SUGGESTED ANSWERS TO NOV 2014 FINANCIAL REPORTING:

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Question 1: 5 Marks each

a)

Particulars	Timing Diff	Net	Deferred tax@35%
Depreciation	(865400 - 7,42,900)	1,22,500	42,875
Provision for DD	(54300 – 0)	54300	19,005
Share issue exp	(623500 – 0)	623500	2,18,225
		Net DTA	2,80,105

Note: (1) Item no (iv) Rs 7,84,500 disallowed under IT Act is a permanent difference.
(2) Item no (v) Rs 2,00,000 whereby 50% is allowed by IT Act and 50% is disallowed under IT Act hence it is a permanent difference.

Q 1 (b)Solution:

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Segment assets should be net off DTA. Segment A holds assets of 1.35 crores (1.85 – 0.5crores); Segment B holds 5.75 crores (6.15 crores – 0.4 crores); and Segment C holds 6.7 crores (7 crores – 0.3 crores). Therefore, the revised total assets are 13.8 crores [1.35+5.75+6.70)crores.

Segment A holds =9.78% of total segment assets < 10%
Segment B holds =41.67% of total segment assets > 10%
Segment C holds =48.55% of total segment assets > 10%

Only Segment A is not reportable but the other segment viz B and C are reportable. B and C's assets exceeds more than 10% of the total assets of all the segments.

Q 1 (c)Solution:

Expenditure charged to P&L A/c for 2012-13: Rs 16 lakhs will be recognized as an expense because the recognition criteria were not met until 1st December 2012. This expenditure will not form part of the cost of the production process recognized in the balance sheet. Carrying value of intangible as on 31.03.2013 will be Rs. 24 lakhs.

(i) Expenditure charged to P&L A/c for 2012-13 will be Rs 16 lakhs.
Carrying amount as on 31/3/2013 = 24 lakhs

(ii) Next year:

Particulars	`lakhs
Development cost as on 31/3/2014 (24 lakhs + 70 lakhs) Less: recoverable amount	94 62
Impairment loss to be charged to P&L A/c	32

Carrying value of intangibles as on 31.03.2014: 62 lakhs and the Amount charged to P/L will be 32lakhs

SUMMARY:

	31/3/2013	31/3/2014
Amount charged to P/L a/c	16,00,000	32,00,000
Carrying amount of asset	24,00,000	62,00,000

Q 1 (d)Solution:

Assumption: Year ending: 31/3/2014

As per the revised Schedule VI disclosures are as follows:

Current Assets:

<u>**(a)** Cash & Cash Equivalents: </u> (maturity < 3 months)

Punjab National Bank FD Rs 15,00,000

State Bank of India FD Rs 10,00,000

<u>**(b)** Other Current Assets: </u> (maturity > 3 months but < 12 months)

ICICI Bank FD Rs 10,00,000

Non – Current Assets:

<u>Other Non – Current Assets: </u> (maturity > 12 months)

Axis Bank FD Rs 10,00,000

Q 2............16 marks

Solution:

Calculation of PC:	**Rs. Crores**
Assets t/o Fixed Assets Current Assets (330-40) Less: Debentures Less: Current liabilities Less: Net assets held by S Ltd (80%) Net PC to outsiders =	 40 290 (25) <u>(200)</u> 105 <u>(84)</u> <u>21</u>
Discharge of PC:	
2100000 Equity shares of Rs. 10 @Rs 100	21
Journal Entries:	
Business Purchase Dr To Liquidator of S Ltd (Being business purchased under the scheme of amalgamation)	21 21
Fixed Assets Dr Current Assets Dr To Business Purchase To Current liabilities To Debentures To Investments in equity shares of H Ltd To Capital Reserve (bal fig) (Being assets and liabilities taken over and investments in vendor company cancelled)	40 290 21 200 25 32 52
Liquidator of S Ltd Dr To Equity Share Capital To Securities Premium (Being purchase consideration discharged)	21 2.1 18.9
!0% Debentures Dr	25

To 10% Investments in Debentures	24
To Capital Reserves (profit on cancellation)	1
(Being Debentures cancelled and profit on cancellation transferred to capital reserve)	

Balance Sheet S Limited as on 1st July 2014 (after absorption) : Purchase Method

Particulars	Rs. crores
I. Equity and Liabilities	
(1) Shareholders' Funds	
(a) Share capital (Note 1)	82.10
(b) Reserves and Surplus (Note 2)	471.90
(2) Non - Current Liabilities (Note3)	-
(3) Current Liabilities (Note 4)	676.00
Total	1230.00
II. Assets	
(1) Non-Current assets	
(a) Fixed Tangible Assets (200+40) – 100	140
(2) Current assets (800+290)	1,090
Total	1230.00

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Notes to Accounts: ***crores***

Note 1): Share Capital:

82100000 Equity Shares of Rs 10 each fully paid up	=	82.10

(of the above 21,00,000 equity shares are issued in pursuant of the Scheme of amalgamation)

Note 2): Reserves and Surplus:

Securities Premium	=	18.90
Capital Reserves (52+1)	=	53.00
Other Reserves (divisible profits)	=	400.00
		471.90

Note 3): Loans and borrowings:

2500000 10% Debentures	=	25.00
Less: Investments cancelled	=	(24.00)
Less: Capital Reserve on cancellation	=	(1.00)
		Nil

Note 4): Current Liabilities:

Trade payables (356+200)..........assumed	=	556.00
Other liabilities (120+0)	=	120.00
		676.00

Q 3 ....16 marks
Solution:
BALANCE SHEET OF HIM LTD AND ITS SUBSIDIARY AS ON 31/3/2014

Equity and Liabilities	*Notes*	
(i) Share holder Funds		
Share Capital	1	25,00,000
Reserves and Surplus	2	3,79,300
- Minority Interest		2,71,500
		-
(ii) Non Current Liabilities		
(iii) Current Liabilities		
Trade payables	3	6,90,500
Bill payables	3	96,000
Short term provisions		
Dividend proposed		2,50,000
Assets		41,87,300
(i) Non Current Assets		
Fixed Assets	3	27,95,000
Intangible Assets – G/W	(WN1)	22,300
(ii) Current Assets		
Inventories	3	7,70,200
Trade receivables	3	3,44,000
Bills receivables	3	1,53,000
Cash / Cash equivalents	3	1,02,800
		41,87,300

Notes to Accounts:
1) Share Capital:

Authorised Capital : 25,000 Equity Shares of Rs. 100/-	Rs 2500000
Issued, Paid up: 25,000 Equity Shares of Rs. 100/-	Rs 25,00,000
Total :	25,00,000

2) Consolidated Reserves and Surplus:

Profit / Loss balance	1,51,800
General Reserves	2,27,500
Total :	3,79,300

3) Consolidated asset / liabilities

	HIM	SIM	Eliminations	Total
Fixed assets	2170000	625000	-	2795000
Inventories	480000	319200	(29000)	770200
Trade receivables	180000	164000	-	344000
Bills receivables	68000	100000	(15000)	153000
Cash & CE	87500	15300	-	102800
Trade payables	455000	235000	-	690500
Bills payables	28000	83000	(15000)	96,000

1) Cost of Control :

Investments balance (Cash paid) Less: Share of pre net - worth	5,10,000 (4,87,700)
Goodwill	22,300

2) Analysis of Net Worth of SIM :

60%	Pre	Post	10%	Pre	Post
Share Capital	580000	-		580000	-
P / L	25000	180000		102000	103000
General Res.	80000	40000		85000	35000
	6,85,000	2,20,000		7,67,000	1,38,000
Share of HIM	4,11,000	1,32,000		76,700	13,800

Total Pre NW = 411000 + 76700 = Rs. 4,87,700

Total Post P/L = 180000 x 60% + 103000 x 10% = Rs. 1,18,300

Total Post G/R = 132000+13800 – 118300 = Rs. 27,500

3) Statement of Post acquisition reserves:

	P/L	G/R
Balance b/d	312500	200000
Share of post profits	118300	27500
Less: Dividends proposed	(250000)	-
Less: Stock Reserve (145000 x 1/5)	(29000)	-
Net =	1,51,800	2,27,500

4) Minority Interest = (580000 + 120000 + 205000) x 30% = Rs. 2,71,500

Q 4 (a)..................................12 marks

Solution:

Calculation of Cost of options:

	31/3/2012	31/3/2013	31/3/2014
Total Options vested	94000	88500	85500
Fair Value (60-40)	20	20	20
Total product	1880000	1770000	1710000
Cumulative Option cost	940000 (1880000 x ½)	1180000 (1770000 x 2/3)	1710000
Less: Already recognised	(Nil)	(940000)	(1180000)
Net Charge to P/L =	9,40,000	2,40,000	5,30,000

Journal Entries in the books of Virtual Ltd:

	31/3/2012	31/3/2013	31/3/2014
Employees Compensation Dr To ESOP outstanding (Being compensation expense recognised during the year)	940000 940000	240000 240000	530000 530000
Profit / loss a/c Dr To Employees Compensation (Being compensation expense trf to P/L a/c.)	940000 940000	240000 240000	530000 530000
ESOP outstanding Dr To General Reserve (Being 500 options forfeited)	-	-	10000 10000

Cash Dr (85000 x 40) ESOP outstanding Dr To Equity Share Capital To Securities Premium (Being balance exercised)	-	-	3400000 1700000 850000 4250000

Q 4 (b)............................... 4 marks

Solution: Calculation of PV of Cash Flows:

Yr	CF	PVF	Product	Yr	CF	PVF	Product
1-6	90000[1]	5.076	4,56,840	6^{th}	500000[2]	0.747	3,73,500
7-12	45000[3]	3.787	1,70,415	12^{th}	1100000[4]	0.557	6,12,700
			627255				986200
• 627255+986200 = Rs 16,13,455							

Note:

1) 20000 x 100 x 9% x ½ = 90000 ; 2) 20000 x 100 x 50% x 50% = 45000

3) 20000 x 100 x 50% x 9% x ½ = 45000 ; 4) 20000 x 100 x 50% x 110% = 1100000

5) Interest is taken as 5% for 12 years (6 x 2 multiples).

Split up of Equity and Debt component		Journal entry
Total proceeds recd Debentures element Equity (bal fig)	20,00,000 (16,13,455) 3,86,545	Bank A/C Dr 20,00,000 To 9% Debentures 16,13,455 To Equity 3,86,545 (Being Equity and Debt initially recognised)

Q 5............................16 marks

Solution:

Calculation of Avg Capital Employed	31/3/12	31/3/13	31/3/14
Tangible Assets Inventories Other Current assets Less: Current liabilities	13.2 6.32 3.71 (6.8)	14.3 8.47 5.51 (5.45)	15.75 10.68 6.29 (3.85)
Closing Capital Employed + Opening Capital Employed (WN1)	16.43 11.13	22.83 16.43	28.87 22.83
Total	27.56	39.26	51.70
Avg Capital Employed	13.78	19.63	25.85
NRR 10% = Normal Profit	1.378	1.963	2.585
FMP:			
Balance of P/L	2.64	5.95	8.25
Less: Opening balance of P/L	(2.18)	(2.64)	(5.95)
Add: Transfer to GR	2.60	0.90	1.25
Add: GW written off	1	1	1
Valuation difference of Stock	0.04	1.13	2.17
	-	(0.04)	(1.13)
Less: Depreciation on revaln 10%	(0.12)	(0.13)	(0.175)
FMP =	3.98	6.17	5.42
Super Profit	2.602	4.21	2.84

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AVG SUPER PROFITS = 3.22 GOODWILL = 4 X 3.22 = Rs. 12.87
Valuation of shares by Net Asset Method = Assets for ESH / Nos of shares Assets available to equity holders = Closing capital on 31/3/2014 / No of shares Capital employed = 28.87 + GW = 28.87+12.87 = Rs 41.71 lakhs Value per share = 41.71 / 0.12 = Rs 347.58
Valuation of shares by Yield Method = ERR / NRR x Face Value ERR = Profit available to ESH / Paid up Share Capital = 6.7773 / 12 x 100 = 56.44% Profits for equity holders = Avg FMP + Avg Transfer to GR = = (3.98+6.17+5.42) + (2.60+0.90+1.25) = Rs6.773 lakhs 3 VPS = (56.44 % / 10%) x 100 = Rs 564.44
Valuation of shares by Fair Value = (564.44+347.58) / 2 = Rs 456.

- The problem has not provided us with opening capital and goodwill on 1/4/2011. Opening capital = ESC + P/L + GR – G/W = 12 + 2.18 + 4.25 – 7.30 = 11.13. Where goodwill = 6.30 + 1.
- We assume that Goodwill at the beginning is 6.30 + written off 1 = 7.30. Alternatively we can take GW at the beginning Nil.
- Tax rate is irrelevant because while calculating FMP the items adjusted mainly reserves, appreciation on depreciation, stock upward revaluation is disallowed by IT Act.

Q 6 (a)......................... 8 marks

Solution: For calculating EVA following steps are applied:

Step1) Calculation of Operating Capital Employed: Step2) Operating Profits

	Rs lakhs		Rs lakhs
E S Capital	400	Profit before interest	1197.14
P S Capital	200	Less: Interest	(240)
Reserves and Surplus	220	EBT	957.14
Debentures	1600	Less: Tax	(287.14)
Less: Underwriting comm.	(20)	PAT	670
Less: Non trade invs	(140)	Less: Pref Dividend	(30)
Less: Property (investments)	(20)	Profits for ESH	640
Less: Advances for plant	(10)	No of equity shares	40,00,000
Less: Capital WIPs	(30)		
Operating capital	2200	EPS (given)	16 /-

Operating profits will be 1197.14 – Income from investments = Rs. 1187.14 lakhs. Accordingly OPAT = 1187.14 Less: Taxes 30% = Rs. 831 lakhs

Step 3) WACOC:

Ke = 9.85% + 1.65 (16.25%-9.85%) = 20.41%

Kd = 15% (1-0.30) = 10.50%

Kp = 15%

Capital employed will be = 400 + 200 + (220 -20) + 1600 = Rs. 2,400 lakhs

Ko = 20.41% [400+200] / 2400 + 10.50% [1600] / 2400 + 15% [200] / 2400 = 13.36%

Calculating Economic Value added = OPAT – Operating Capital Employed x WACO = 831 – (2200 x 13.36%)

= 831 – 293.92 = Rs 537.08 lakhs

Q 6 (b)........................ 8 marks
Solution:
Valuation of Human Resources by Lev and Schwartz:

	Skilled	**Unskilled**
Annual Salary.......a	75000	50000
Remaining life	3	2
Cum PVF @15%.......b	2.284	1.626
Product......(a * b)	171300	81300
No of Employees	40	50
Valuation in terms of Present Value	68,52,000	40,65,000
Total Valuation of human resources = Rs 10917000		

Factor @ 15% = 0.870, 0.756, 0.658

Q 7 ....4 marks each
(a)
Solution: Valuation of Investments: AS 13 on "Accounting for Investments" requires investments to be classified as long term and current investments distinctly in its financial statements. The investments in shares in a Joint Venture can very well be considered as trade investments since they would not be intended to be liquidated within a period of one year from its acquisition. Hence they would be classified as long term investments.
AS 13 states, "long-term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually". In the instant case, the decline in the value of investment seems to be temporary and the company has profitable plans in the coming years. Also investments in LTI are never valued at MV but even cash flows are considered.
Conclusion: No diminution required.
(b)
Solution: Derivatives: (AS-30)

Derivatives are contracts such as options, forwards, futures, and swaps. Because they are often entered into at no cost, many times derivatives were not recognized in financial statements prior to IAS 39 / AS-30. But now the accounting is done as soon as the contract for derivative is entered into. Even MTM valuation is done on year ending.

For an instrument to be eligible for derivative all the combined conditions should be satisfied:

1) Value of contract is based on current value of underlying asset. Ex: Interest rate in case of IRS, forward contract may be based upon the forex rate etc.

2) It requires low or no initial investments. In case of Swaps / forward Zero investments are required, in case of options premium is required. The initial investments are smaller as compared to other contract to have similar response to change in market factor.

3) Settlement takes place at a future date.

(c) Solution: The difference of Rs 100000 cannot be a prior period item as no error took place in the preparation of financial statement of past period. The estimated write off of the inventory Rs 6,00,000 (10-4) is revised to Rs 7,00,000. This is change in Accounting Estimates as per AS-**5.** Many items in the financial statement cannot be exactly calculated but can only be estimated. Estimation changes because of change in circumstances, more development in the case. In the given case the company is required to just disclose the change in a/c estimate in the financial statement.

(d) Solution:

Construction of factory shed is a qualifying asset because factory shed in being constructed. P & M is just installed which is not eligible for Q.A. Assuming that plant installation takes less period of time to get ready. This means only Rs 10,00,000 of loan is used for QA. Accordingly Interest of Rs 1,50,000 (1000000 x 9/12 x 20%) needs to be capitalised. The remaining interest will be charged to profit / loss a/c i.e. Rs 450000. (6-1.5).

Assumption*:* Year ending is March, Plant installation does not tak substantial period of time for installation.

If we assume that the installation of plant is a part of expansion programme or installation takes substantial period of time then in such case the Borrowing costs capitalised will be: Rs. 5,25,000

(e)Solution:

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case of Samrat Ltd, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper. The Auditor is required to issued a qualified report under section 143 and SA 705 of the Companies Act.

- Under the new schedule VI (because the paper is based on Sch VI) such a grant is disclosed under the head EQUITY.

THANKS

COMMENTS AND STRAIGHT TALK ON THE FINANCIAL REPORTING PAPER OF NOV 2014:

OVERALL: A very simple paper in the history of ICAI.

Q1 (a) Simple question on Deferred tax....a similar question was asked in Nov 2004
(b) AS-17 Segment Reporting again a simple question directly from Nov 2008.
(c) Combined problem on AS-28 and AS-26 and the same is taken from May 2008 regarding capitalisation of IA and its impairment.

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(d) Students never study Schedule VI disclosures and they are caught here! Exactly. Yes it was a problem on disclosure of FD's a tricky question for every one because they have not studied it.

Q2) A standard question on absorption with new company having shares in old. It is a common question in every text book. All the Coaching Classes can claim "The question came from our book".........its true.
Q3) Can anyone imagine ICAI can ask such an easy question on CFS where in the regime of IFRS such simple question may be a cluster of Holding + Subsidiary + Associates and JV. The problem was based on shares acquisition in 2 lots.

Q4) (a) A past RTP question. The problem of Share based payment was just based on performance condition and different vesting period.
(b) AS – 30 / 31 : ICAI has asked already 6-7 times the question on Compound Financial Instruments. This was bit creative and without error!. A similar question is included by Israr sir in his AS book AS-30 Q 28 (3rd Edition).

Q 5) Valuation of Shares. Already this topic has too many assumptions where the solution differs based on the assumption. But what about the paper with incomplete information? Somewhere Opening Capital and Opening GW is missing. Also Tax rate may be irrelevant. This question is similar to an already asked question in the past may be Nov 2003 and June 2009.

Due to its incomplete information the solution may differ from person to person.

Q 6) (a) Normally EVA is supposed to be a saving grace in tough papers, but here it was the opposite. EVA was bit different question. No credit to the paper setter as the question directly belongs to the text book of PC Tulsian.
(b) HRA: In the last attempt of May 2014 this topic has created havoc. But this time a repeatedly asked question made the paper quite easy to solve. It was just based on Present Value concept.

Q. 7 (a) Many students who are unaware of proper provisions of AS may write even a bibliography on AS-27 "Joint Venture".......sorry. This problem is from AS-13 Investment Accounts. This question has been asked several times by the ICAI by considering the investee company an associate.
(b) Short note: 3 conditions of derivative as per AS-30 that's all.
(c) AS-5: Students may even write something related to AS-2. It is related to change in A/C estimates. This question is taken from the past IPCC paper group II. Sometimes we don't understand the difference between the level of IPCC and CA Final for AS.
(d) Offfff!. A repeatedly asked question on AS-16. In fact in IPCC itself this question has been asked dozen a times.
(e) AS- 12. This question is taken from a past CA Final paper May 2005 on promoters contribution. We mean to say an easy question.

Disclaimer: Our Objective of giving solution is that students can go through it as soon as possible and come to know about mistakes made by them and accordingly make improvement in them. Also these are based on certain assumptions and answer may vary based on assumptions. The solutions are prepared putting best efforts basis only . The solution is based on views of authors. Students should also apply own knowledge before going further based on it. We hold no responsibility for anything and we shall not entertain any claim. Wishing all of u all the best for ur paper and bright future.