cenvat Credit.
- (d) Write short note on "Disclosure of carrying amounts of financial assets and financial liabilities in balance sheet".
- (e) Vishnu Company has at its financial year ended 31st March, 2013, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors. The directors have estimated the possible outcomes as below:

Result	Probability	Amount of loss
For first ten cases:		
Win	0.6	
Loss-low damages	0.3	90,000
Loss-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	
Loss-low damages	0.3	60,000
Loss-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss. (4 x 4=16 Marks)

Answer

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

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

(b) Adjusted net profit for the current year

	₹
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 ₹ 13,75,000)	<u>(4,12,500)</u>
Adjusted net profit for the current year	<u>5,09,62,500</u>

Weighted Average Number of Equity Shares

Number of equity shares resulting from conversion of debentures:

$$1,25,000 \text{ debentures} \times 8 = 10,00,000 \text{ shares}$$

Number of equity shares for computation of diluted EPS:

$$1,00,00,000 + 10,00,000 = 1,10,00,000 \text{ shares}$$

Computation of diluted earnings per share

$$\begin{aligned} \text{Diluted earnings per share} &= \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}} \\ &= (5,09,62,500 / 1,10,00,000) = ₹ 4.63 \text{ (approx.)} \end{aligned}$$

(c) Journal Entries

			₹ 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)			
(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 of acquisition of capital asset)			

(d) “Disclosure of carrying amounts of financial assets and financial liabilities in Balance Sheet”.

As per para 8 of AS 32 ‘Financial instruments: Disclosures’, 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:

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,
- (b) held-to-maturity investments;

- (c) loans and receivables;
- (d) available-for-sale financial assets;

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
 - (b) financial liabilities measured at amortised cost.
- (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 and 5 cases is 40% and 50% respectively. According to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", 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.

The amount of contingent loss may be calculated as under:

$$\begin{aligned}
 \text{Expected contingent loss in first ten cases} &= [₹ 90,000 \times 0.3 + ₹ 1,60,000 \times 0.1] \times 10 \text{ cases} \\
 &= [₹ 27,000 + ₹ 16,000] \times 10 \text{ cases} \\
 &= ₹ 43,000 \times 10 \text{ cases} = ₹ 4,30,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Expected contingent loss in remaining five cases} &= [₹ 60,000 \times 0.3 + ₹ 95,000 \times 0.2] \times 5 \text{ cases} \\
 &= [₹ 18,000 + ₹ 19,000] \times 5 \text{ cases} \\
 &= ₹ 37,000 \times 5 \text{ cases} = ₹ 1,85,000
 \end{aligned}$$

$$\begin{aligned}
 \text{Total contingent liability} &= ₹ 4,30,000 + ₹ 1,85,000 \\
 &= ₹ 6,15,000.
 \end{aligned}$$

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