

MOCK TEST PAPER – 2
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING
SUGGESTED ANSWERS/HINTS

1. (a) Computation of Expected Returns on Plan Assets as on 31st March, 2012, as per AS 15

	₹
Return on opening value of plan assets of ₹ 6,00,000 (held for the year) @ 10.25%	61,500
Add: Return on net gain of ₹ 90,000 (i.e. ₹ 1,65,000 – ₹ 75,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	4,500
Expected return on plan assets as on 31 st March, 2012	66,000

Computation of Actual Returns on Plan Assets as on 31st March, 2012, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31 st March, 2012		9,00,000
Less: Fair value of Plan Assets as on 1 st April, 2011	6,00,000	
Add: Contribution received as on 30 th September, 2011	1,65,000	(7,65,000)
		1,35,000
Add: Benefits paid as on 30 th September, 2011		75,000
Actual returns on Plan Assets as on 31 st March, 2012		2,10,000

- (b) According to Central Excise Rules, 2002, excise duty is levied upon the manufacture or production of goods. However, it is collected only at the time of removal of goods from factory premises or factory warehouse.

Guidance Note on 'Accounting Treatment for Excise Duty' says that excise duty is a duty on manufacture or production of excisable goods in India.

As explained in the Guidance Note, the liability for excise duty arises at the point of time at which the manufacture is completed. The excise duty paid or provided on finished goods should, therefore, be included in inventory valuation.

Further, the Guidance Note states that excise duty should be considered as a manufacturing expense and like other manufacturing expenses are considered as

an element of cost for the purpose of inventory valuation, excise duty should also be considered as an element of cost while valuing the inventory.

Therefore, in the given case of Overseas Ltd., the Managing Director's contention that "excise duty is payable only on clearance of goods and hence is not a cost" is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 12% on the selling price, that is on ₹ 200 lakhs for valuation of stock.

Excise duty on goods meant for exports, should also be provided for, since the liability for excise duty arises when the manufacture of the goods is completed. However, if it is assumed that all the conditions specified in Rule 19 of the Central Excise Rules, 2002 regarding export of excisable goods without payment of duty are fulfilled by Overseas Ltd. excise duty may not be provided for.

(c) Calculation of possible value of brand under potential earning model

	₹ in lakhs
Profit after tax (130 – 30)	100.00
Less: Profit allocated to tangible fixed assets	<u>(60.00)</u>
Profit relating to intangible assets including brand	<u>40.00</u>
Capitalisation factor 25%	
Capitalised value of intangibles including brand $\left(\frac{40.00}{25} \times 100 \right)$	160.00
Less: Identifiable intangibles other than brand	<u>(100.00)</u>
Brand value	<u>60.00</u>

- (d) As per para 4 of the 'General Instructions for preparation of Statement of Profit and Loss' given in the Revised Schedule VI to the Companies Act, 1956, 'other income' does not include operating income. However, rent income arising from leasing of real estate properties is an operating income as Real Estate is one of the divisions of Combine Ltd. There is a separate head for operating income i.e. 'Revenue from Operations'. Therefore, classification of rent income as 'Other income' in the Statement of Profit and Loss will not be correct. It would infact be shown under the heading 'Revenue from Operations' only.

**2. Consolidated Balance Sheet of H Ltd. with its subsidiary
S Ltd. as on 31st March, 2012**

Particulars	Note No.	(₹ in 000's)
I. Equity and Liabilities		
(1) Shareholder's Funds		

(a) Share Capital	1	4,000
(b) Reserves and Surplus	2	3,063
(2) Minority Interest (W.N.7)		1,560
(3) Current Liabilities		
Trade payables	3	1,118
Short term provisions	4	482
Total		10,223
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	5	5,904
(2) Current assets		
(a) Inventories	6	1,759
(b) Trade receivables	7	1,598
(c) Cash and cash equivalents	8	512
(d) Short term loans and advances	9	450
Total		10,223

Notes to Accounts

		(₹ in 000's)	(₹ in 000's)
1.	Share Capital		
	Authorised share capital		
	5 lakhs equity shares of ₹ 10 each		<u>5,000</u>
	Issued, Subscribed and Paid up		
	4 lakhs equity shares of ₹ 10 each fully paid		4,000
2.	Reserves and surplus		
	Capital Reserve (Note 6)	650.60	
	General Reserve (₹928+ ₹54)	982	
	Profit and Loss Account:		
	H Ltd.	₹ 1,305	
	Add: Share in S Ltd. [(615.67-90) x 60%]	₹ <u>315.40</u>	
		₹ 1,620.40	
	Less: Dividend wrongly credited	₹ <u>(180)</u>	

			₹ 1,440.40		
	Less: Unrealised profit		₹ (10)	<u>1,430.40</u>	3,063
3.	Trade payables				
	Sundry Creditors	H Ltd.	₹ 487		
		S Ltd.	₹ <u>427</u>	914	
	Bills payable	H Ltd.	₹ 124		
		S Ltd.	₹ <u>80</u>	<u>204</u>	1,118
4.	Short –term provisions				
	Provision for Taxation	H Ltd.	₹ 220		
		S Ltd.	₹ <u>180</u>	400	
	Other Provisions	H Ltd.	₹ 65		
		S Ltd.	₹ <u>17</u>	<u>82</u>	482
5.	Tangible Assets				
	Plant and Machinery				
		H Ltd.	₹ 2,541		
		S Ltd.	₹ <u>2,450</u>	4,991	
	Furniture and fittings				
		H Ltd.	₹ 615		
		S Ltd.	₹ <u>298</u>	<u>913</u>	5,904
6.	Inventories				
	Stock	H Ltd.	₹ 983		
		S Ltd.	₹ <u>786</u>	1,769	
	Less: Unrealised profit (₹ 50 x 1/5)			<u>(10)</u>	1,759
7.	Trade receivables				
	Debtors	H Ltd.	₹ 700		
		S Ltd.	₹ <u>683</u>	1,383	
	Bills Receivables	H Ltd.	₹ 120		
		S Ltd.	₹ <u>95</u>	<u>215</u>	1,598
8.	Cash and cash equivalents				
	Cash and Bank Balances	H Ltd.		410	
		S Ltd.		<u>102</u>	512
9.	Short term loans and advances				
	Sundry Advances	H Ltd.		260	
		S Ltd.		<u>190</u>	450

Working Notes:

1. Shares of S Ltd. before bonus issue:

3 Bonus shares had been issued for every 5 shares held i.e 3/5 or 60%

Total shares as on 31.3.2012 = (100+60)% = 160%

Shares before bonus issue = 240 thousand /160 x 100 = 150 thousand shares

Bonus issue = 150 thousand /5 x 3 = 90 thousand shares
240 thousand shares

Shares acquired by H Ltd. before bonus issue = 90 thousand shares

% of holding = 90 thousand/150 thousand x 100 = 60%

2. S Ltd. General Reserve

(₹ in 000)		(₹ in 000)	
To Bonus to equity shareholders $\left(\frac{2,400 \times 3}{8} \right)$	900	By Balance b/d	1,500
		By Profit and Loss A/c	
To Balance c/d	<u>690</u>	(Balancing figure)	<u>90</u>
	<u>1,590</u>		<u>1,590</u>

3. S Ltd. Profit and Loss Account

	(₹ in 000)		(₹ in 000)
To General Reserve	90	By Balance b/d	633
To Dividend paid on 14.7.2011 $\frac{₹ 1,500 \times 20}{100}$	300	By Net Profit for the year (Balancing figure)	615.67*
To Corporate Dividend Tax (16.2225% of ₹ 300)	48.67		
To Balance c/d	<u>810</u>		
	<u>1,248.67</u>		<u>1,248.67</u>

* Out of ₹ 6,15,670 profit for the year, ₹ 90,000 has been transferred to reserves by S Ltd. (W.N.2)

4. Distribution of Revenue Profits

	₹ in '000
Revenue Profit as above	<u>615.67</u>
Share of H Ltd. (60%)	369.40
Share of Minority shareholders (40%)	<u>246.27</u>

5. Computation of Capital Profits

	₹ in 000	₹ in 000
General Reserve on the date of acquisition		1,500
Less: Bonus issue of shares		<u>900</u>
		600
Profit and Loss Account balance on the date of acquisition	633	
Less: Dividends paid ₹ 300		
Corporate tax paid ₹ <u>48.67</u>	<u>(348.67)</u>	<u>284.33</u>
		<u>884.33</u>
Share of H Ltd. (60%)		530.60
Share of Minority shareholders		<u>353.73</u>

6. Computation of Capital Reserve

	₹ in '000
60% of share capital of S Ltd.	1,440
Add: Share of H Ltd. in the capital profits as in (W.N.5)	<u>530.60</u>
	1,970.60
Less: Investments in S Ltd.	1,500
Less: Dividends received out of pre- acquisition profits $\frac{₹ 300 \times 60}{100}$	<u>(180)</u>
	<u>650.60</u>

7. Calculation of Minority Interest

	₹ in '000
40% of share capital of S Ltd.	960
Add: Share of Revenue Profits (Note 4)	246.27
Share of Capital Profits (Note 5)	<u>353.73</u>
	<u>1,560</u>

3. Computation of number of shares issued

Calculation of Rectified Profits and Purchase consideration

	₹	₹
Yes Ltd.:		
Given profits		50,00,000
Less: Irrecoverable Debtors	1,00,000	
50% Contingent Liability	<u>2,50,000</u>	<u>(3,50,000)</u>
		46,50,000
Add: Profit on omitted sale (15% of ₹ 2,50,000)		<u>37,500</u>
		46,87,500
Less: Debenture interest		<u>(2,00,000)</u>
		44,87,500
Less: Income Tax @ 25%		<u>(11,21,875)</u>
Profits after Tax (PAT)		33,65,625
Less: Preference Dividend (10% of ₹ 2,00,00,000)		<u>(20,00,000)</u>
Rectified Profits		<u>13,65,625</u>
Average PE ratio = 10		
Total consideration for all equity shareholders (Average PE ratio × Profit)		1,36,56,250
Less: 10% thereof for shareholders of No Ltd.		<u>(13,65,625)</u>
Balance available for other shareholders of Yes Ltd.		<u>1,22,90,625</u>
No Ltd.:		
Given profits		25,00,000
Less: Increase in FOREX liability (US\$10,000 × 50)	5,00,000	
50% Contingent Liability	<u>5,00,000</u>	<u>(10,00,000)</u>
		15,00,000
Add: Undervaluation of inventory (45,00,000 × 10/90)		<u>5,00,000</u>
		20,00,000
Less: Debenture interest		<u>(2,00,000)</u>
		18,00,000
Less: Income Tax @ 25%		<u>(4,50,000)</u>
Profits after Tax (PAT)		13,50,000
Less: Preference Dividend (10% of ₹ 20,00,000)		<u>(2,00,000)</u>

Rectified Profits		<u>11,50,000</u>
Average PE ratio = 8		
Total consideration for all equity shareholders (Average PE ratio × Profit)		92,00,000
Less: 10% thereof for shareholders of Yes Ltd.		<u>(9,20,000)</u>
Balance available for other shareholders of No Ltd.		<u>82,80,000</u>
Statement showing Disposal of Purchase Consideration		

	Yes Ltd. ₹	No Ltd. ₹	Total ₹
Number of shares [Purchase consideration/(Face Value + Securities Premium)]	<u>5,34,375</u>	<u>3,31,200</u>	<u>8,65,575</u>
Share Capital	53,43,750	33,12,000	86,55,750
Securities Premium	<u>69,46,875</u>	<u>49,68,000</u>	<u>1,19,14,875</u>
Purchase Consideration	<u>1,22,90,625</u>	<u>82,80,000</u>	<u>2,05,70,625</u>

**Projected Profit and Loss Account of Ok Ltd.
for the period 1st January, 2012 to 31st March, 2012**

	Note No.	₹
I. Revenue from operations		—
II. Other income	5	<u>17,00,000</u>
III. Total Revenue(I+II)		<u>17,00,000</u>
IV. Expenses:		
Employee benefits expense	7	14,00,000
Finance costs	6	90,000
Other expenses	8	<u>16,00,000</u>
V. Total expenses		<u>30,90,000</u>
VI. Loss for the period (V - IV)		(13,90,000)

**Projected Balance Sheet of Ok Ltd.
as on 31st March, 2012**

Particulars	Note No.	(₹ in Lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		

(a) Share Capital	1	1,06,55,750
(b) Reserves and Surplus	2	1,59,51,760
Total		2,66,07,510
II. Assets		
(1) Non-current assets		
Non-current investments	3	2,65,70,625
(2) Current assets		
Cash and cash equivalents	4	36,885
Total		2,66,07,510

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	<i>Authorised</i>		
	20 lakhs shares of ₹ 10 each	<u>2,00,00,000</u>	
	<i>Issued & Paid up</i>		
	10,65,575 shares of ₹ 10 each (out of the above 8,65,575 shares have been issued for consideration other than cash)	1,06,55,750	1,06,55,750
2.	Reserves and surplus		
	Securities Premium (₹ 1,19,14,875 + 56,00,000)		1,75,14,875
	Loss for the period	(13,90,000)	
	Less: Proposed Dividend (2% of ₹ 86,55,750)	<u>(1,73,115)</u>	<u>(15,63,115)</u>
	Balance of Profit and Loss Account carried forward		<u>1,59,51,760</u>
3.	Non-current investments		
	Shares in Subsidiaries (W.N. 4)		2,65,70,625
4.	Cash and cash equivalents		
	Cash at Bank (W.N. 3)		36,885
5.	Other income		
	Dividends received from Subsidiaries (₹ 12,00,000 + 5,00,000)		17,00,000
6.	Finance costs		

	Interest on Bank O/D		90,000
7.	Employee benefits expenses		
	Management expenses*		14,00,000
8.	Other expenses		
	Preliminary expenses**		16,00,000

Working Notes:

1. Shares issued by Ok Ltd. to Great capital Ltd. (GCL)

Number of shares issued	2,00,000
Face value of share capital @ ₹ 10 each	₹ 20,00,000
Securities premium @ ₹ 28 each	₹ <u>56,00,000</u>
Total cash received from GCL	₹ <u>76,00,000</u>

2. Overdraft of Ok Ltd. as on 31.3.2012

	₹
Towards incorporation expenses i.e. preliminary expenses	16,00,000
Towards management expenses	<u>14,00,000</u>
Total bank overdraft availed	<u>30,00,000</u>
Interest @ 18% p.a. for 2 months	<u>90,000</u>

3. Bank balance of Ok Ltd. as on 31.3.2012

Bank Account of Ok Ltd.

		₹			₹
01.02.2012	To Overdraft	30,00,000	01.02.2012	B Incorporation expenses	16,00,000
31.03.2012	To GCL	76,00,000	31.03.2012	B Management expenses	14,00,000
31.03.2012	To Dividend		31.03.2012	B Interest on	

* Management expenses are assumed to be the expenses incurred on the directors who are either the whole time or part time employment of the company.

** As per para 56 of AS 26, 'Intangible Assets', preliminary expenses are to be recognized as expenses as and when they are incurred.

				y Overdraft	90,000
	Yes	12,00,000 ¹	31.03.2012	By Overdraft	30,00,000
	No	5,00,000 ²	31.03.2012	By Dividend paid	1,73,115 ³
			31.03.2012	By Shares in Yes Ltd. bought from No Ltd.	40,00,000
			31.03.2012	By Shares in No Ltd. bought from Yes Ltd.	20,00,000
				By Balance c/d (Bal.fig.)	<u>36,885</u>
		<u>1,23,00,000</u>			<u>1,23,00,000</u>

4. Investments of Ok Ltd. in Projected Balance Sheet

	₹
Purchase consideration paid for acquiring shares of outside holders of- Yes Ltd	1,22,90,625
No Ltd.	82,80,000
Consideration paid in cash for acquiring cross holdings From Yes Ltd. (shares of No Ltd.)	20,00,000
From No Ltd. (shares of Yes Ltd.)	<u>40,00,000</u>
	<u>2,65,70,625</u>

4. Statement showing valuation of shares (ex-dividend)

Particulars	Rs.
Net trading assets (W.N.2)	15,60,000
Add: Goodwill (W.N.3)	1,58,000
Less: Proposed dividend	<u>(1,20,000)</u>
Net assets available for equity shareholders	<u>15,98,000</u>
No. of shares outstanding	<u>12,000 Shares</u>
Value per share (15,98,000 ÷ 12,000)	<u>133.17</u>

¹ (40,00,000 x 10) x 3% = 12,00,000.

² (20,00,000 x 10) x 2.5% = 5,00,000.

³ [(5,34,375 + 3,31,200) x 10] x 2% = 1,73,115.

Working Notes:

1. Calculation of FMP (Future Maintainable Profits)

Particulars	₹	₹
Profits for the year		
2009-10	4,00,000	
2010-11	4,80,000	
2011-12	<u>4,40,000</u>	13,20,000
Less: Bad debts as on 31.03.12		<u>(20,000)</u>
Profits for 3 years		<u>13,00,000</u>
Average profits for 3 years ($\text{₹ } 13,00,000 \div 3$)		4,33,333
Less: Additional depreciation on revaluation of assets		
(i) Building 2% on ₹ 1,00,000	2,000	
(₹ 4,00,000 – ₹ 3,00,000)		
(ii) Machinery 10% on ₹ 30,000	<u>6,000</u>	(8,000)
(₹ 5,00,000 – ₹ 4,40,000)		
Profit before tax		4,25,333
Income tax @ 50%		<u>2,16,667*</u>
Profit after tax/FMP		<u>2,08,666</u>

2. Trading capital employed

Particulars	₹	₹
A. Assets		
(i) Building	4,00,000	
(ii) Machinery	5,00,000	
(iii) Stock	6,00,000	

* Income tax

	₹
a. Profit before tax	4,25,334
b. Add: Depreciation not allowable	<u>8,000</u>
c. Taxable income	<u>4,33,334</u>
d. Income tax @ 50%	<u>2,16,667</u>

	(iv) Sundry debtors (3,20,000 – 20,000)	3,00,000	
	(v) Bank	<u>1,20,000</u>	19,20,000
B.	Less: Liabilities		
	(i) Creditors	1,20,000	
	(ii) Provision for taxation	2,20,000	
	(iii) Bank overdraft	<u>20,000</u>	<u>(3,60,000)</u>
C.	Net trading assets/ closing capital employed		<u>15,60,000</u>

3. Valuation of goodwill (Super profits method)

Particulars	₹
Closing capital employed (W.N. 2)	15,60,000
Normal rate of return	10%
Normal profit	1,56,000
Future maintainable profit (W.N. 1)	2,08,666
Super profit	52,667
No. of years of purchase (given)	3 years
Goodwill (rounded off)	1,58,000

5. (a) Value Added Statement of Plus Ltd.

		(₹ in lakhs)
Turnover		1,150
Add: Change in Finished Stock (Closing Stock 100 – Opening Stock 80)		<u>20</u>
		1,170
Less: Bought in Materials and Services:		
Raw Materials Purchased	312.50	
Printing and Stationery	11.00	
Auditor's Remuneration	14.00	
Rent, Rates and Taxes	82.50	
Other Expenses	<u>42.50</u>	<u>462.50</u>
Value Added		<u>707.50</u>
Disposals as follows:		
To Employees:		
Wages and Salaries	163.50	

	Employees State Insurance	17.50	
	PF Contribution	<u>14.00</u>	195.00
To	Providers of Capital:		
	Interest	20.00	
	Dividend	<u>73.00</u>	93.00
To	Government: Income Tax		138.00
To	Provide for Maintenance:		
	Loss on Sale of Machinery	37.50	
	Depreciation	100.00	
	Retained Earnings	<u>144.00</u>	<u>281.50</u>
			<u>707.50</u>

(b) (₹ in '000s)

Closing equity = 30% of (100 – 120) = (6)

Pre-acquisition equity = 30% of (100 – 40) = 18

Calculation of capital reserve/ goodwill

	(₹ '000s)
Investments in One Ltd.	15
Less : Pre-acquisition equity	<u>18</u>
Capital Reserve	<u>3</u>

Post-acquisition loss = 30% of (120 – 40) = 24

Adjustment for equity method

	₹	₹	
P & L A/c	18		Balancing figure
To Capital Reserve		3	
To Investment in One Ltd.		15	Carrying amount

Note: Loss not recognized = ₹ 24 – ₹ 18 = ₹ 6

Consolidated Balance Sheet of Whole Ltd., group as at 31.3.2012

Liabilities	₹ '000	Assets	₹ '000
Share Capital (₹ 10)	600	Goodwill	10
P & L A/c (300 – 18)	282	Sundry Assets	1,175
Capital Reserve	3		

Minority Interest	75		
Sundry Liabilities	<u>225</u>		<u> </u>
	<u>1,185</u>		<u>1,185</u>

6. (a)

Journal Entries

<i>Year 2007</i>		₹	₹
Employee Compensation Expense A/c To Employee Stock Options Outstanding A/c (Being the compensation expenses recognized in respect of the ESOP)	Dr.	11,40,840	11,40,840
Profit and Loss A/c To Employee Compensation Expense A/c (Being Expenses of the year transferred to P & L A/c)	Dr.	11,40,840	11,40,840
<i>Year 2008</i>			
Employee Compensation Expense A/c To Employee Stock Options Outstanding A/c (Being the compensation expenses recognized in respect of the ESOP)	Dr.	6,81,660	6,81,660
Profit and Loss A/c To Employee Compensation Expense A/c (Being Expenses of the year transferred to P & L A/c)	Dr.	6,81,660	6,81,660
<i>Year 2009</i>			
Employee Compensation Expense A/c To Employee Stock Options Outstanding A/c (Being the compensation expenses recognized in respect of the ESOP)	Dr.	10,27,500	10,27,500
Profit and Loss A/c To Employee Compensation Expense A/c (Being Expenses of the year transferred to P & L A/c)	Dr.	10,27,500	10,27,500
<i>Year 2011</i>			
Bank A/c	Dr.	50,00,000	
Employee Stock Options Outstanding A/c	Dr.	15,00,000	

To Share Capital A/c To Securities Premium (Being shares issued to employees against options vested in them in pursuance of the ESOP)			10,00,000 55,00,000
Year 2012 Bank A/c Employee Stock Options Outstanding A/c To Share Capital A/c To Securities Premium A/c (Being shares issued to employees against options vested in them in pursuance of the ESOP)	Dr. Dr.	25,00,000 7,50,000	5,00,000 27,50,000
Employee Stock Options Outstanding A/c To General Reserve A/c (Being the balance standing to the credit of stock options outstanding account, in respect of vested options expired unexercised, transferred to general reserve account)	Dr.	60,00,000	60,00,000

Working Notes:

1. Fair value of options recognized as expense in the year 2007

Number of options expected to vest = $500 \times 500 \times .97 \times .97 \times .97 = 2,28,168$ options

Fair value of options expected to vest = $2,28,168 \times ₹ 15 = ₹ 34,22,520$

One third of fair value recognized as expense = $₹ 34,22,520 / 3 = ₹ 11,40,840$

Year 2008	
Fair Value of options revised in the year = $500 \times 500 \times 0.90 \times 0.90 \times 0.90 \times ₹ 15$	₹ 27,33,750
Revised cumulative expenses in year 2008 = $27,33,750 \times \frac{2}{3}$	₹ 18,22,500
Less: Already recognized in year 2007	₹ (11,40,840)
Expenses to be recognized in year 2008	₹ 6,81,660
Year 2009	
Number of options actually vested = $380 \times 500 = 1,90,000$	
Fair Value of options actually vested = $1,90,000 \times ₹ 15$	₹ 28,50,000
Less: Expense recognized till year 2008	₹ (18,22,500)
Balance amount to be recognized	₹ 10,27,500

2. Amount recorded in share capital account and securities premium account upon issue of shares

Particulars	Year 2011	Year 2012
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Number of employees exercising option	200	100
Number of shares issued upon exercise of option @ 500 per employee	1,00,000	50,000
Exercise price received @ ₹50 per share	50,00,000	25,00,000
Corresponding amount recognized in the 'Employee stock options outstanding A/c' @ ₹15 per option	<u>15,00,000</u>	<u>7,50,000</u>
Total consideration	<u>65,00,000</u>	<u>32,50,000</u>
Amount to be recorded in 'Share capital A/c' @ ₹10 per share	10,00,000	5,00,000
Amount to be recorded in 'Securities premium A/c' @ ₹55 (i.e. 65 –10) per share	<u>55,00,000</u>	<u>27,50,000</u>
	<u>65,00,000</u>	<u>32,50,000</u>

(b) The PV of minimum lease payments at 10% discount rate:

$$= ₹ 1,00,000 \times 6.1446 = ₹ 6,14,460$$

Santa Ltd. should recognize the asset and the liability at ₹ 6,14,460.

The excess of sales proceeds over carrying amount

$$= ₹ 6,14,460 - ₹ 1,00,000 = ₹ 5,14,460$$

As per para 48 of AS 19 'Leases', if a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that Santa Ltd. has decided to charge depreciation on straight line basis, AS 19 requires Santa Ltd. to:

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

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

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

The deferred income (excess) should be presented as a deduction from the carrying amount of the asset. Thus, the asset should be presented by Santa Ltd. in its balance sheet dated December 31, 2011 as follows:

	₹
Gross Block	6,14,460
Less: Accumulated depreciation	<u>(61,446)</u>
Net Block	5,53,014
Less : Deferred Income (5,14,460 – 51,446)	<u>(4,63,014)</u>
Net Block	<u>90,000</u>

In effect, the carrying amount of the equipment does not change with the sale and lease back transaction. In substance, the sale and lease back transaction is a borrowing transaction resulting in recognition of a liability in the balance sheet and recognition of interest expense in the profit and loss account.

7. (a) As per para 6 of AS 2 "Valuation of Inventories", cost of inventories comprise of all costs of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Interest and other borrowing costs are usually considered as overheads that don't contribute to bringing the inventories to their present location and condition. Therefore, the proposal of UC Ltd., to include interest on bank over draft as an element of cost is not acceptable. Interest on bank overdraft will not form part of cost of production.

(b) Statement Showing Computation of Tier-I Capital

		(₹ in lakhs)
Paid up Equity Capital		100
Free Reserve		<u>500</u>
	(A)	600
Deduct deferred expenditure	(B)	<u>200</u>
	(C)	<u>400</u>
Investments		
In shares of subsidiaries and Group Companies		100
In Debenture of subsidiaries and Group Companies		<u>100</u>
		200
10% (C)	(D)	<u>40</u>
Excess of Investment over 10% of (C) = (E)		<u>160</u>
Tier-I Capital [(C - E)]		<u>240</u>

- (c) As per para 4 of AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where, recoverable amount is the higher of an asset's net selling price and its value in use. In the given case, recoverable amount will be nil [higher of value in use i.e nil and net selling price i.e. negative ₹ 70,000]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore,

asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

- (d) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2012. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs.2.10 crore.

(e) Present value of Debentures redeemable in 2014	₹ 71,23,200
[₹ 1,00,00,000 x 1.12 x 0.636]	
Present value of interest on debentures	
[₹ 8,00,000* x 3.038 (sum of 4 years discount factors @12%)]	₹ <u>24,30,400</u>
Value of Debt component of the convertible debentures	₹ <u>95,53,600</u>
* Interest payable on debentures every year = ₹ 1,00,00,000 x 8% = ₹ 8,00,000.	