

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

1. (a) Computation of Unearned Finance Income

Gross investment = Minimum lease payments + Unguaranteed residual value
 = (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

$$= [(Rs. 5,00,000 \times 5 \text{ years}) + Rs. 1,00,000] + Rs. 1,00,000 = Rs. 27,00,000$$

Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value	
	Rs.		Rs.	
1	5,00,000	.8696	4,34,800	
2	5,00,000	.7561	3,78,050	
3	5,00,000	.6575	3,28,750	
4	5,00,000	.5718	2,85,900	
5	5,00,000	.4972	2,48,600	
	1,00,000	.4972	49,720	
	(guaranteed residual value)			
			17,25,820	(i)
	1,00,000	.4972	49,720	(ii)
	(unguaranteed residual value)			
		(i) + (ii)	17,75,540	(b)

$$\text{Unearned Finance Income} = (a) - (b)$$

$$= Rs. 27,00,000 - Rs. 17,75,540 = Rs. 9,24,460$$

(b) According to AS 10 (Revised), these costs can be capitalized:

1.	Cost of the plant	Rs. 25,00,000
2.	Initial delivery and handling costs	Rs. 2,00,000

3.	Cost of site preparation	Rs. 6,00,000
4.	Consultants' fees	Rs. 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	<u>Rs. 3,00,000</u>
		<u>Rs. 43,00,000</u>

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs. 2,00,000 and operating losses before commercial production amounting to Rs. 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

(c) Transaction 1: Calculation of exchange difference on fixed assets

$$\text{Foreign Exchange Liability} = \frac{5,000}{50} = \text{US \$ 100 lakhs}$$

$$\text{Exchange Difference} = \text{US \$ 100 lakhs} \times (\text{Rs. 54.98} - \text{Rs. 50}) = \text{Rs. 498 lakhs.}$$

Loss due to exchange difference amounting Rs. 498 lakhs will be capitalised and to be added in the carrying value of fixed assets. Depreciation on the unamortised amount will be provided in the remaining years

Transaction 2: Soft loan exchange difference (US \$ 1 lakh i.e Rs. 50 lakhs)

$$\text{Value of loan 31.3.2017} \rightarrow \text{US \$ 1 lakh} \times \text{Rs. 54.98} = \text{Rs. 54,98,000}$$

AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.

$$\text{Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2017} = \text{US\$ 1.00 lakh} \times \text{Rs. (54.98} - 50) = \text{Rs. 4.98 lakh.}$$

Loan account is to be increased to Rs. 54.98 lakh and FCMITD account is to be debited by Rs. 4.98 lakh. Since loan is repayable in 3 equal annual instalments, Rs. 4.98 lakh/3 = Rs. 1.66 lakh is to be charged to Profit and Loss Account for the year ended 31st March, 2017 and balance in FCMITD Account Rs. (4.98 lakh – 1.66 lakh) = Rs. 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.

- (d)** As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable

exceeds any such deferred credit, the amount should be charged to profit and loss statement.

- (i) In this case the grant refunded is Rs. 30 lakhs and balance in deferred income is Rs. 21 lakhs, Rs. 9 lakhs shall be charged to the profit and loss account for the year 2016-2017. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.
- (ii) If the grant was deducted from the cost of the plant in the year 2013-2014 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by Rs. 30 lakhs. The increased cost of Rs. 30 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2016-2017 shall be $(84 + 30)/7$ years = Rs. 16.286 lakhs presuming the depreciation is charged on SLM.

2. Balance Sheet of S Ltd. as on 31st March, 2017

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	29,00,000
(b) Reserves and Surplus	2	7,05,000
(2) Current Liabilities		
Trade Payables		4,20,000
Total		40,25,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(b) Tangible assets	4	24,95,000
(c) Non-current Investments	5	7,80,000
(2) Current assets		
(a) Inventories (4,80,000 – 4,00,000)		4,00,000
(b) Trade Receivables		2,30,000
(c) Cash & Cash equivalents		1,20,000
Total		40,25,000

Notes to Accounts

		(Rs.)	(Rs.)
1. Share Capital			
	2,90,000 Shares of Rs.10 each fully paid up of which 40,000 shares were issued pursuant to a contract without payment being received in cash		29,00,000
2. Reserves and surplus			
	Securities Premium Account	3,80,000	
	Profit & Loss Account (3,40,000 – 15,000)	<u>3,25,000</u>	7,05,000
3. Tangible Assets			
	Freehold Properties		
	As per last balance sheet	10,00,000	
	Addition during the year	<u>1,20,000</u>	
		11,20,000	
	Less: Sold during the year	<u>(75,000)</u>	
		10,45,000	
	Plant & Machinery		
	As per last balance sheet	13,00,000	
	Addition during the year	<u>1,50,000</u>	
		<u>14,50,000</u>	24,95,000
4. Non-current Investment			
	Shares in subsidiary company		7,80,000

Working Notes :

- (1) Calculation of shares to be issued by S Ltd. to the shareholders of B Pvt. Ltd. [Basis Point (1) and (2) of the question]
- | | |
|---|-----------------|
| 60,000 shares @ Rs. 14 per share | Rs. 8,40,000 |
| Less : Value of freehold property | <u>(60,000)</u> |
| Net amount due | <u>7,80,000</u> |
| No of shares issued 7,80,000 / Rs. 19.5 = 40,000 shares | |
| Amount credited to Share Capital | 4,00,000 |
| Amount credited to Securities Premium | <u>3,80,000</u> |
| | <u>7,80,000</u> |

- (2) Net Amount Payable to B Pvt. Ltd.

Particulars	Amount
Assets taken over by S Ltd.	
Plant & Machinery	Rs. 1,50,000

Free-hold Property	<u>Rs. 1,20,000</u>
Total (A)	<u>Rs. 2,70,000</u>
Assets sold to B Pvt. Ltd.	
Freehold Retail shop building	Rs. 60,000
Retail Stock	<u>Rs. 80,000</u>
Total (B)	<u>Rs. 1,40,000</u>
Net Payable (A-B)	<u>Rs. 1,30,000</u>
Add: Freehold properties taken over by the shareholders of B Pvt. Ltd. (Para 2 of point 2)	Rs. 60,000
Net Amount Payable	Rs. 1,90,000

(3) Rs. 15,000 loss on the sale of Building to B Pvt. Ltd., has been debited to the Profit & Loss Account of S Ltd.

(4) Investment A/c has been credited by dividend received Rs. 60,000 out of pre-acquisition profit from B Ltd.

(5) Bank Balance:

As given	2,50,000
Add: Dividend received	<u>60,000</u>
	3,10,000

Less: Paid to B Ltd. including Rs. 60,000 for assets taken over by its erstwhile shareholders	<u>(1,90,000)</u>
	<u>1,20,000</u>

Balance Sheet of B Pvt. Ltd. as on 31st March, 2017

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	1,00,000
(2) Current Liabilities		
Trade Payables		70,000
Total		<u>7,70,000</u>
II. Assets		
(1) Non-current assets		

Fixed assets		
Tangible assets	4	1,50,000
(2) Current assets		
(a) Inventories		2,00,000
(b) Trade Receivables		80,000
(c) Cash & Cash equivalents		3,40,000
Total		7,70,000

Notes to Accounts

		(Rs.)	(Rs.)
1. Share Capital			
60,000 Shares of Rs.10 each fully paid			6,00,000
2. Reserves and surplus			
Profit & Loss Account			1,00,000
3. Tangible Assets			
Freehold Properties			
As per last balance sheet	2,50,000		
Addition during the year	<u>60,000</u>		
	3,10,000		
Less: Sold during the year	<u>(1,60,000)</u>	1,50,000	
Plant & Machinery			
As per last Balance Sheet	1,00,000		
Less: Sold during the year (cost)	<u>(1,00,000)</u>	<u>-</u>	1,50,000

Working Notes:

	Rs.
(1) Profit & Loss Account (given)	90,000
Add: Profit on sale of machinery and freehold property	<u>70,000</u>
	1,60,000
Less: Dividend paid	<u>(60,000)</u>
	<u>1,00,000</u>
(2) Freehold properties have been reduced by Rs. 1,00,000 transferred to S Ltd. & Rs. 60,000 taken over by the shareholders of B Pvt. Ltd.	

(3) Cash at Bank:	Rs.
Balance as given.	2,10,000
Add: Received from S Ltd.	<u>1,90,000</u>
	4,00,000
Less: Dividend Paid	<u>(60,000)</u>
	<u>3,40,000</u>

**3. Consolidated Balance Sheet of A Ltd. and its subsidiary S Ltd.
as at 31st March, 2017**

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	10,50,000
(b) Reserves and Surplus	2	3,42,000
(2) Minority Interest [W.N.6(b)]		92,000
(3) Non-current Liabilities		
Long-term borrowings	3	6,00,000
Total		<u>20,84,000</u>
II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	7,10,000
(b) Intangible assets	5	2,24,000
(2) Net current assets	6	11,50,000
Total		<u>20,84,000</u>

Notes to Accounts

		Rs.
1.	Share Capital	
	Issued and Subscribed:	
	1,05,000 shares of Rs. 10 each fully paid up	10,50,000
2.	Reserves & surplus	
	Securities premium	1,20,000
	General Reserve	1,60,000

	Profit and Loss Account [W.N.6(d)]	<u>62,000</u>	3,42,000
3.	Long Term Borrowings		
	6,000, 8% Debentures of Rs. 100 each		6,00,000
4.	Tangible Assets		
	A Ltd. [W.N.3]	5,50,000	
	S Ltd. [W.N.3]	<u>1,60,000</u>	7,10,000
5.	Intangible assets		
	Goodwill [W.N.6(c)]		2,24,000
6.	Net current assets		
	A Ltd. [W.N.5]	8,50,000	
	S Ltd. [W.N.5]	<u>3,00,000</u>	11,50,000

Working Notes:

Percentage of shareholding of A Ltd. in S Ltd.:

$$48,000 \text{ shares out of } 60,000 \text{ shares i.e. } \frac{48,000}{60,000} \times 100 = 80\%$$

1. Investment in S Ltd.

	Rs.
Face value of shares (48,000 shares x Rs. 10)	4,80,000
Premium (50%) over face value	<u>2,40,000</u>
Cost of investment	<u>7,20,000</u>

Acquired by issue of debentures at 20% premium:

	Rs.
8% Debentures	6,00,000
(Nominal value = 7,20,000/120 × 100)	
Add: Securities premium @ 20%	<u>1,20,000</u>
	7,20,000
Writing down of investment to face value in 10 years	
2015-2016 : 1/10 × 2,40,000	(24,000)
2016-2017: 1/10 × 2,40,000	<u>(24,000)</u>
Investment as on 31.3.2017	<u>6,72,000</u>

2. Balance of Profit and Loss Account for the year ended on 31st March, 2017

	<i>A Ltd.</i>	<i>S Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Balance as on 31.3.2015	80,000	(80,000)
Profit/(Loss)		
For 2015-2016	1,60,000	(40,000)
For 2016-2017	2,00,000	(60,000)
Less: Transfer to General Reserve		
2015-2016	(20,000)	
2016-2017	(20,000)	
Dividend @ 10%		
2015-2016	(1,05,000)	
2016-2017	(1,05,000)	
Investment written off		
2015-2016	(24,000)	
2016-2017	(24,000)	
Provision for share of loss in subsidiary		
2015-2016: (40,000 × 80%)	(32,000)	
2016-2017: (60,000 × 80%)	<u>(48,000)</u>	
	<u>62,000</u>	<u>(1,80,000)</u>

Note: In the absence of information, taxation has not been considered.

3. Fixed Assets as on 31st March, 2017

	<i>A Ltd.</i>	<i>S Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Fixed assets on 31.3.2015	6,50,000	2,00,000
Less: Depreciation for		
2015-2016	(60,000)	(20,000)
2016-2017	<u>(40,000)</u>	<u>(20,000)</u>
	<u>5,50,000</u>	<u>1,60,000</u>

4. General reserve of A Ltd.

	<i>Rs.</i>
Balance as on 31.03.2015	1,20,000
Add: Transfer from Profit and loss account in 2015-2016	20,000

in 2016-2017	<u>20,000</u>
	<u>1,60,000</u>

5. Separate Balance Sheets as at 31st March, 2017 to calculate net current assets

Particulars	Note No.	A Ltd. (Rs.)	S Ltd. (Rs.)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	10,50,000	6,00,000
(b) Reserves and Surplus	2	3,42,000	(1,40,000)
(2) Non-Current Liabilities			
Long-term borrowings	3	6,00,000	
Long term provision	4	80,000	
Total		20,72,000	4,60,000
II. Assets			
(1) Non-current assets			
(a) Fixed assets			
(i) Tangible assets*(W.N.3)		5,50,000	1,60,000
(b) Non-current investment		6,72,000	
(2) Net current assets (bal. fig.) (see note)		8,50,000	3,00,000
Total		20,72,000	4,60,000

Notes to Accounts

		A Ltd. Rs.	S Ltd. Rs.
1.	Share Capital		
	Issued and Subscribed:		
	1,05,000 shares of Rs. 10 each fully paid up	10,50,000	
	60,000 shares of Rs. 10 each fully paid up		6,00,000
2.	Reserves & surplus		
	Securities premium	1,20,000	-
	General Reserve (W.N. 4)	1,60,000	40,000
	Profit and Loss Account	<u>62,000</u>	<u>(1,80,000)</u>
		<u>3,42,000</u>	

* Fixed assets given in the question are assumed to be tangible fixed assets.

	Total	3,42,000	(1,40,000)
3.	Long Term Borrowings		
	8% Debentures	6,00,000	
4.	Long term Provision		
	Provision for loss in subsidiary	80,000	

Note: In the absence of information about the movement in individual current assets and current liabilities, balance sheets as on 31.3.2017 have been prepared on the basis of net current assets, which is the difference of total current assets and total current liabilities. However, Schedule III requires separate disclosure of current liabilities and current assets in the balance sheet.

(6) Computations for Consolidation

(a) Analysis of General reserve and Profits (Losses) of S Ltd.

	Pre-acquisition Capital Profit or loss Rs.	Post-acquisition Profit or loss Rs.
General Reserve on 31.3.2015	40,000	—
Profit and Loss Account on 31.3.2015	(80,000)	
Profit/(Loss) for the years 2015-2016		(40,000)
2016-2017		(60,000)
	<u>(40,000)</u>	<u>(1,00,000)</u>
Minority Interest (20%)	(8,000)	(20,000)
Share of A Ltd. (80%)	(32,000)	(80,000)

(b) Minority Interest

	Rs.
Share Capital	1,20,000
Add: Pre-acquisition capital loss	(8,000)
Post-acquisition loss	<u>(20,000)</u>
	<u>92,000</u>

(c) Cost of Control

		Rs.
Investment in S Ltd.		6,72,000
Less: Paid up value of investment	4,80,000	
Capital profit/(losses)	<u>(32,000)</u>	<u>(4,48,000)</u>
Goodwill		<u>2,24,000</u>

(d) Consolidated Profit and Loss Account

	Rs.
Balance of Profit and Loss Account of A Ltd.	62,000
Less: Share of loss in S Ltd.	<u>(80,000)</u>
	(18,000)
Add back: Provision for loss in subsidiary (mutual transaction) (32,000 + 48,000)	<u>80,000</u>
	<u>62,000</u>

(e) Long term provision for loss in subsidiary as

Rs.

Provision for loss in subsidiary as shown in A Ltd.	80,000
Less: Intra company transaction	<u>(80,000)</u>
	<u>Nil</u>

4. (a) (i)

L Ltd.

**Value Added Statement
for the year ended March 31, 2017**

	Rs. (‘000)	Rs. (‘000)	%
Sales		28,525	
Less: Cost of bought in material and services:			
Operating cost	15,411		
Excise duty	1,718		
Interest on bank overdraft	<u>93</u>	<u>(17,222)</u>	
Value added by manufacturing and trading activities		11,303	
Add: Other income		<u>756</u>	
Total value added		<u>12,059</u>	
Application of value added:			
To pay employees:			
Wages, salaries and other benefits		10,247	84.97
To pay government:			
Corporation tax		230	1.91
To pay providers of capital:			
Interest on 10% Debentures	1,157		
Dividend	<u>45</u>	1,202	9.97
To provide for the maintenance and expansion of the company:			

Depreciation	255		
Fixed Assets Replacement Reserve	25		
Deferred Tax Account	45		
Retained profit	<u>55</u>	<u>380</u>	<u>3.15</u>
		<u>12,059</u>	<u>100.00</u>

(ii) Reconciliation between Total Value Added and Profit Before Taxation

	Rs. ('000)	Rs. ('000)
Profit before tax		400
<i>Add back:</i>		
Depreciation	255	
Wages, salaries and other benefits	10,247	
Debenture interest	<u>1,157</u>	<u>11,659</u>
Total Value Added		<u>12,059</u>

Notes:

- (1) Deferred tax could alternatively be shown as a part of 'To pay government'.
- (2) Bank overdraft, being a temporary source of finance, has been considered as the provision of a banking service rather than of capital. Therefore, interest on bank overdraft has been shown by way of deduction from sales and as a part of 'cost of bought in material and services'.

(b) Computation of Economic Value Added

	Rs. in lakhs
Profit after tax	420
<i>Add:</i> Interest net of tax = $60 \times \left(\frac{100 - 30}{100} \right)$	<u>42</u>
Return to providers of funds	462
<i>Less:</i> Cost of Capital	<u>(342)</u>
Economic Value Added	<u>120</u>

MVA of Rs. 14005 crore:

The MVA of Rs. 14005 crore is the difference between the current Market Value of J Ltd. and the capital contributed by the fund providers. While EVA measures current earning efficiency of the company, MVA takes into consideration the EVA from not only the assets in place but also from the future projects/activities of the company. The difference between MVA over EVA thus represents the value attributed to the

future potential of the company & may change from time to time based on market sentiments. In short the MVA is the net present value of all future EVA's.

Working Notes:

1. Calculation of Net Profit after interest and tax

Interest on Debentures = 50,00,000 units x 10 x 12% = Rs. 60,00,000

Therefore, Financial Leverage = $\frac{\text{Profit before Interest \& taxes (PBIT)}}{\text{PBIT less Interest}}$

$$1.10 = \frac{\text{PBIT}}{\text{PBIT} - \text{Rs. 60,00,000}}$$

$$1.10 (\text{PBIT} - \text{Rs. 60,00,000}) = \text{PBIT}$$

$$1.10 \text{ PBIT} - \text{Rs. 66,00,000} = \text{PBIT}$$

$$1.10 \text{ PBIT} - \text{PBIT} = \text{Rs. 66,00,000}$$

$$0.10 \text{ PBIT} = \text{Rs. 66,00,000}$$

$$\text{PBIT} = \text{Rs. 6,60,00,000}$$

Profit after interest but before tax = Rs. 6,60,00,000 – Rs. 60,00,000

= Rs. 6,00,00,000

Less: Income Tax @ 30% (Rs. 1,80,00,000)

Profit After Interest & Tax Rs. 4,20,00,000

2. Calculation of Weighted Average Cost of Capital (WACC)

	Rs. in lakhs	Amount (Rs.) (1)	Weight (2)	Cost% (3)	WACC% (4)=2x3
Equity Shareholders' fund					
Common Shares	1,582				
Securities Premium	155				
Free Reserves	154				
Capital Reserves	<u>109</u>				
		2,000	0.80	15	12.00
Debentureholders' fund		500	0.20	8.4*	1.68
		<u>2,500</u>	<u>1.00</u>		<u>13.68</u>

Cost of Capital = Capital Employed x WACC%

* Rate of interest on debentures is taken net of tax of 30%.

= Rs. 2,500 lakhs x 13.68%

= Rs. 342 lakhs

5. (a) Fair value of an ESPP = Rs. 56 – Rs. 50 = Rs. 6

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

Fair value of ESPP which will be recognized as expenses in the year 2016-2017

= 40,000 shares x Rs. 6 = Rs. 2,40,000

Vesting period = 1 month

Expenses recognized in 2016-2017 = Rs. 2,40,000

Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
30.04.2016	Bank A/c (40,000 shares x Rs. 50) Dr.	20,00,000	
	Employees compensation expense A/c Dr.	2,40,000	
	To Share Capital A/c (40,000 shares x Rs. 10)		4,00,000
	To Securities Premium (40,000 shares x Rs. 46)		18,40,000
	(Being shares issued under ESPP @ Rs. 50)		

- (b)

Journal Entries

Financial Asset measured at FVTOCI – on the basis of Trade Date Accounting

Dates	Journal Entry	Amount	Amount
30/3/2017	Financial Asset Dr.	200	
	To Payables		200
31/3/2017	Financial Asset Dr.	4	
	To OCI		4
2/4/2017	Financial Asset Dr.	2	
	To OCI		2
	Payables Dr.	200	
	To Cash		200

Financial Asset measured at FVTOCI – on the basis of Settlement Date Accounting

Dates	Journal Entry	Amount	Amount
30/3/2017	No Entry		
31/3/2017	Fair Value Change Dr.	4	
	To OCI		4

2/4/2017	Fair Value Change	Dr.	2	
	To OCI			2
	Financial Asset	Dr.	206	
	To Cash			200
	To Fair Value Change			6

6. 1. Rectification of current year's profit i.e. 2016-2017

Profit After Tax = Rs. 2,200 lakhs

Provision for taxation = Rs. 600 lakhs

Profit Before Tax = PAT + Provision for taxation

= Rs. 2,200 lakhs + Rs. 600 lakhs = Rs. 2,800 lakhs

Rate of tax = $\frac{\text{Provision for tax}}{\text{Profit before tax}} \times 100 = \frac{600}{2,800} \times 100 = 21.43\% \text{ (approx.)}$

	<i>Rs. in lakhs</i>
Profit for the year after tax	2,200
Less: Depreciation net of tax on motor vehicles (Rs. 80 lakhs x 20% x 6/12) x (100-21.43)%	(6.29)
Depreciation net of tax on Premises and Land (Rs. 800 lakhs x 2%) x (100-21.43)%	(12.57)
Depreciation net of tax on Plant and Machinery (Rs. 6,000 lakhs x 10%) x (100-21.43)%	(471.42)
Provision for doubtful receivables net of tax (Rs. 800 lakh x 10%) x (100-21.43)%	<u>(62.86)</u>
Rectified profit of 2016-2017	<u>(1,646.86)</u>

2. Calculation of Capital Employed

	<i>(Rs. in lakhs)</i>	<i>(Rs. in lakhs)</i>
Premises and land		2,400
Plant and machinery		4,800
Motor vehicles (book value less depreciation for ½ year)		72
Raw materials		1,840
Work-in-progress		260
Finished goods		360
Trade Receivables (800 x 90%)		720
Investments (market value)		3,000

Cash at bank and in hand		<u>384</u>
		13,836
Less: Liabilities:		
Provision for taxation	600	
5% Debentures	4,000	
Secured loans	400	
Trade Payables	<u>600</u>	<u>(5,600)</u>
Total capital employed on 31.3.2017		8,236
Less: Half of current year's rectified profit (1,646.86 x 1/2)		<u>(823.44)</u>
Average Capital Employed		<u>7412.56</u>

3. Calculation of Future Maintainable Profits

(Rs. in lakhs)				
	2013-14	2014-15	2015-16	2016-17
Profit after tax	938	1092	810	1,646.86
Less: Depreciation net of tax on Premises and Land (Rs. 800 lakhs x 2%) x (100-21.43)%	(12.58)	(12.58)	(12.58)	
Depreciation net of tax on Plant and Machinery (Rs. 6,000 lakhs x 10%) x (100-21.43)%	<u>(471.42)</u>	<u>(471.42)</u>	<u>(471.42)</u>	
Adjusted Profit	<u>454</u>	<u>608</u>	<u>326</u>	<u>1,646.86</u>
Average adjusted profit (454 + 608 + 326 + 1,646.86)/4				758.72
Less: Excess depreciation (net of tax) due to upward revaluation of premises and land [(2400-800) x 2%] x (100 - 21.43)%				(25.14)
Depreciation on motor vehicle (net of tax) for remaining six months (in future depreciation on motor vehicle will be charged for full year) (Rs. 80 lakhs x 20% x 6/12) x (100-21.43)%				(6.28)
Add: Short depreciation (net of tax) due to downward revaluation of plant and machinery [(6,000 - 4,800) x 10%] x (100 - 21.43)%				<u>94.28</u>
Future Maintainable Profit				<u>821.58</u>

4. Calculation of General Expectation

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

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

Therefore, share of Rs. 10 (Face value of shares of D 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, D 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 D Ltd.

	(Rs. in lakhs)
Future maintainable profit	821.58
Less: Normal profit i.e. 11% of average capital employed (7412.56 x 11%)	<u>(815.38)</u>
Super Profit	<u>6.20</u>
Goodwill at 4 years' purchase of Super Profit (6.2 x 4)	<u>24.80</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 2013-2014, 2014-2015 and 2015-2016 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 2011-2012 and 2012-2013 have been left out, as during these years normal business was hampered.

7. (a) B limited invested Rs. 600 lakhs in the equity shares of G Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakhs and remaining as temporary (current) investment i.e. Rs. 300 lakhs. Irrespective of the fact that investment has been held by B Limited only for 3 months (from 1.1.2017 to 31.3.2017), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2017 became Rs. 200 lakhs i.e. Rs. 100 lakhs in respect of current investment and Rs. 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at Rs. 100 lakhs. The reduction of Rs. 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, G Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quite a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by Rs. 200 lakhs and shown the investments at Rs. 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of Rs. 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternatively for treatment of long term investment.

If one assumes that the decline in the value of long term investment is temporary and G Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.

- (b) In the given case, A Ltd. concurrently agreed to repurchase the same goods from B Ltd. on 1st Feb., 2017. Also the re-selling price is pre-determined and covers purchasing and holding costs of B Ltd. Hence, the transaction between A Ltd. and

B Ltd. on 1st Feb., 2017 should be accounted for as financing rather than sale. The resulting cash flow of Rs. 9.60 lakhs received by A Ltd., cannot be considered as revenue as per AS 9 “Revenue Recognition”.

Journal Entries in the books of A Ltd.

			(Rs. in lakhs)	
1.02.2017	Bank Account	Dr.	9.60	
	To Advance from B Ltd*.			9.60
	(Being advance received from B Ltd amounting [Rs. 8 lakhs + 20% of Rs. 8 lakhs = 9.60 lakhs] under sale and re-purchase agreement)			
31.03.2017	Financing Charges Account	Dr.	0.40	
	To B Ltd.			0.40
	(Financing charges for 2 months at Rs. 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.2017	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P & L Account)			

- (c) AS 17 ‘Segment Reporting’ requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.
- (d) As per AS 9 “Revenue Recognition”, revenue recognition is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales.

*The balance of B Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of A Ltd. as on 31st March, 2017.

On the other hand, in Apparels Business, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

- (e) Para 28 of AS 25 “Interim Financial Reporting” states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports. As at September 30, 2017, L Ltd. would report the entire Rs. 6,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since Rs. 1,60,000 property tax payment relates to the entire 2017 calendar year, only Rs. 80,000 of the payment would be reported as an expense at September 30, 2017, while out of the remaining Rs. 80,000, Rs. 40,000 for Jan. 2017 to March, 2017 would be shown as payment of the outstanding amount of previous year and another Rs. 40,000 related to quarter October, 2017 to December, 2017, would be reported as a prepaid expense.