Paper-16: Advanced Financial Accounting & Reporting

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.

Working Notes should form part of the answer.

"Whenever necessary, suitable assumptions should be made and indicated in answer by the candidates."

Part A questions are compulsory. Attempt all of them.

Part B has seven question. Attempt any five of them.

Part A (25 marks)

1. **(a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark)and give workings/reasons briefly in support of your answer (= 1 mark):** **[10×2=20]**

(i) R. Chandra Ltd. has provided the following information:
Depreciation as per accounting records ₹ 20,00,000, Depreciation as per income tax records ₹ 8,00,000. There is adequate evidence of future profit sufficiency. As per AS 22 Deferred Tax Asset/ Liability to be recognized will be
(A) ₹ 6,00,000 (DTA)
(B) ₹ 5,40,000 (DTL)
(C) ₹ 60,000 (Net DTL)
(D) None of these

Answer:

A — ₹6,00,000 (Net DTA).

Deferred tax Assets = 50% (20,00,000 – 8,00,000) = ₹6,00,000.

(ii) Quick Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2014 at ₹ 600 lakh. As at that date value in use is ₹ 400 lakh. If the net selling price is ₹ 450 lakh, the recoverable amount of the Asset as per AS-28 will be:
(A) ₹ 200 lakh
(B) ₹150 lakh
(C) ₹450 lakh
(D) None of (A), (B), (C)

Answer:

C — ₹450 lakh.

Recoverable amount is higher of Value in use ₹400 lakh and net selling price ₹450 lakh.
Recoverable amount = ₹450 lakh.

(iii) A company follows a policy of refunding money to the dissatisfied customers if they claim within thirty days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.75 of the customers do not claim refunds. The company sold goods amounting to ₹150 lakhs during the last month of the financial year. The amount of contingency is:

(A) ₹37.5 lakhs;
(B) ₹112.5 lakhs;
(C) ₹1.125 lakhs;
(D) None of the above.

Answer:

A — ₹37.5 lakhs.

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of product. Provision should be recognized as per AS-29. The best estimate for provision is ₹ 37,50,000 (150,00,000 x 0.25).

(iv) X Ltd. holds 69% of Y Ltd., Y Ltd. holds 51% of W Ltd., Z Ltd. holds 49% of W. Ltd. As per AS 18, Related Parties are :

(A) X Ltd., Y Ltd. & W Ltd;
(B) X Ltd. & Z Ltd;
(C) Y Ltd. & Z Ltd;
(D) X Ltd. & Y Ltd. only.

Answer:

A — X Ltd., Y Ltd. & W Ltd.

X Ltd., YLtd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of Associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa.

(v) On January 2, 2014 E Ltd. bought a trademark from M Ltd. for ₹ 20,00,000. Ekta retained an independent consultant, who estimated the trademark's remaining life to be 20 years. Its unamortised cost on Maccounting records was ₹17,60,000. E decided to amortize the trademark over the maximum period allowed. In E December 31, 2014 balance sheet, what amount should be reported as expenses to be amortisedin this regard?

(A) ₹ 17,60,000
(B) ₹ 88,000
(C) ₹ 1,00,000
(D) ₹ 2,00,000.

Answer:

D — ₹2,00,000.

As per AS-26 intangible assets should be measured initially at cost therefore, Ekta Ltd. should amortize the trademark at its cost of ₹ 20,00,000. The unamortised cost on the seller's books (₹17,60,000) is irrelevant to the buyer. Although the trademark has a remaining useful life of 20 years, intangible assets are generally amortized over a maximum period of 10 years per AS-26. Therefore, the 2014 amortization expense and accumulated amortization is 2,00,000 (₹ 20,00,000 ÷ 10 years).

(vi) Vivek Ltd. bought a forward contract for three months of US $ 4,00,000 on 1st March at 1 US $ = ₹ 50.10 when spot exhange rate was US $ 1 = ₹ 50.11. On 31 st March when the books were closed forward exchange rate for two months was US $ 1 = ₹ 50.15. On 30th April, the contract was sold at ₹ 50.18 per dollar. As per AS 30, the profits from sale of contract to be recognized in the P & L A/c will be :
(A) ₹ 2,000
(B) ₹ 10,000
(C) ₹ 12,000
(D) None of these

Answer:

C — ₹12,000.

Sale Rate	₹ 50.18
Less: Fair Value on 31st March	₹ 50.15
Premium on Contract	₹ 0.03
Contract Amount US$ 4,00,000	
Total Profit (4,00,000 × 0.03)	₹ 12,000

(vii) In a production process, normal waste is 5% of input. 5,000 units of input were put in process resulting in a wastage of 300 units. Cost per unit of input is ₹1,000. The entire quantity of waste is on at the year end. If waste has Nil realizable value. What is the cost of abnormal waste in total?

(A) ₹52,631.50
(B) ₹1,052.63
(C) ₹1000.00
(D) ₹5012.63

Answer:

A — ₹52,631.50

In this case normal waste is 250 units and abnormal waste is 50 units.
The cost of 250 units will be included in determining the cost of inventories (finished goods) at the year – end.
The cost of abnormal waste amounting to ₹ 52,631.50 (50 units × ₹1,052.63) will be charged in the profit and loss account.
Cost per unit of input = 5,000 × 1,000/4,750 =₹1,052.63.

(viii) A&B Ltd. obtained a Loan from a bank for ₹ 240 lakhs on 30.04.2012. It was utilized for : Construction of a shed ₹ 120 lakhs, Purchase of a machinery ₹ 80 lakhs, Working Capital ₹ 40 lakhs, Construction of shed was completed in March 2014. The machinery was installed on the same date. Delivery truck was not received. Total interest charged by the bank for the year ending 31.03.2014 was ₹ 36 lakhs. As per AS 16, Interest to be debited to Profit & Loss Account will be :
(A) ₹ 36 lakhs

(B) ₹ 18 lakhs
(C) ₹ 9 lakhs
(D) None of these

Answer:

B — ₹18 lakhs

Qualifying Asset as per AS-16 = ₹ 120 lakhs (construction of a shed)
Borrowing cost to be capitalized = 36 × 120/240 = ₹ 18 lakhs
Interest to be debited to Profit or Loss account = ₹ (36 – 18) lakhs = ₹ 18 lakhs

(ix) Montana Ltd. is having a plant (asset), carrying amount of which is ₹ 120 lakh on March 31, 2012. Its balance useful life is 3 years and residual value at the end of 3 years is ₹ 9 lakh. Estimated future cash flow from using the plant will be ₹ 30 lakh per annum for 3 years. If the discount rate is 10% "the Value in Use" for the plant as per AS-28 will be
[Given: PVIFA (10%, 3 yrs) = 2.487 and PVIF (10%, 3 yrs) = 0.7513]
(A) ₹ 81.37 lakh
(B) ₹ 66.00 lakh
(C) ₹ 65.61lakh
(D) Insufficient Information

Answer: A ₹ 81.37 Lakh.

Present Value of future cash flows for 3 years: 30 x 2.487 = ₹ 74.61 Lakh.
Present value of residual value on 31.3.2015 =9 x 0.7513 = ₹ 6.76 Lakh.
Value in Use = ₹ 81.37 Lakh.

(x) PQR Ltd. acquire 40% of ABC Ltd.'s shares on April 2, 2013, the price paid was ₹ 70,000. ABC Ltd.'s Shareholder equity shares are as follows:

	₹
Equity Shares (Paid up)	**25,000**
Share premium	**75,000**
Retained Earning	**25,000**
	1,25,000

Further ABC Ltd. reported a net income of ₹ 15,000 and paid dividends of ₹ 5,000. PQR Ltd. has subsidiary on 31-03-2014. Calculate the amount at which the investment in ABC Ltd. should be shown in the consolidated Balance Sheet of PQR Ltd. as on 31.03.2014.
(A)₹54,000
(B)₹20,000
(C)₹74,000
(D)₹70,000

Answer:

C — ₹74,000

As per AS – 23 when the investor company prepares the consolidated Balance Sheet, the investment in associate i.e., ABC Ltd. shall be carried by equity method and goodwill and capital reserve to be identified and disclosed.

Extract of Consolidated Balance Sheet of PQR Ltd. as on 31.03.2014

		₹
Investment in ABC Ltd.		
Associates	54,000	
Goodwill (Identified)	20,000	74,000

Value of the investment as per equity method ₹70,000 + 40% (₹15,000) – 40% (₹5,000)=₹74,000

Goodwill Identified = (₹70,000– 40% of ₹1,25,000) = ₹20,000.

(b) A Limited company has been including interest in the valuation of closing stock. In 2012 -2013, the management of the company decided to follow AS 2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by ₹ 3,00,000. Is a disclosure necessary? If so, draft the same. [5]

Answer:

As per AS 5 (Revised), change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the instant case, the company has changed its accounting policy in order to conform with the AS 2 (Revised) on Valuation of Inventories. Therefore,
a disclosure is necessary in the following lines by way of notes to the annual accounts for the year 2012 - 2013.
"To be in conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock unlike preceding years. Had the same principle been followed in previous years, profit for the year and its corresponding effect on the year end net assets would have been higher by ₹ 3,00,000."

Part B (75 marks)

2. The following was the Balance Sheet of V Ltd as on 31st March 2014:

Particulars		**Note No.**	**Amount (₹ in Lakhs)**
Equity and Liabilities			
(1) Shareholders' Funds	**(a) Share Capital**	**1**	**1,150**
	(b) Reserves and Surplus	**2**	**(87)**
(2) Non-Current Liabilities	**Long-Term Borrowings**	**3**	**630**
(3) Current Liabilities	**Trade Payables**		**170**
	Total		**1,863**
Assets			
(1) Non-Current Assets	**Tangible Assets**	**4**	**1,152**
(2) Current Assets	**Inventories**		**380**
	Trade Receivables		**256**

Cash and Cash Equivalents	5	75
Total		1,863

Notes:

(1) Share Capital	**₹**
Authorised:	
Issued, Subscribed and Paid up:	**800**
80 Lakh Equity Shares of ₹ 10 each, fully paid up	**350**
35 Lakh 12% Cumulative Preference Shares of ₹ 10 each, fully paid up	
Total	**1,150**

(2) Reserves and Surplus:	**Debit Balance of Profit & Loss Account**	**(87)**
Total		**(87)**

(3) Long-Term Borrowings	
10% Secured Cumulative Debentures of ₹ 100 each, fully paid up	**600**
Outstanding Debenture Interest	**30**
Total	**630**

(4) Tangible Assets	
Land and Buildings	**445**
Plant and Machinery	**593**
Furniture, Fixtures and Fittings	**114**
Total	**1,152**

(5) Cash and Cash	
Equivalents Balance at Bank	**69**
Cash in Hand	**6**
Total	**75**

On 1st April 2014, P Ltd took over the entire business of V Ltd on the following terms:

- **V Ltd's Equity Shareholders would receive 4 fully paid Equity Shares of P Ltd of ₹ 10 each issued at a Premium of ₹ 2.50 each for every Five Shares held by them in V Ltd.**
- **Preference Shareholders of V Ltd would get 35 Lakh 13% Cumulative Preference Shares of ₹ 10 each fully paid up in P Ltd, in lieu of their present holding.**
- **All the Debentures of V Ltd would be converted into equal number of 10.5% Secured Cumulative Debentures of ₹ 100 each, fully paid up after the takeover by P Ltd, which would also pay Outstanding Debenture Interest in cash.**
- **Expenses of Amalgamation would be borne by P Ltd. Expenses came to be ₹ 2 Lakh. P Ltd discovered that its Creditors included ₹ 7 Lakh due to V Ltd for goods purchased.**
- **Also P Ltd's Stock included goods of the Invoice Price of ₹ 5 Lakh earlier purchased from V Ltd, which had charged profit at 20% of the Invoice Price.**
-

You are required to:

(i) Prepare Realisation A/c in the books of V Ltd.

(ii) Pass Journal Entries in the books of P Ltd, assuming it to be an amalgamation in the nature of Merger. [15]

Answer:

A. Computation of Purchase Consideration

Particulars	₹ Lakhs
Equity Shares: (issued at Premium ₹ 2.50) 80 Lakh Shares x $\frac{4}{5}$ = 64 Lakh Shares issued at ₹ 12.50 per Share. Therefore, Total Value of Equity Shares (including Premium) (64 Lakh Shares x ₹ 12.50)	800
Preference Shares: 13% Cumulative Preference Shares of ₹ 10 each (35 Lakh Shares x ₹ 10)	350
Total Purchase Consideration	1,150

B. Realisation Account

Dr. **Cr.**

Particulars	₹ Lakhs	Particulars	₹ Lakhs
To Land and Buildings A/c	445	By Trade payables A/c	170
To Plant and Machinery A/c	593	By 10% Debentures A/c	600
To Furniture, Fixtures & Fittings A/c	114	By Outstanding Debenture	30
To inventories A/c	380	interest A/c	1,150
To Trade Receivables A/c	256	By P Ltd A/c	
To Cash in Hand A/c	6		
To Cash at Bank A/c	69		
To Equity Shareholders A/c (bal. figure)	87		
Total	1,950	Total	1,950

C. Journal Entries in the books of P Ltd (₹ Lakhs)

S.N.	Particulars		Dr.	Cr.
1	Business Purchase A/c	Dr.	1,150	
	To Liquidator of V Ltd A/c			1,150
	(Being Purchase Consideration Due)			
2	Land and Building A/c	Dr.	445	
	Plant and Machinery A/c	Dr.	593	
	Furniture, Fixtures and Fittings A/c	Dr.	114	
	Inventories A/c	Dr.	380	
	Trade Receivables A/c	Dr.	256	
	Cash in Hand A/c	Dr.	6	
	Cash at Bank A/c	Dr.	69	
	Profit and Loss A/c	Dr.	87	
	To 10.5% Debentures A/c			600
	To Outstanding Interest A/c			30
	To Trade Payables A/c			170
	To Business Purchase A/c			1,150
	(Being Assets and Liabilities taken over from V Ltd under amalgamation)			
3	Liquidator of V Ltd A/c	Dr.	1,150	
	To Equity Share Capital A/c			640
	To 13% Cumulative Preference Shares A/c			350
	To Securities premium A/c.			160
	(Being discharge of consideration, by allotment of 64 Lakh Equity Shares of ₹ 10 each at a premium of ₹ 2.50 per Share & 35 Lakh 13% Cumulative Pref. Shares of ₹ 10 each at par)			

4	10% Secured Cumulative Debentures A/c Dr. To 10.5% Secured Cumulative Debentures A/c (Being Secured Cumulative Debentures of V Ltd converted into 10.5% Secured Cumulative Debentures of P Ltd)	600	600
5	Outstanding Debenture Interest A/c Dr. To Bank A/c (Being Outstanding Debenture Interest Paid by P Ltd)	30	30
6	Trade Payables A/c Dr. To Trade Receivables A/c (Being settlement of mutual liability)	7	7
7	Amalgamation Expenses A/c Dr. To Cash A/c (Being Amalgamation Expenses met by P Ltd)	2	2
8	Profit and Loss A/c Dr. To Inventories A/c (5 x 20%) (Being unrealized profit on Stock eliminated from the Inventories of P Ltd)	1	1

3. On 31.03.2013, R Ltd. acquired 1,05,000 Shares of S Ltd. for ₹ 12,00,000. The Trial Balance of S Ltd. on that date was as under -

Trial Balance
as at 31.03.2013

Particulars	Dr. Amount (₹)	Cr Amount (₹)
Equity Shares (1,50,000 @ ₹ 10)	**-**	**15,00,000**
Pre – incorporation Profits	**-**	**30,000**
Profit and Loss Account	**-**	**60,000**
Creditors	**-**	**75,000**
Fixed Assets (Tangible)	**10,50,000**	**-**
Current Assets	**6,15,000**	
	16,65,000	**16,65,000**

On 31.03.2014, the Trial Balance of the two Companies were as follows -

Trial Balance
as at 31.03.2014

Particulars	R Ltd. Amount (₹)	R Ltd. Amount (₹)	S Ltd. Amount (₹)	S Ltd. Amount (₹)
Equity Shares of ₹ 10 each fully paid (before Bonus Paid)	**-**	**45,00,000**	**-**	**15,00,000**
Securities Premium	**-**	**9,00,000**	**-**	**-**
Pre – incorporation Profits	**-**	**-**	**-**	**30,000**
General Reserve	**-**	**60,00,000**	**-**	**19,05,000**
Profit and Loss Account	**-**	**15,75,000**	**-**	**4,20,000**
Creditors	**-**	**5,55,000**	**-**	**2,10,000**
Fixed Assets (Tangible)	**79,20,000**	**-**	**23,10,000**	**-**
Investments (1,05,000 Equity Shares in S Ltd at cost)	**12,00,000**	**-**	**-**	**-**
Current Assets	**44,10,000**	**-**	**17,55,000**	**-**

	1,35,30,000	**1,35,30,000**	**40,65,000**	**40,65,000**

Directors of S Ltd. made a bonus issue on 31.03.2014 in the ratio of one Equity Share of ₹ 10 each fully paid for every two Equity Shares held on that date.

Calculate as on 31.3.2014 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases: (1) Before issue of Bonus Shares; (2) Immediately after the issue of Bonus Shares. It may be assumed that Bonus Shares were issued out of Post-Acquisition Profits by using General Reserve.
Prepare a Consolidated Balance Sheet after the Bonus Issue. [15]

Answer:

A Basic Information

Company Status	Dates	Holding Status
Holding Company =R Ltd. Subsidiary = S Ltd.	Acquisition: 31.03.2013 Consolidation: 31.03.2014	Holding Company = 70% Minority Interest = 30%

B. Analysis of Reserves and Surplus of S Ltd.

(a) Pre-Incorporation Profits = ₹ 30,000 – **Capital Profit**

(b) General Reserve

Before Bonus Issue	After Bonus Issue
As on 31.3.2014 19,05,000	As on 31.3.2014 19,05,000 Less: Bonus Issue 7,50,000 (15 Lacs x 1/2) Corrected Bal 11,55,000
As on 01.04.13 **NIL** **Capital** | Tfr between 01.04.13 & 31.3.2014 **19,05,000** **Revenue**	01.04.2013 **NIL** **Capital** | Tfr between 1.4.13 & 3 1.3.14 **11,55,000** **Revenue**

(c) Profit & Loss Account

As on 31.03.2014 ₹ 4,20,000

As on 01.04.2013 60,000 **Capital**

Profits between 01.04.2013 & 31.03.2014 **3,60,000** **Revenue**

C. Analysis of Net Worth of S Ltd.

Particulars	Before Bonus Issue			After Bonus Issue		
	Total	**R**	**Minority**	**Total**	**R**	**Minority**

		100%	70%	30%	100%	70%	30%
(a)	Share Capital **Add:** Bonus Issue	15,00,000 –			15,00,000 7,50,000		
(b)	**Capital Profits**	**15,00,000**	10,50,000	4,50,000	**22,50,000**	15,75,000	6,75,000
	Pre Incorporation Profits General Reserve Profit and Loss Account	30,000 NIL 60,000			30,000 NIL 60,000		
		90,000	63,000	27,000	**90,000**	63,000	27,000
(c)	**Revenue Reserve:** Gen. Reserve	**19,05,000**	13,33,500	5,71,500	**11,55,000**	8,08,500	3,46,500
(d)	**Revenue Profits:** P & L A/c	**3,60,000**	2,52,000	1,08,000	**3,60,000**	2,52,000	1,08,000
	Minority Interest			**11,56,500**			**11,56,500**

D. Cost of Control

	Particulars	Before Bonus Issue	After Bonus Issue
	Cost of Investment	12,00,000	12,00,000
Less:	(a) Nominal Value of Share Capital	(10,50,000)	(15,75,000)
	(b) Share in Capital Profits	(63,000)	(63,000)
	Goodwill / Capital Reserve on Consolidation	**87,000**	**(4,38,000)**

E. Consolidation of Reserves & Surplus

	Particulars	Before Bonus Issue		After Bonus Issue	
		Gen. Res.	**P&L A/c**	**Gen. Res.**	**P&L A/c**
	Balance as per Balance Sheet of R Ltd.	60,00,000	15,75,000	60,00,000	15,75,000
Add:	Share of Revenue	13,33,500	2,52,000	8,08,500	2,52,000
	Consolidated Balance	**73,33,500**	**18,27,000**	**68,08,500**	**18,27,000**

Name of the Company: R Ltd. And its subsidiary S Ltd.

Consolidated Balance Sheet as at 31st March 2014

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital	1	45,00,000	-

Ref No.	Particulars		Note No.	As at 31st March, 2014	As at 31st March, 2013
				₹	₹
		(b) Reserves and surplus	2	99,73,500	-
		(c) Money received against share warrants		-	-
				1,44,73,500	-
	2	**Minority Interest**		11,56,500	-
	3	**Non-current liabilities**			
		(a) Long-term borrowings		-	-
		(b) Deferred tax liabilities (net)		-	-
		(c) Other long-term liabilities		-	-
		(d) Long-term provisions		-	-
				-	-
	4	**Current liabilities**			
		(a) Short-term borrowings		-	-
		(b) Trade payables		-	-
		(c) Other current liabilities	3	7,65,000	-
		(d) Short-term provisions		-	-
				7,65,000	-
		TOTAL (1+2+3+4)		**1,63,95,000**	**-**
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	1,02,30,000	-
		(ii) Intangible assets		-	-
		(iii) Capital work-in-progress		-	-
		(iv) Intangible assets under development		-	-
		(v) Fixed assets held for sale		-	-
		(b) Non-current investments		-	-
		(c) Deferred tax assets (net)		-	-
		(d) Long-term loans and advances		-	-
		(e) Other non-current assets		-	-
				1,02,30,000	-

Ref No.	Particulars		Note No.	As at 31st March, 2014 ₹	As at 31st March, 2013 ₹
	2	**Current assets**			
		(a) Current investments		-	-
		(b) Inventories		-	-
		(c) Trade receivables		-	-
		(d) Cash and cash equivalents		-	-
		(e) Short-term loans and advances		-	-
		(f) Other current assets	5	61,65,000	-
				61,65,000	-
		TOTAL (1+2)		**1,63,95,000**	**-**

Note 1. Share Capital

	As at 31st March, 2014	As at 31st March, 2013
Equity Shares	**45,00,000**	
	45,00,000	

Note 2. Reserve and Surplus :-

	As at 31st March, 2014	As at 31st March, 2013
General Reserve	68,08,500	-
Profit and loss	18,27,000	-
Capital reserve on consolidation	4,38,000	-
Securities Premium	9,00,000	-
	99,73,500	-

Note 3. Current Liabilities :-

	As at 31st March, 2014	As at 31st March, 2013
Bills Payable:-		
- R Ltd	5,55,000	-
- S Ltd	2,10,000	-
	7,65,000	-

Note 4. Tangible Assets:-

	As at 31st March, 2014	As at 31st March, 2013
Fixed Assets		
- R Ltd	79,20,000	-
- S Ltd	23,10,000	-
	1,02,30,000	-

Note 5. Current Assets:-

	As at 31st March, 2014	As at 31st March, 2013
Current Assets		
- R Ltd	44,10,000	-
- S Ltd	17,55,000	-
	61,65,000	-

4. (a) The capital structure of A Ltd. is as under:

- **80,00,000 Equity shares of ₹10 each**
- **1,00,000 12% Preference shares of ₹250 each**
- **1,00,000 10% Debentures of ₹500 each**
- **Term loan from Bank (at 10%) = ₹450 lakhs.**

The Company's Profit and Loss Account for the year showed a balance PAT of ₹100 lakhs, after appropriating Equity Dividend at 20%. The company is in the 40% tax bracket. Treasury Bonds carry 6.5% interest, beta factor for the company may be taken at 1.5. The long run market rate of return may be taken at 16.5%. Calculate EVA. [8]

Answer:

A. Profit and Loss Statement

B.

Particulars	Commutation	₹ lakhs
Profit before Interest and Taxes	Balancing Figure	578.33
Less: Interest on Debentures	10% x ₹500 lakhs	50.00
Interest on Bank Term Loan	10% x ₹450 lakhs	45.00
Profit before tax		483.33
Less: Tax at 40%	(₹290.00 /60%) x 40%	193.33
Profit after tax	Reverse Working	290.00
Less: Preference Dividend	12% x ₹250 lakhs	30.00
Residual Earnings for Equity Shareholders	Reverse Working	260.00
Less: Equity Dividend	20% x ₹800	160.00
Net Balance in P&L Account	Given	100.00

C. Computation of Cost of Equity (Ke) = Risk free rate + beta x (market rate – risk free rate)
= 6.5% +1.5 (16.5% - 6.5%) =21.5%

D. Computation of WACC

Component	Amount	Ratio	Individual Cost	WACC
Equity	₹800 lakhs	800/2000=40%	Ke =21.5%	8.60%
Preference	₹250 lakhs	250/2000=12.5%	K_p = 12%	1.50%
Debt	₹950 lakhs	950/2000=47.5%	K_d = Interest x (100 – tax rate) = 10% x (100% - 40%) = 6%	2.85%
Total	₹2000 lakhs		K_o	12.95%

E. Computation of EVA

Particulars	₹ lakhs
Profit before Interest and Taxes	578.33
Less: Taxes	193.33
Net Operating Profit After Taxes i.e. Return to providers of Capital	385.00
Less: Capital charge (Fair return to providers of capital) = WACC x Capital Employed	2,000 x 12.95% =259
Economic Value Added	126

(b) Write a note on "Integral Foreign Operation and its translation" as per AS – 11. [7]

Answer:

"Integral Foreign Operation" as per AS – 11

Integral Foreign Operation is a foreign operation which is carried as if it were extensions of the reporting enterprise activities like dependent branches, sales depot, foreign arm which produces raw material and transfer it to head office (reporting enterprise) or foreign operation only raises finance to help the reporting enterprise.

Translation of financial statements of integral foreign operation - The individual items in the financial statements of the foreign operation are translated as if all these transactions had been entered into by the reporting enterprises. Therefore the financial statements should be translated by using the principles as prescribed for foreign currency transactions of the reporting entity.

It means—

- Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of the transaction; alternatively average rate can also be applied.
- The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost.
- If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
- The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.
- Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.
- Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt with as per AS-22 "Accounting for taxes on income".

5. Following are the balances of Priya Ltd. (Extracts)

		(₹ in lakhs)
Particulars	**As at 31.3.2012**	**As at 31.3.2013**
Share Capital	**1,000.00**	**1,000.00**
General Reserve	**800.00**	**850.00**
Profit and Loss Account	**120.00**	**175.00**
Term Loans	**370.00**	**330.00**
Sundry Creditors	**70.00**	**90.00**
Provision for Tax	**22.50**	**25.00**
Proposed Dividend	**200.00**	**250.00**
Fixed Assets and Investments (Non-trade)	**1,600.00**	**1,800.00**
Stock	**550.00**	**600.00**

Debtors	**340.00**	**220.00**
Cash and Bank	**92.50**	**100.00**

Other Information:

i. **Current cost of fixed assets excluding non-trade investments on 31.3.2012 ₹ 2,200 lakhs and on 31.3.2013 ₹ 2,532.8 lakhs.**

ii. **Current cost of stock on 31.3.2012 ₹ 670 lakhs and on 31.3.2013 ₹ 750 lakhs.**

iii. **Non-trade investments in 10% government securities ₹ 490 lakhs.**

iv. **Debtors include foreign exchange debtors amounting to $ 70,000 recorded at the rate of $ 1 = ₹ 43.50 but the closing exchange rate was $ 1 = ₹ 47.50.**

v. **Creditors include foreign exchange creditors amounting to $ 1,20,000 recorded at the rate of $ 1 = ₹ 42.50 but the closing exchange rate was $ 1 = ₹ 47.50.**

vi. **Profit included ₹ 120 lakhs being government subsidy which is not likely to recur.**

vii. **₹ 247 lakhs being the last installment of R and D cost were written off the profit and loss account. This expenditure is not likely to recur.**

viii. **Tax rate during 2012 - 13 was 50% effective future tax rate is estimated at 35%.**

ix. **Normal rate of return is expected at 14%.**

Based on the information furnished, Mr. K, a director contends that the company does not have any goodwill. Examine his contention. [15]

Answer:

			(₹ in lakhs)
(1)	**Average Capital employed**		
		As at 31.3.2012	As at 31.3.2013
	Current cost of fixed assets other than non trade investments	2,200.00	2,532.80
	Current cost of stock	670.00	750.00
	Debtors	340.00	222.80
	Cash and Bank	92.50	100.00
		3,302.50	3,605.60
	Less: Outside Liabilities:		
	Term loans	370.00	330.00
	Sundry creditors	70.00	96.00
	Tax provision	22.50	25.00
		462.50	451.00
	Capital Employed	**2,840.00**	**3,154.60**
	Average Capital Employed at current value = $\frac{2,840.0+3,154.6}{2}=$		2,997.30
(2)	**Future maintainable profit**		

	Increase in General Reserve		50
	Increase in Profit and Loss Account		55
	Proposed Dividend		250
	Profit after tax		355
	Pre-tax profit = $\frac{355}{1-0.5}$		710.00
	Less: Non-trading income	49.00	
	Exchange loss on creditors [1.2 lakhs ×(47.50-42.5)]	6.00	
	Subsidy	120.00	
			175.00
			535.00
	Add: Exchange gain on debtors [0.7 lakhs ×(47.5 – 43.5)]	2.80	
	R & D costs	247.00	
	Stock adjustment	30.00	
			279.80
	Adjusted pre-tax profit		814.80
	Less: Tax @ 35%		285.18
	Future maintainable profit		529.62

Valuation of Goodwill

		(₹ in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{529.62}{0.14}\right)$	3,783.00
	Less: Average Capital Employed	2,997.30
	Goodwill	785,.70
(2)	Super Profit Method	
	Future Maintainable Profit	529.62
	Normal Profit @ 14% on average capital employed	419.62
	Goodwill	110.00

Under capitalisation method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes:

		(₹ in lakhs)
(1)	Stock adjustment	
	Difference between current cost and historical cost of closing stock	150.00

	Difference between current cost and historical cost of opening stock	120.00
		30.00
(2)	Debtors' adjustment	
	Value of foreign exchange debtors at the closing exchange rate ($ 70,000 × 21.5)	15.05
	Value of foreign exchange debtors at the original exchange rate ($ 70,000 × 17.5)	12.25
		2.80
(3)	Creditors' adjustment	
	Foreign exchange creditors at the closing exchange rate ($ 1,20,000 × 21.5)	25.80
	Foreign exchange creditors at the original exchange rate ($ 1,20,000 × 16.5)	19.80
		6.00

6.(a) Ajay Ltd acquired 70% of the Shares of Vijay Ltd on 1st January Year 1 when Vijay's Net Worth was ₹ 21,60,000, represented by ₹ 20,00,000 in Equity Capital and ₹ 1,60,000 in Reserves. Cost of Investment to Ajay was ₹ 12,00,000. The subsidiary reported the following Losses/Profits (after acquisition) -

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Loss ₹ 5,00,000	**Loss ₹ 8,00,000**	**Loss ₹ 10,00,000**	**Loss ₹ 2,40,000**	**Profit ₹ 1,00,000**	**Profit ₹ 2,00,000**	**Profit ₹ 3,00,000**

Calculate the amount to be shown as Minority Interest and Goodwill / Capital Reserve at the end of every year. [9]

Answer:

A. Cost of Control

Particulars	₹
Cost of Investment	12,00,000
Less: Nominal Value of Equity Capital (70% x ₹ 20,00,000)	(14,00,000)
Less: Share of Capital Profit (on acquisition date) (70% x ₹ 1,60,000)	(1,12,000)
Capital Reserve on Consolidation	3,12,000

Note: Capital Reserve on Consolidation will be reflected on the Liabilities side of the Consolidated Balance Sheet from Year 1 to Year 7 at the same amount, i.e. ₹ 3,12,000.

B. Closing Balance in P&L of Subsidiary, without considering Opening Balance of ₹ 1,60,000

(₹ 000's)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Opening Balance	NIL	(5,00)	(13,00)	(23,00)	(25,40)	(24,40)	(22,40)
Add: Profits for the year	(5,00)	(8,00)	(10,00)	(2,40)	1,00	2,00	3,00
Closing Balance	(5,00)	(13,00)	(23,00)	(25,40)	(24,40)	(22,40)	(19,40)
Minority Share at 30%	(1,50)	(3,90)	(6,90)	(7,62)	(7,32)	(6,72)	(5,82)

Note: In Minority Interest calculation, the balance in P&L A/c as on the date of acquisition is treated as Capital Profit and considered separately.

C. Minority Interest (₹ 000's)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
(a) Opening Balance	6,48	4,98	2,58	NIL	NIL	NIL	NIL
(b) Share in Revenue Profits	(1,50)	(2,40)	(3,00)	(72)	30	60	90
(c) Balance MI taken to CBS (a)-(b)	4,98	2,58	NIL	NIL	NIL	NIL	66
(d) Loss Adjusted in Ajay's Share	-	-	42	72	-	-	-
(e)Gain trfd. to Ajay for losses absorbed	-	-	-	-	(30)	(60)	(24)
(f) Cumulative Adj. against Ajay	-	-	42	1,14	84	24	Nil

Note:

- Opening Balance ₹ 6,48,000 = (Equity Capital ₹ 20,00,000 + Reserves ₹ 1,60,000) x 30%
- Year 7: Profit for the year is ₹ 90,000. Balance of Minority Loss adjusted against Ajay's Share is ₹ 24,000. Therefore, Minority's Share for Year 7 = Profit for the year ₹ 90,000 Less Profit transferred to Ajay to the extent not recovered ₹ 24,000 = ₹ 66,000.

(b) P Ltd is considering the acquisition of R ltd. The financial data at the time of acquisition being-

Particulars	P Ltd	R Ltd
Net Profit after Taxes	**₹ 60 Lakhs**	**₹ 12 Lakhs**
Number of Shares	**12 Lakhs**	**5 Lakhs**
Earnings Per Share	**₹ 5 per Share**	**₹ 2.40 per Share**
Market Price per Share Price	**₹ 150 per Share**	**₹ 48 per Share**
Earning Ratio	**30**	**20**

It is expected that the Net Profit after Tax of the two Companies would continue to be ₹ 72 Lakhs, even after the amalgamation. Explain the effect on EPS of the merged Company under each of the following situations -

- **P Ltd offers to pay ₹ 60 per Share to the Shareholders of R Ltd.**
- **P Ltd offers to pay ₹ 78 per Share to the Shareholders of R Ltd.**

The amount in both cases is to be paid in the form of Shares of P Ltd. **[6]**

Answer:

Particulars	Situation 1	Situation 2
1. Consideration paid to Shareholders of R Ltd	₹ 60 x 5 Lakh Shares = ₹ 300 Lakhs	₹ 78 x 5 Lakh Shares = ₹ 390 Lakhs
2. Current Market Capitalisation of R Ltd	₹ 48 x 5 Lakh Shares = ₹ 240 Lakhs	₹ 48 x 5 Lakh Shares = ₹ 240 Lakhs
3. Synergy Gain / (Loss) of P Ltd on acquisition	(₹ 60) Lakhs	(₹ 150) Lakhs
4. Number of Equity Shares to be issued by P Ltd (Note: Issue Price assumed as Current Market Price)	$\frac{₹300\text{ Lakh}}{₹150}$ = 2 Lakh Shares	$\frac{₹300\text{ Lakh}}{₹150}$ = 2.6 Lakh Shares
5. Total Number of Equity Shares of P Ltd (post- merger)	12 + 2 = 14 Lakhs	12 + 2.6 = 14.6 Lakhs
6. PAT (Post Merger)	₹ 72 Lakhs	₹ 72 Lakhs
7. EPS (Post Merger) = (6 ÷ 5)	**₹ 5.14 per Share**	**₹ 4.93 per Share**

7. (a) On 24th January, 2013 Chinnaswamy of Chennai sold goods to Watson of Washington, U.S.A. for an invoice price of $ 40,000 when the spot market rate was ₹54.20 per US $. Payment was to be received after three months on 24th April, 2013. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, Chinnnaswamy immediately acquired a forward contract to sell on 24th April, 2013 US $ 40,000 @ ₹ 53.70. Chinnaswamy closed his books of account on 31st March, 2013 when the spot rate was ₹ 53.20 per US $. On 24th April, 2013, the date of receipt of money by Chinnaswamy, the spot rate was ₹ 52.70 per US $.

Pass journal entries in the books of Chinnaswamy to record the effect of all the above mentioned effects. [10]

Answer:

Journal Entries in the books of Chinnaswamy

2013			₹	₹
Jan. 24	Watson Account To Sales Account (Credit sales made to Watson of Washington, USA for $40,000 recorded at spot market rate of ₹54.20 per US $)	Dr.	21,68,000	 21,68,000
" "	Forward (₹) Contract Receivable Account Deferred Discount Account To Forward ($) Contract Payable (Forward contract acquired to sell on 24th April, 2013 US $40,000 @ ₹53.70)	Dr. Dr.	21,48,000 20,000	 21,68,000
March 31	Exchange Loss Account To Watson (Record of exchange loss @ ₹1 per $ due to market rate becoming ₹53.20 per US $ rather than ₹54.20 per US $)	Dr.	40,000	 40,000
	Forward ($) Contract Payable To Exchange Gain Account (Decrease in liability on forward contract due to fall in exchange rate)	Dr.	40,000	 40,000
	Discount Account To Deferred Discount Account (Record of proportionate discount expense for 66 days out of 90 days)	Dr.	14,667	 14,667
April 24	Bank Account Exchange Loss Account To Watson (Receipt of $40,000 from Watson, USA customer @ ₹ 52.70 per US $; exchange loss being ₹20,000)	Dr. Dr.	21,08,000 20,000	 21,28,000
	Forward ($) Contract Payable Account To Exchange Gain Account To Bank Account (Settlement of forward contract by payment of $40,000)	Dr.	21,28,2000	 20,000 21,08,000

" "	Bank Account To Forward (₹) Contract Receivable (Receipt of cash in settlement of forward contract receivable)	Dr.	21,48,000	17,48,000
" "	Discount Account To Deferred Discount Acount (Recording of discount expense for 24 days: 24 days — ₹20,000 ×24/90 =₹ 5,333)	Dr.	5,333	5,333

(b) On April 1, 2013, a company Sky Blue Ltd. offered 100 shares to each of its 1,500 employees at ₹60 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under the plan shall be subject to lock-in on transfers for three years from grant date. The market price of shares of the company on the grant date is ₹70 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹68 per share.

On April 30, 2013, 1,200 employees accepted the offer and paid ₹60 per share purchased. Nominal value of each share is ₹10.

Record the issue of shares in book of the Sky Blue Ltd. under the aforesaid plan. [5]

Answer :

Fair value of ESPP per share = ₹68 – ₹60 = ₹8

Number of share issued = 1,200 × 100 = 1,20,000

Fair value of ESPP = 1,20,000 × ₹8 = ₹9,60,000

Vesting period = One month

Expense recognized in 2013-14 = ₹9,60,000

Particulars	₹	₹
<u>**April 30, 2013**</u>		
Bank A/c(1,20,000 x 60)	72,00,000	
Employees' Compensation A/c (1,20,000 x 8)	9,60,000	
To Share Capital (1,20,000 x 10)		12,00,000
To Securities premium (1,20,000 x 58)		69,60,000

8. Write short notes on any three of the following: [5x3=15]

(a) Economic value added (EVA for short) and its uses;
(b) Growing scope of Human Capital Reporting;
(c) Aspects covered in Corporate Environmental Accounting System;
(d) Responsibilities of the Comptroller and Auditor General of India.

Answer:

(a) Economic value added (EVA for short) and its uses:

Economic Value Added (EVA) for short, is primarily a benchmark to measure earnings efficiency.

Though the term "Economic Profit" was very much there since the inception of "Economics", Stern Stewart & Co., of USA has got a registered Trade Mark for this by the name "EVA", an acronym for Economic Value Added.

EVA as a residual income measure of financial performance, is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

In addition, EVA is a management tool to focus managers on the impact of their decisions in increasing shareholders' wealth. These include both strategic decisions such as what investments to make, which businesses to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholder wealth is to integrate the EVA framework in four key areas; to measure business performance; to guide managerial decision making; to align managerial incentives with shareholders' interests; and to improve the financial and business literacy throughout the organisation.

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

(b) Growing scope of Human Capital reporting:

Human Capital Reporting —

- Recent Reporting Trends: In the recent years, there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (i.e. which can be measured in monetary terms) to a more comprehensive approach of reporting under which Human Resources are also considered as Measurable Assets of a Going Concern.
- Relevance: An organization is a dynamic entity and operates through the effort of its human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organisation. Comparison of the specific values of human capital based on the organisation's scales of wages and salaries with the general industry standards can provide inputs on the Firm's HR policies.
- Purpose: Human Capital Reporting provides scope for planning and decision-making in relation to proper manpower planning. Such reporting can also bring out the effect of various rules, procedure and incentives relating to work force. This can even act as an eye opener for modifications of existing statutes, laws etc.
- Accounting: Business entities account for Fixed Assets on Historical Cost basis. Similarly, employee related costs like cost of recruitment, training and orientation of employees, etc. can be considered for the purpose of capitalization. An appropriate portion of such capitalized costs can be amortised each year over the estimated years of effect of such costs.
- Standards: Currently, there is no standard format for Human Capital Reporting. Generally, the Human Capital Report contains data pertaining to number of employees,

employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and number of disabled employees.

(c) Aspects covered in Corporate Environmental Accounting System:

Environmental Accounting System should include aspects such as –

- Concept of National Income arising out of the use of Natural Resources;
- Concept of Costs incurred to make use of such Resources;
- Depreciation of Natural Resources;
- Valuation of Natural Resources;
- Disclosing the value of Natural Resources in the Balance Sheet;
- Contribution of Natural Resources to Industrial Development;
- Contribution of Industries to the Environment; and
- Extent to which changes in the environment due to business activities has affected social well being.

(d) Role of the Comptroller and Auditor General of India:

Under section 10 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971), the Comptroller and Auditor General shall be responsible-

(a) for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such accounts; and

(b) for keeping such accounts in relation to any of the matters specified in clause (a) as may be necessary;

Provided that the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for compiling-

(i) the said accounts of the Union (either at once or gradually by the issue of several orders); or (ii) the accounts of any particular services or departments of the Union;

Provided further that the Governor of a State with the previous approval of the President and after consultation with Comptroller and Auditor General, by order, relieve him from the responsibility for compiling-

(i) the said accounts of the State (either at once or gradually by the issue of several orders); or (ii) the accounts of any particular services or departments of the State;

Provided also that the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for keeping the accounts of any particular class or character.

(2) Where, under any arrangement, a person other than the Comptroller and Auditor General has, before the commencement of this Act, been responsible-

(i) for compiling the accounts of any particular service or department of the Union or of a State, or (ii) for keeping the accounts of any particular class or character, such arrangement shall, notwithstanding anything contained in subsection (1), continue to be in force unless, after consultation with the Comptroller and Auditor General, it is revoked in the case referred to in clause (i), by an order of the President or the Governor of the State, as the case may be, and in the case referred to in clause (ii) by an order of the President.