Gurukripa's Guideline Answers to Nov 2014 Exam Questions CA Final – FINANCIAL REPORTING

Question 1 is compulsory **(4 × 5 = 20 Marks)**
Answer **any five** questions from the **remaining six** questions **(16 × 5 = 80 Marks).** [Answer any 4 out of 5 in Q.7]

Question 1 (a): AS – 22 DTA / DTL Recognition **5 Marks**

From the given information, you are required to compute the Deferred Tax Assets and Deferred Tax Liability for Ramanujam Limited as on 31st March 2014. The tax rate applicable is 35%.

(i) The Company has charged Depreciation of ₹ 7,42,900 in its Books of Accounts while as per Income Tax computation, the Depreciation available to the Company is ₹ 8,65,400.

(ii) The Company has made Provision for Doubtful Debts for ₹ 54,300 during the year.

(iii) The Company has debited Share Issue Expenses of ₹ 6,23,500 which will be available for deduction under the Income Tax Act from the next year.

(iv) The expenses of ₹ 7,84,500 has been charged to Profit and Loss Account which are disallowed under the Income Tax Act.

(v) The Company has made Donation of ₹ 2,00,000 which has been debited to Profit and Loss Account and only 50% thereof will be allowed as deduction as per Income Tax Law.

Solution:

Similar to Page No.22.6, Q.No.13 of Padhuka's Students' Referencer on Accounting Standards [N 04, N 05]

Computation of DTA / DTL (₹)

Description	Adj.	Net Amt	Nature of Diff.	Treatment	DTA/DTL at 35%
Profit before Tax as per Books		XXX			
Add: Depreciation as per Books **Less:** Depreciation as per IT	7,42,900 (8,65,400)	(1,22,500)	Timing	Difference **originating** in the current year. So, **Create DTL.**	(42,875)
Add: Provision disallowed in IT		(54,300)	Permanent	Ignored	NA
Add: Share Issue Exp. Disallowed u/s 35D		6,23,500	Timing	Difference **originating** in the current year. So, **Create DTA.**	2,18,225
Add: Expense Disallowed under IT (assumed to be permanent diff)		7,84,500	Permanent	Ignored	NA
Add: Donation (50% of 2 Lakhs)		1,00,000	Permanent	Ignored	NA
Total Income		XXX			

Question 1 (b): AS – 17 Segment Reporting **5 Marks**

ABC Limited has three segments, viz. A,B, and C. The Total Assets of the Company is ₹ 15 Crores. The Assets of Segment A is ₹ 1.85 Crores, Segment B is ₹ 6.15 Crores and Segment C is ₹ 7.00 Crores. Assets of each Segments include Deferred Tax Assets of ₹ 0.50 Crores in A, ₹ 0.40 Crores in B and ₹ 0.30 Crores in C. The accountant of ABC Limited contends that all segments are reportable segments. Based on Segments Assets Criteria, determine the veracity of the contention of the Accountant.

Solution:

Same as Page No. 17.9, Q. No. 21 of Padhuka's Students' Referencer on Accounting Standards [N 08]

1. Segment Assets do not include Income Tax Assets. Therefore, the Revised Total Assets is [₹15 Crores – (0.5+0.4+0.3)] = ₹ 13.8 Crores, which is analysed as under –

Assets excluding DTA		Percentage of Total
A	1.85 – 0.5 = 1.35	9.78%
B	6.15 – 0.4 = 5.75	41.67%
C	7.00 – 0.3 = 6.70	48.55%
Total	**13.80**	**100.00%**

2. Segment A holds only less than 10% of Total Assets and hence **not** a reportable segment.
3. Segment B and C having more than 10% of Total Assets are reportable segments.
   Therefore, contention of the Accountant that all are reportable segments is **wrong**.

Note: However, if Segment A was a Reportable Segment in the earlier year, it will continue as a Reportable Segment, based on "Continuity Principle" **[Para 31]**.

Question 1 (c): AS – 26, 28 Intangible Assets — 5 Marks

Sunny Limited is developing a new production process. During the financial year ended 31st March 2013, the Company has incurred total expenditure of ₹ 40 Lakhs on the process. On 1st December 2012, the process has met the norms to be recognized as "Intangible Assets", and the expenditure incurred till that date is ₹ 16 Lakhs. During the financial year ending on 31st March 2014, the Company has further incurred ₹ 70 Lakhs. The Recoverable Amount as on 31st March 2014 of the process is estimated to be ₹ 62 Lakhs. You are required to work out:

(i) Expenditure to be charged to Profit and Loss Account for the financial year ending on 31st March 2013 and 31st March 2014 (ignore Depreciation)

(ii) Carrying Amount of the Intangible Assets as at 31st March 2013 and 31st March 2014.

Solution:

Same as Page No. 26.13, Q. No. 35 of Padhuka's Students' Referencer on Accounting Standards [M 08]

1. **Expenditure charged to P&L for 2012–2013:** ₹ 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.
2. **Carrying Amount of Intangible Asset as on 31.03.2013:** The Production Process will be recognized (i.e. Carrying Amount) as an Intangible Asset at a cost of ₹ 24 Lakhs (i.e. expenditure incurred till the date in which recognition criteria were met, i.e. Total during FY 2012–13 ₹ 40 Lakhs **less** Expenses upto 1st Dec 2012 ₹ 16 Lakhs).
3. **Expenditure charged to P&L A/c for 2013–2014:**

	Particulars	₹ Lakhs
	Book Value on 31.3.2014 = Carrying Amt on 31.3.2013 + Expenditure in 2013–2014 = 24 + 70	94
Less:	Recoverable Amount	62
	Impairment Loss to be charged to P&L A/c	**32**

4. **Carrying Amount of Intangible Asset as on 31.03.2014:** The Production Process will be shown at Book Value ₹ 94 Lakhs, or Recoverable Amount ₹ 62 Lakhs, whichever is less, hence at ₹ **62 Lakhs** as above.

Question 1 (d): Schedule III Disclosure — 5 Marks

XYZ Limited is having the following Fixed Deposit Receipts:

Bank	Date of FDR	Maturity Date	Amount
Axis Bank Limited	**01–Jan–14**	**30–Apr–15**	**10,00,000**
Punjab National Bank	**01–Jan–14**	**30–Jun–14**	**15,00,000**
State Bank of India	**28–Feb–14**	**30–May–14**	**10,00,000**
ICICI Bank	**31–Jan–13**	**31–Jan–15**	**10,00,000**

Prepare Notes to Accounts showing the above Deposits in accordance with the requirements of Revised Schedule III.

Solution:

Refer Page No. 1.22 Point 2 (d) of Padhuka's Students' Guide on Financial Reporting

Note 'X': Cash & Bank Balances as on 31.03.2014 (Balance Sheet Date)

Particulars	(₹)
(A) Cash in Hand	xxx
(B) Balances with Bank	
(i) Less than 12 Months Maturity.	
– Cash Equivalent as per AS–3 (less than 3 Months Maturity)	25,00,000
– Other Bank Balances	10,00,000
(ii) More than 12 Months Maturity	10,00,000
	45,00,000

Question 2: Amalgamation – Purchasing Co. holding in Selling Company **16 Marks**

The Summarised Balance Sheet of 'S' Limited and 'H' Limited as on 30th June 2014 were as follows: (₹ Crores)

Particulars	S Limited		H Limited	
Equity and Liabilities				
Equity Share Capital		80		25
Reserves and Surplus		400		75
10%, 25,00,000 Debentures of ₹ 100 each		–		25
Non–current Liabilities: Other Liabilities		120		–
Current Liabilities		356		200
Total Liabilities		**956**		**325**
Assets				
Fixed Assets(at cost)	200		75	
Less: Depreciation	100	100	50	25
Investment in 'H' Limited				
2 Crores Equity Shares of ₹ 10 each at cost	32			
10% 25,00,000 Debentures of ₹ 100 each at cost	24	56	–	–
Current Assets		800		300
Total Assets		**956**		**325**

In a duly approved scheme of absorption, 'S' Limited took over the assets of 'H' Limited at an agreed value of ₹ 330 Crores and the Liabilities were taken over at Book Value. Other Shareholders of 'H' Limited were allotted Equity Shares in 'S' Limited at a premium of ₹ 90 per share in satisfaction of their claim. 'S' Limited valued the Fixed Assets taken over at ₹ 40 Crores and all other Assets and Liabilities were recorded at Book Value. The scheme of absorption was completed on 1st July 2014.

You are required to:

(i) Pass necessary Journal entries in the books of 'S' Limited to record the transactions.

(ii) Prepare the Balance Sheet of 'S' Limited after absorption in the Schedule III format along with Notes to accounts.

Solution:

Refer Illustrations in Page No. 2.55 to Page No.2.71 of Padhuka's Students' Guide on Financial Reporting

1. Basic Information

Selling Co : H Ltd	**Date of B/S:** 1st July	**Nature of Amalgamation:**
Buying Co : S Ltd	**Date of Amg:** 1st July	Purchase (Since Assets are revalued for takeover)

2. Net Assets Taken over

Particulars	₹ Crores
Assets taken over	330.00
Less: Liabilities taken over – Debentures	(25.00)
– Current Liabilities	(200.00)
Net Assets Taken over	**75.00**
Since Purchasing Company S Ltd. Holds (₹ 20 Crores out of ₹ 25 Crores) = 80% of H Ltd. Shares, Outsiders Share of Interest (Minority Interest = 20%=₹15 Crores)	15.00
Purchase Consideration is paid in the form of Equity Shares of ₹ 10 each at ₹ 90 Premium. Value per Share = ₹ 100. Hence 15 Lakhs Shares × ₹ 100 = ₹15 Crores.	–

3. Journal Entries in the Books of S Ltd (₹ Crores)

Particulars		Debit	Credit
1. Business Purchase A/c	Dr.	15.00	
To Liquidator of H Ltd A/c			15.00
(Being Purchase Consideration Due on a scheme of amalgamation pursuant to HC Order No. ___ dated ___)			
2. Liquidator of H Ltd A/c	Dr.	15.00	
To Equity Share Capital A/c			1.50
To Securities Premium A/c			13.50
(Being Discharge of Purchase Consideration by issue of 15 Lakhs Equity Shares of ₹ 10 each at a premium of ₹ 90)			

Particulars		Debit	Credit
3. Fixed Assets A/c (at given value)	Dr.	40.00	
Current Assets A/c	Dr.	300.00	
To 10% Debentures A/c			25.00
To Current Liabilities A/c			200.00
To Investments A/c (Cancellation of Investment in Equity Shares of H Ltd.)			32.00
To Business Purchase A/c			15.00
To Capital Reserve A/c **(Bal. Fig)**			**68.00**
(Being Assets and Liabilities taken over)			
4. 10% Debentures A/c	Dr.	25.00	
To Investment in H Ltd (in Debentures)			24.00
To Capital Reserve			1.00
(Being Cancellation of Debentures on takeover)			

4. Balance Sheet of S Ltd as on 1st July (₹ Crores)

	Particulars as at 1st July		Note	This Year	Prev. Yr
I	**EQUITY AND LIABILITIES**				
(1)	**Shareholders' Funds:**				
	(a) Share Capital		**1**	81.50	
	(b) Reserves & Surplus		**2**	482.50	
(2)	**Non–Current Liabilities:**	Other Liabilities		120.00	
(3)	**Current Liabilities:**	(₹ 356 + ₹ 200)		556.00	
	Total			**1240.00**	
II	**ASSETS**				
(1)	**Non–Current Assets:**	– Fixed Assets (100 + 40)		140.00	
(2)	**Current Assets**	(₹ 800 + ₹ 300)		1100.00	
	Total			**1240.00**	

Notes to the Balance Sheet: **Note 1: Share Capital (₹ Crores)**

Particulars	This Year	Prev. Year
Authorised: ……… Equity Shares of ₹ …. each		
Issued, Subscribed & Paid up: 8.15 Crores Equity Shares of ₹ 10 each (Of the above Shares, 75 Lakhs Shares are allotted for consideration other than cash)	81.50	
Total	**81.50**	

Note 2: Reserves and Surplus (₹ Crores)

	Particulars	Free Reserves	Securities Premium	Capital Reserve
	Opening Balance	400.00	Nil	Nil
Add:	Arising on Amalgamation	Nil	13.50	68.00 + 1.00
	Closing Balance	400.00	13.50	69.00
	Total		**482.50**	

Question 3: Consolidation of Financial Statements **16 Marks**

'HIM' Limited is a Company carrying on the business of beauty products and is having a subsidiary 'SIM' Limited. Their Balance Sheet as on 31st March 2014 were as under:

	HIM Limited	SIM Limited
Shareholders Fund		
Share Capital	**25,00,000**	**5,80,000**
Reserves and Surplus		
General Reserves	**2,00,000**	**1,20,000**
Profit and Loss Account	**3,12,500**	**2,05,000**

	HIM Limited	SIM Limited
Current Liabilities		
Trade Payable	4,55,000	2,35,500
Bills Payable	28,000	83,000
Total Liabilities	**34,95,500**	**12,23,500**
Assets		
A. Non–Current Assets		
1. Fixed Assets	21,70,000	6,25,000
2. Non–current Investments (4060 Shares in SIM Limited)	5,10,000	–
B. Current Assets		
Inventories	4,80,000	3,19,200
Trade Payable	1,80,000	1,64,000
Bills Receivable	68,000	1,00,000
Cash and Bank Balances	87,500	15,300
Total Assets	**34,95,500**	**12,23,500**

HIM Limited has also given the following information:

(i) HIM Limited has acquired the shares in SIM Limited in two lots on two different dates. The relevant information at the time of acquisition of shares was as under:

No. of Shares acquired	Balance in General Reserves	Balance in Profit and Loss Account
1st Acquisition 3480	80,000	25,000
2nd Acquisition 580	85,000	1,02,000

(ii) Bill Receivable of HIM Limited includes ₹ 15,000 being acceptance from SIM Limited.

(iii) Both the Companies have declared dividends of 10% for the year ended on 31st March 2014, but it has not been provided in the books of accounts.

(iv) SIM Limited's Inventory includes Stock of ₹ 1,45,000 purchased from HIM Limited. HIM Limited sells goods at Mark–up of 25% on its cost.

Prepare the Consolidated Balance Sheet of HIM Limited along with "Notes to Accounts".

Solution:

Similar to Page No. 3.91 Q.No. 35 of Padhuka's Students' Guide on Financial Reporting [N 00 (Mod.), N 13 (Mod.)]

1. Basic Information

Company Status		Date of Acquisition: 31.03.2014	Holding Status	
			1st Acquisition	**2nd Acquisition**
Holding Company	= HIM Ltd	1st Acquisition = 3480 Shares	60%	10%
Subsidiary Company	= SIM Ltd	1st Acquisition = 580 Shares		

Date of Consolidation = 31.03.2014

2. Analysis of Reserves (₹)

(a) General Reserve Account

Balance as per B/s ₹ **1,20,000**

1st Acquisition = ₹ 80,000	2nd Acquisition = ₹ 5,000	Post–Acquisition = ₹ 35,000
(a) HIM:	(a) HIM:	(a) HIM: 70% – ₹ 24,500 Post–acqn
60% – ₹ 48,000 Pre–acqn	60% – ₹ 30,000 Post–acqn	(b) Minority: 30% – ₹ 10,500
10% – ₹ 8,000 Pre–acquisition	10% – ₹ 500 Pre–acquisition	
(b) Minority: 30% – ₹ 24,000	(c) Minority: 30% – ₹ 1,500	

(b) Profit & Loss Account

Balance as per B/s ₹ **2,05,000**

1st Acquisition = ₹ 25,000	2nd Acquisition = ₹ 77,000	Post–Acquisition = ₹ 1,03,000
(a) HIM: 60% – ₹ 15,000 Pre–acqn 10% – ₹ 2,500 Pre–acquisition (b) Minority: 30% – ₹ 7,500	(a) HIM: 60% – ₹ 46,200 Post–acqn 10% – ₹ 7,700 Pre–acquisition (b) Minority: 30% – ₹ 23,100	(a) HIM: 70% – ₹ 72,100 Post–acqn (b) Minority: 30% – ₹ 30,900

3. Other Adjustments

Particulars		Debit	Credit
(a) Inter–unit owings cancelled			
Bills Payable A/c	Dr.	15,000	
To Bills Receivable A/c			15,000
(Being Inter–unit owings cancelled)			
(b) Dividend declared to be provided in Books			
Profit & Loss A/c	Dr.	2,50,000	
To Dividend Payable A/c			2,50,000
(Being provision for dividend to be declared)			
(c) Unrealised Profit on Downstream Transaction (Note)			
Profit & Loss A/c [HIM Ltd]	Dr.	29,000	
To Closing Stock			29,000
(Being Elimination of Unrealised Profit in Closing Stock)			

Note: HIM Ltd sold to SIM Ltd = Profit = 25% on Cost = 1/5 on Sale Price = 1/5 on ₹ 1,45,000 = ₹ 29,000

4. Minority Interest

Particulars	(₹)
(a) Share Capital [₹ 5,80,000 × 30%]	1,74,000
(b) Pre–acquisition Reserve & Post–acquisition Reserve [24,000 + 1,500 + 10,500 + 7,500 + 23,100 + 30,900]	97,500
Total	**2,71,500**

5. Cost of Control

	Particulars	(₹)
	Cost of Investments	5,10,000
Less:	Share in Net Assets	
	(a) Share Capital (₹ 5,80,000 × 70%)	(4,06,000)
	(b) Pre–Acquisition Profit (48,000 + 15,000 + 12,500 + 7,700 + 8,000 + 500)	(81,700)
	Goodwill	**22,300**

6. Consolidated Balance Sheet of HIM Ltd SIM Ltd as at 31.03.2014 (₹)

	Particulars as at 31st March		Note	This Year	Prev. Yr
I	**EQUITY AND LIABILITIES**				
(1)	**Shareholders' Funds:**				
	(a) Share Capital		**1**	25,00,000	
	(b) Reserves & Surplus		**2**	3,79,300	
(2)	**Minority Interest**			2,71,500	
(3)	**Current Liabilities**				
	Trade Payables	– Creditors (4,55,000 + 2,35,500)		6,90,500	
		– Bills Payable (28,000 + 83,000 – 15,000)		96,000	
		– Dividends Payable		2,50,000	
	Total			**41,87,300**	

	Particulars as at 31st March	Note	This Year	Prev. Yr
II	**ASSETS**			
(1)	**Non–Current Assets**			
	Fixed Assets: (i) Tangible Assets (21,70,000 + 6,25,000)		2,79,500	
	(ii) Intangible Assets – Goodwill on Consolidation		22,300	
(2)	**Current Assets**			
	(a) Inventories (4,80,000 + 3,19,200 – 29,000)		7,70,200	
	(b) Trade Payables (1,80,000 + 1,64,000)		3,44,000	
	(c) Bills Receivable (68,000 + 1,00,000 – 15,000)		1,53,000	
	(d) Cash & Cash Equivalents (87,500 + 15,300)		1,02,800	
	Total		**41,87,300**	

Working Notes:

1. Balance Sheet items have been consolidated on line–by–line addition basis.
2. Inter–Company Owings (Trading Liabilities and Debentures) have been eliminated in full.

Notes to the Balance Sheet (₹)

Note 1: Share Capital

Particulars	This Year	Prev. Year
Authorised: Equity Shares of ₹ 10 each		
Issued, Subscribed & Paid up: 2,50,000 Equity Shares of ₹ 10 each	25,00,000	
Total	**25,00,000**	

Note 2: Reserves and Surplus

	Particulars	General Reserve	Profit & Loss A/c
	HIM Ltd	2,00,000	3,12,500
Less:	Proposed Dividend	–	(2,50,000)
Add:	Post–Acquisition Reserve of SIM Ltd	(3,000 + 24,500) = 27,500	(46,200 + 72,100) = 1,80,800
Less:	Unrealised Profit on Closing Stock	–	(29,000)
	Total	**2,27,500**	**1,51,800**

Question 4(a):Accounting for ESOP **12 Marks**

Virtual Limited granted on 1st April 2011, 1,00,000 Employees Stock Option at ₹ 40, when the Market Price was ₹ 60. These options will vest at the end of Year 1, if the earning of Virtual Limited is more than 15% or it will vest at the end of the year 2, if the average earnings of two years is more than 12% or lastly it will vest at the end of third year, if the average earnings of 3 years will be 9% or more. 6000 unvested options lapsed on 31st March 2012. 5,500 unvested options lapsed on 31st March 2013 and finally 3,000 unvested options lapsed on 31st March 2014.

The earnings of Virtual Limited was as follows:

Year ended on	Earnings in %
31.3.2012	13%
31.3.2013	9%
31.3.2014	7%

Employees exercised for 85,000 Stock Options which vested in them at the first opportunity and the balance options were lapsed. Pass necessary journal entries and show the necessary working.

Solution:

Similar to Page No. 5.26 Q.No. 17 of Padhuka's Students' Guide on Financial Reporting

Journal Entries in the Books of Virtual Ltd

Date	Particulars		Debit ₹	Credit ₹
31.03.2012	Employees Compensation Expenses A/c	Dr.	9,40,000	
	To Employees Stock Options Outstanding A/c			9,40,000
	(Being Compensation Expenses recognized in respect of Employee Stock Option, i.e. 94,000 options at a discount of ₹ 20 each) **[Working Note 1]**			
31.03.2013	Employees Compensation Expenses A/c	Dr.	2,40,000	
	To Employees Stock Options Outstanding A/c			2,40,000
	(Being Compensation Expenses recognized in ESOP A/c) **[Working Note 2]**			
31.03.2014	Employees Compensation Expenses A/c	Dr.	5,30,000	
	To Employees Stock Option Outstanding A/c			5,30,000
	(Being Compensation Expenses recognized in ESOP) **[Working Note 3]**			
31.12.2014	Bank A/c [85,000 × ₹ 20]	Dr.	34,00,000	
	Employee Stock Options Outstanding A/c	Dr.	17,00,000	
	To Equity Share Capital A/c [85,000 × ₹ 10]			8,50,000
	To Securities Premium A/c [85,000 × ₹ 50]			42,50,000
	(Being 85,000 Options exercised)			
During FY 2014–15	Employee Stock Option Outstanding A/c [500 × ₹ 20]	Dr.	10,000	
	To General Reserve A/c			10,000
	(Being ESOP outstanding A/c on lapse of 500 options transferred to General Reserve)			

Working Notes:

Computation of Expense to be recognized for Liability component

1. Year 2012–13

Particulars	Amount
Number of Shares expected to vest	94,000
Compensation Expenses accrued at ₹ 20 (₹ 60 – ₹ 40)	₹ 18,80,000
Vesting Period	2 Years
Expense Recognized for 2012–13 = ₹ 18,80,000 ÷ 2 Years	**₹ 9,40,000**

2. Year 2013–14

Particulars	Amount
Number of Shares expected to vest	88,500
Compensation expenses accrued at ₹ 20 (₹ 60 – ₹ 40)	₹ 17,70,000
Vesting Period	3 Years
Cumulative Expenses to be recognized upto 2013 – 14 = ₹ 17,70,000 ÷ 3 Years × 2 Years	₹ 11,80,000
Less: Expense recognized in 2012–13	₹ 9,40,000
Expense Recognized in 2013–14	**₹ 2,40,000**

3. Year 2014–15

Particulars	Amount
Number of Shares vesting at Year End	85,500
Compensation Expenses accrued at ₹ 20 (₹ 60 – ₹ 40)	₹ 17,10,000
Less: Expense recognized in 2012–13 and 2013–14	₹ 11,80,000
Expense Recognized in 2014–15	**₹ 5,30,000**

Question 4(b) AS – 30, 31 Financial Instruments **4 Marks**

Adventure Limited issued 20,000, 9% Convertible Debentures of ₹ 100 each at par at the beginning of the year. The Debentures are of 6 years term. The interest will be paid half yearly. The debenture–holders have the option to get 50% of the Debentures converted into 2 Ordinary Shares at the end of 3rd year. The Debenture holders who do not opt for conversion will be paid 50% of their Face Value at the end of the year 3. The balance non–convertible portion will be repaid at 10% premium at the end of term of the Debentures. At the time of issue, the prevailing market interest rate for similar Debt without Convertibility Option is 10%.

Present Value of Annuity is as under

Period	1–3	4–6	7–12
Annuity factor @10%	2.487	1.868	2.459
Annuity factor @ 5%	2.723	2.353	3.787

Present Value of ₹ 1 at the end of 3 years at 10% and 5% is 0.565 and 0.747 respectively. Present Value of ₹ 1 at the end of 6 years at 10% and 5% is 0.317 and 0.557 respectively.

Compute the Liability Component and Equity Component and pass necessary Journal Entries recognizing the issue of Debentures.

Solution:

Similar to Page No. 31.19, Q. No. 35 of Padhuka's Students' Referencer on Accounting Standards

1. **Computation of Fair Value of Liability Component:** PV of Cash Flows from debentures discounted at market rate of 10%

(a) Year 1 to 3 ⇒ Half Yearly cash flow of ₹ 4.5 (i.e. ₹ 100 × 9% × $\frac{6}{12}$)

(b) End of year 3 ⇒ 50% redemption ⇒ ₹ 50

(c) Year 4 to Year 6 ⇒ Half Yearly Cash Flow of ₹2.25 (i.e. ₹ 50 × 9% × $\frac{6}{12}$)

(d) End of Year 6 ⇒ Balance + 10% Premium = 50 + 5 = ₹ 55

Half year	Cash Flow	HYDF @ 5%	DCF
1	4.50	0.9524	4.29
2	4.50	0.9070	4.08
3	4.50	0.8638	3.89
4	4.50	0.8227	3.70
5	4.50	0.7835	3.53
6	54.50	0.7462	40.67
7	2.25	0.7107	1.60
8	2.25	0.6768	1.52
9	2.25	0.6446	1.45
10	2.25	0.6139	1.38
11	2.25	0.5847	1.32
12	57.25	0.5568	31.88
			99.30

2. Value of Option (Equity) = Issue Price of Debenture ₹ 100 (–) Liability Component as above ₹ 99.30 = ₹ 0.70

3. Journal Entries

Particulars		Debit (₹)	Credit (₹)
Bank A/c	Dr.	20,00,000	
To Debenture Liability A/c (20,000 × ₹ 99.30)			19,86,000
To Options Liability A/c (20,000 × ₹ 0.70)			14,000
(Being issue of 20,000 9% Debenture of ₹100 each with a convertible option, accounted)			

Question 5: Valuation of Shares **16 Marks**

The majority Shareholders of MSL Limited desire to sell their holding to influx funds. The following information has been provided by MSL Limited:

Particulars	2012	2013	2014
Equity and Liabilities			
12000 Equity Shares of ₹100 each	**12.00**	**12.00**	**12.00**
General Reserve	**6.85**	**7.75**	**9.00**
Profit and Loss Account	**2.64**	**5.95**	**8.25**
Current Liabilities	**6.80**	**5.45**	**3.85**
Total	**28.29**	**31.15**	**33.10**

Particulars	2012	2013	2014
Assets			
Tangible Assets	**12.00**	**13.00**	**14.00**
Intangible Assets			
Goodwill	**6.30**	**5.30**	**4.30**
Current Assets			
Inventories	**6.28**	**7.34**	**8.51**
Other Current Assets	**3.71**	**5.51**	**6.29**
Total	**28.29**	**31.15**	**33.10**

(i) The valuation of the Tangible Assets has been done by a Professional Valuer and increase of 10% in the year 2011–12 and 2012–13 and 12.5% in 2014 is estimated over the given book value.

(ii) The inventories have been valued at ₹ 6.32 Lakhs as on 31st March 2012, ₹ 8.47 Lakhs as on 31st March 2013 and ₹ 10.68 Lakhs as on 31st March 2014.

(iii) The Company has been charging depreciation @ 10% p.a.

(iv) The balance of P & L Account and General Reserve on 1st April 2011 was ₹ 2.18 Lakhs and ₹ 4.25 Lakhs respectively.

(v) Tax Rate was 30% in all the years.

(vi) The Goodwill shall be revalued based on 4 years purchase of average super profits of last three years.

(vii) The normal expectation in the industry is 10%.

Calculate the Fair Value of Shares of MSL Limited.

Solution:

Similar to Page No. 4.25 Q.No. 9 of Padhuka's Students' Guide on Financial Reporting [M 11]

1. Valuation of Net Assets (other than Goodwill) (₹ Lakhs)

	Particulars	2012	2013	2014
1. Value of Assets (other than Goodwill)				
	Tangible Assets (Fair Value)	13.20	14.30	15.75
		[12+10%]	[13+10%]	[14+12.5%]
	Inventories [value as given]	6.32	8.47	10.68
	Other Current Assets	3.71	5.51	6.29
Less:	Current Liabilities	(6.80)	(5.45)	(3.85)
	Net Assets available for Equity Shareholders / CE	**16.43**	**22.83**	**28.87**

2. Computation of Profits (₹ Lakhs)

	Particulars	P&L A/c	Gen Res	Total
	Closing Bal. as on 31.03.2014	8.25	9	17.25
Less:	Bal as on 31.03.2013	5.95	7.75	13.7
	Profit for the year 2013–14	**2.3**	**1.25**	**3.55**
	Closing Bal. as on 31.03.2013	5.95	7.75	13.7
Less:	Bal as on 31.03.2012	2.64	6.85	9.49
	Profit for the year 2012–13	**3.31**	**0.9**	**4.21**
	Closing Bal. as on 31.03.2012	2.64	6.85	9.49
Less:	Bal as on 31.03.2011	2.18	4.25	6.43
	Profit for the year 2011–12	**0.46**	**2.6**	**3.06**

3. Computation of FMP (₹ Lakhs)

	Particulars	2012	2013	2014
	Profits after Taxes for the year (as per WN 2)	3.06	4.21	3.55
	Profit Before Taxes= $\frac{PAT}{1-30\%}$	4.37	6.01	5.07
Less:	Additional Depreciation @ 10% on increase in value of Tangible Assets	0.12	0.13	0.18
		[13.2–12]	[14.3–13]	[15.75–14]

	Particulars	2012	2013	2014
Add:	Increase in Value of Closing Stock	0.04 [6.32–6.28]	1.13 [8.47–7.34]	2.17 [15.75–14]
Less:	Increase in value of Opening Stock	–	(0.04)	(1.13)
	Profit after above adjustments	4.29	6.97	5.94
Less:	Tax @ 30%	1.29	2.09	1.78
	Future Maintainable Profits	**3.00**	**4.88**	**4.16**

4. Computation of Goodwill (₹ Lakhs)

Particulars	2012	2013	2014
Profits for 3 years = FMP as above	3.00	4.88	4.16
Capital Employed	16.43	22.83	28.87
Normal Industry Return @ 10% (Capital Employed × 10%)	1.64	2.28	2.89
Super Profit (Future Profit – Industry Return)	1.36	2.60	1.27

Average Super Profit = $\frac{1.36 + 2.60 + 1.27}{3}$ **= 1.74.** **Goodwill at 4 years purchase [1.74 × 4] = 6.96**

5. Value of Shares as at 2014 (₹ Lakhs)

	Particulars	2014
	Net Assets Value of Company	28.87
Add:	Goodwill as above	6.96
	Total Fair Value of Company	**35.83**
	No. of Equity Shares	12,000 Shares
	Value per Equity Share = $\frac{35.83 \text{ Lakhs}}{12{,}000 \text{ Shares}}$	**298.58**

Question 6(a): EVA **8 Marks**

DISA&Co. has provided the following information:

Particulars	₹ in Lakhs
Equity Share Capital (₹ 10 each)	400
15% Preference Share Capital	200
Reserves and Surplus	220
15% Debentures	1600
10% Non–Trade Investment (Nominal Value ₹100 Lakhs)	140
Land and Building held for Investment	20
Advance given for purchase of Plant	10
Capital Work in Progress	30
Underwriting Commission (not written off)	20
Earnings per Share	16
Tax Rate	30%
Beta Factor	1.65
Market Rate of Return	16.25%
Risk Free Rate	9.85%

Calculate Economic Value Added by the Company.

Solution:

Similar to Page No. 7.31 Q.No. 3 of Padhuka's Students' Guide on Financial Reporting [M 10]

1. Computation of WACC

Component	Amount	Return	Product
Equity Share Capital	₹ 400 Lakhs	9.85 + 1.65 (16.25 – 9.85) = 20.41%	81.64
Preference Shares	₹ 200 Lakhs	15.00%	30.00
Reserves & Surplus	₹ 220 Lakhs	As above = 20.41%	44.90
Debt	₹ 1600 Lakhs	[15% × (1–30%)] = 10.50%	168.00
Total	**₹ 2,420 Lakhs**		**324.54**

WACC = $\frac{324.54}{2,420} = 13.41\%$

2. Computation of EBIT (by reverse working)

	Particulars	₹ Lakhs
	EBIT	1197.14
Less:	Interest [1600 × 15%]	(240.00)
	EBT ($\frac{670}{70\%}$)	957.14
Less:	Taxes [957.14 × 30%]	(287.14)
	EAT	670.00
Less:	Preference Dividend [200 × 15%]	(30.00)
	Equity Earnings [40 Lakhs × ₹ 16]	640.00
	No. of Shares	40.00
	EPS	**16.00**

3. Computation of Capital Employed

	Particulars	₹ Lakhs
	Equity	400
	Preference	200
	Reserves & Surplus	220
	Debentures	1600
Less:	Underwriting Commission not written off	(20)
	Total	**2400**

4. Computation of EVA

(a) NOPAT = EBIT × (1 – Tax rate) = 1,197.14 x (1–30%) = ₹ 838

(b) EVA = Net Operating Profit After Tax – [Capital Employed × WACC] = 838 – [2,400 × 13.41%] = 516.16

Note/ Assumption:

1. NOPAT exclude income from Non Trade investments & Investment Properties. Hence, the same has to be reduced from NOPAT.
2. However, in this case, Non–Trade investment & Land & Building (held as Investments) need not be reduced from Capital Employed, since given Beta is Beta of the Company as a whole after considering all types of income.
3. Alternatively, Investment Income can be reduced from NOPAT & Investments can be reduced from Capital Employed to find EVA.

Question 6(b): Human Resource Accounting **8 Marks**

From the following details, compute the Total Value of Human Resources of skilled and unskilled group of employees according to Lev and Schwartz (1971) Model:

	Skilled	Unskilled
Annual average earning of an employee till the retirement age	**75,000**	**50,000**
Age of retirement	**68 years**	**65 years**
Discount Rate	**15%**	**15%**
No. of employees in the group	**40**	**50**
Average age	**65**	**63**

Solution:

Similar to Page No. 7.42 Q.No. 2 of Padhuka's Students' Guide on Financial Reporting [N 12]

	Particulars	Skilled	Unskilled
1.	Average Age	65 years	63 years
2.	Age of Retirement	68 years	65 years
3.	Remaining Period of employment	3 years	2 years
4.	Annual Earnings Per Employee	75,000	50,000
5.	Annuity Factor at 15% for 3 / 2 Years	2.2832	1.6257
6.	Value of Employees = Present Value of Future Earnings of Employees = Annual Earnings × Annuity Factor (4) × (5)	1,71,240	81,285
7.	No of Employees	40	50
8.	So, Total Value of Human Resources (6) ×(7)	**₹ 68,49,600**	**₹ 40,64,250**
		₹ 1,09,13,850	

Question 7(a): AS – 13 Investments **4 Marks**

JVR Limited has made investment of ₹ 97.84 Crores in Equity Shares of QSR Limited in pursuance of Joint Venture agreement in 2001–02. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re–assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment. However, QSR Limited has futuristic and profitable business plans and projection for the coming years. Discuss whether the connection of JVR Limited to bring down the Carrying Amount of Investment in QSR Limited is in accordance with Accounting Standards

Solution:

Refer to Page No. 30.2, Q. No. 21 of Padhuka's Students' Referencer on Accounting Standards

(a) The question is on accounting in the books of Stand Alone Financial Statements of JVR Ltd. Hence AS–27 is not applicable. AS–13 is applicable.

(b) **Provisions of AS–13:**

- **Carrying Amount:** Long–Term Investments are usually carried at **Cost**.
- **Basis:** Long–Term Investments are of individual importance to an enterprise. So, the Carrying Amount is determined on an **individual** basis.
- **Decline in Value:**
  (a) When there is a **permanent decline** in the value of a long–term investment, the Carrying Amount is reduced in order to recognise the decline. The reduction in value shall be determined and made for each investment **individually**.
  (b) **Temporary Fall** in the value of long–term investments need **not** be provided for.

(c) **Conclusion:** If QSR Ltd has demonstrative future maintainable profits, then the present losses can be considered as "Temporary" in nature. Hence as there is no permanent decline in the value, there is no need for creating any provision for loss on value of investments.

Question 7(b): AS – 30 Derivative **4 Marks**

What is a Derivative? Define with reference to AS–30, Financial Instruments: Recognition and Measurement.

Solution:

Refer to Page No. 30.2, Q. No. 3 of Padhuka's Students' Referencer on Accounting Standards

1. **Meaning and Features [Para 8.1]:** A Derivative is a Financial Instrument or other contract within the scope of AS – 30, with **all** three of the following characteristics –

Feature	Description
(a) Change in Value based on "**underlying**"	• Value of a Derivative changes in response to the change in the "**underlying**". • Such "**underlying**" can be a specified – (i) Interest Rate, (ii) Financial Instrument Price, (iii) Commodity Price, (iv) Foreign Exchange Rate, (v) Index of Prices or Rates, (vi) Credit Rating or Credit Index, or (vii) Other Variable. • If the "underlying" is a Non–Financial Variable, that Variable should **not** be specific to a party to the contract.
(b) No or Low Initial Investment	• The Derivative requires **no** Initial Net Investment or an Initial Net Investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. • An **Option Contract** is thus a Derivative, because the Premium is less than the investment that would be required to obtain the underlying Financial Instrument to which the option is linked. **[Para A.30]** • A **Currency Swap** that requires an initial exchange of different currencies of equal Fair Values is a **Derivative** because it has a zero Initial Net Investment. **[Para A.30]**
(c) Future Settlement	The Derivative is settled at a **future date**.

2. **Examples [Para A.28]:** Typical examples of Derivatives are – Futures and Forwards, Swap and Option Contracts.

Question 7(c): AS – 5 Prior Period / Revision in Estimate **4 Marks**

Finished Goods costing ₹ 10 Lakhs were damaged due to flood in July 2013. These goods were included in Closing Stock as on March 31,2014 at an estimated realizable value of ₹ 4.00 Lakhs.
These goods could be ultimately sold for ₹ 3 Lakhs only in August 2014. The difference of ₹ 1 Lakh was debited as Prior Period expenditure in financial year 2014–15. As an auditor, please comment in the light of provisions of Accounting Standards.

Solution:

Same as Page No. 5.8, Q. No. 26 of Padhuka's Students' Referencer on Accounting Standards [P (Aud) M 07]

1. **Prior Period Item:** Write–back of provision made in respect of inventories in the earlier year **does not constitute** Prior Period Adjustment since it is not an error or omission relating to prior period Financial Statements. It merely involves making estimates based on prevailing circumstances when these Financial Statements were being prepared.

2. **Revision of Estimate:** An **estimate** may have to be **revised** – (a) if changes occur in the circumstances on which the estimate was based, (b) or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an Extra–Ordinary Item or a Prior Period Item.

3. **Analysis:** There is no error or omission in the Prior Period, in this case. It is a case of change in accounting estimates as to the estimated NRV of damaged item, which have changed when the damaged goods have been finally sold.

4. **Conclusion:** The difference of ₹ 1 Lakh is **not** a Prior Period Item. Hence, debiting it to Prior Period Expenditure in the accounting year 2013–14 is a wrong accounting treatment.

Question 7(d): AS – 16 Borrowing Costs **4 Marks**

XYZ Limited acquired a Bank Loan of ₹ 40 Lakhs on interest rate of 20% per annum on 1 July 2013. The said loan was utilized by the Company for three transaction as under:

(i) Construction of Factory Shed ₹ 10,00,000

(ii) Purchase of Plant and Machinery ₹ 25,00,000

(iii) Balance Loan was unallocated and used generally for the purpose of business.

The Accountant of the Company has charged the total interest to the Profit and Loss Account. Comment in view of provisions of AS–16.

Solution:

Similar to Page No. 16.4, Q. No. 11 & 12 of Padhuka's Students' Referencer on Accounting Standards

[M 11, N 11 (Mod.), F (A/c) – RTP, M 99, N 02, F (Aud) – M 96, P (A/c) – RTP, N 04, M 10 (Mod.)]

The treatment for the Total Interest is as under –

Purpose / Utilisation	Loan Amt.	Interest Amount	Accounting Treatment
Construction of Factory Shed	₹ 10 Lakhs	₹ 10 Lakhs × 20% × $\frac{9}{12}$ = ₹ 1,50,000	Added to Cost of Factory Shed as per AS–16.
Purchase of Machinery	₹ 25 Lakhs	₹ 25 Lakhs × 20% × $\frac{9}{12}$ = ₹ 3,75,000	Added to Plant & Machinery as per AS–16.
Other Purposes	₹ 5 Lakhs	₹ 5 Lakhs × 20% × $\frac{9}{12}$ = ₹ 75,000	Written off to P&L A/c as **Expense**, as per AS–16.
Total	**₹ 40 Lakhs**	**₹ 52.20 Lakhs**	

Question 7(e): AS – 12 Government Grants **4 Marks**

Samrat Limited has set up its business in a designated backward area which entitles the Company for subsidy of 25% of the total investment from Government of India. The Company has invested ₹ 80 Crores in the eligible investments. The Company is eligible for the Subsidy and has received ₹ 20 Crores from the Government in February 2014. The Company wants to recognize the said Subsidy as its Income to improve the bottom line of the Company. Do you approve the action of the Company in accordance with the Accounting Standards?

Solution:

Similar to Page No. 12.9, Q. No. 26 of Padhuka's Students' Referencer on Accounting Standards [F (A/c) –

N 92, N 95, F (Aud) – RTP, P (A/c) – RTP, M 08

1. The Government Grants may be in the nature of Promoters' Contribution, i.e. –
   (a) they are given with reference to the Total Investment in an undertaking, or
   (b) by way of contribution towards its Total Capital Outlay, (e.g. Central Investment Subsidy Scheme)

2. They cannot be shown as income in the Profit and Loss Account . Such Grants are **not** ordinarily expected to be repaid. Hence they are treated as **Capital Reserve,** and as part of Shareholders' Funds which cannot be distributed as dividend or considered as Deferred Income.

3. Only Grants which are not revenue in nature can be capitalized. The correct treatment is to credit the Subsidy to **Capital Reserve.**

STUDENTS' NOTES