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) D Ltd. incurred costs to modify its building and to rearrange its production line. As a result, an overall reduction in production costs is expected. However, the modifications did not increase the building's market value, and the rearrangement did not extend the production line's life.

Should the building modification costs and the production line rearrangement costs be capitalized?

	Building modification costs	Production line rearrangement costs
A.	Yes	No
B.	Yes	Yes
C.	No	No
D.	No	Yes

Answer:

B — Yes,Yes.

As per AS-10, Only expenditure that increases the benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value. In this case future benefits from the existing asset appear to have increased beyond its previously assessed standard of performance as there is overall reduction in production cost which is expected. Therefore both the building modification and production line rearrangement contributed to the improved efficiency in the production process. Therefore, both costs should be capitalized and answer **B** is correct.

(ii) On January 2, 2014 Virat Ltd. bought a trademark from Mithil Ltd. for ₹ 5,00,000. Virat Ltd. retained an independent consultant, who estimated the trademark's remaining life to be 20 years. Its unamortised cost on Induga accounting records was ₹ 3,80,000. Virat Ltd. decided to amortize

the trademark over the maximum period allowed. In Virat's December 31, 2014 balance sheet, what amount should be reported as accumulated amortization?

A. ₹ 7,600
B. ₹ 9,500
C. ₹ 25,000
D. ₹ 50,000

Answer:

D — ₹ 50,000.

As per para 23 of AS-26 (refer point 26.8), intangible assets should be measured initially at cost therefore, Virat Ltd. should amortize the trademark at its cost of ₹ 5,00,000. The unamortised cost on the seller's books (₹3,80,000) 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 (refer point 26.16-2). Therefore, the 2014 amortization expense and accumulated amortization is 50,000 (₹ 5,00,000 ÷ 10 years).

(iii) V Ltd. acquired 2,000 equity shares of D Ltd. on April, 01,2013 for a price of ₹ 3,00,000. D Ltd. made a net profit of ₹ 80,000 during the year 2013-14. D Ltd. issued bonus shares of one share for every five shares held out of the post acquisition profits earned during the year 2013-14. The Share Capital of D Ltd. is ₹ 2,50,000 consisting of shares of ₹ 100 each. If the share of V Ltd. in the pre-acquisition profit of D Ltd. is ₹ 56,000, the amount of Goodwill/Capital Reserve to be shown in the Consolidated Balance Sheet as on March 31, 2013 is —
A. ₹ 4,000 (Goodwill)
B. ₹ 4,000 (Capital Reserve)
C. ₹ 44,000 (Goodwill)
D. ₹ 50,000 (Goodwill)

Answer:

A — ₹ 4000 (goodwill) .

Cost of investments	₹ 3,00,000
Less: Share of capital profit	₹ 56,000
	2,44,000
Face value of shares (including bonus shares of 400)	₹2,40,000
Cost of control-Goodwill	₹ 4,000

(vi) On 1-1-2014 Vivan Ltd. has 3,600 equity shares outstanding. On 31-6-2014, it issued 1,200 equity shares for cash (without bonus claim). On 1-11-2014 it bought back 600 equity shares. Calculate the weighted average number of shares as on 31-12-2014?
A. 4,100 shares
B. 5,400 shares
C. 4,800 shares
D. None of the above

Answer:

A — 4,100 shares.

Computation of weighted average number of shares as per AS-20 is as follows:

$$(3,600\times\frac{6}{12})+(4,800\times\frac{4}{12})+(4,200\times\frac{2}{12})=4,100\text{ shares.}$$

(v) Tulip Ltd. holds 25% share in Lotus Ltd. at a cost of ₹ 7.50 lakhs as on 31.3.2006 out of Lotus's Share Capital and Reserve of ₹ 30 lakhs each. For the year ended 31.3.2013, Lotus Ltd. made a profit of ₹ 2,40,000 and 30% of it was distributed as dividend.

In the Consolidated Financial Statement, the carrying amount of investment as at 31.3.2013 will be —
A. ₹ 15.00 lakhs
B. ₹ 15.60 lakhs
C. ₹ 15.42 lakhs
D. ₹ 14.82 lakhs

Answer:

C — ₹ 15.42 lakhs

Particulars	₹ in lakhs
Share in Lotus Ltd.	7.50
Share of Reserve (25% of ₹ 30 Lakh)	7.50
Share of Profit (25% of ₹ 2.40 Lakh)	0.60
	15.60
Less: Dividend (2.40 Lakh x 30% x 25%)	0.18
Carrying amount of investments in Consolidated financial statements.	15.42

(vi) G Ltd. takes over P Ltd. on 31.03.2014

There is Export Profit Reserve of ₹15,000 in the Balance Sheet of P Ltd. which is to be maintained for two more years. The journal entry will be :

A. Statutory Reserves A/c debit , to Amalgamation Adjustment A/c
B. Amalgamation Adjustment A/c debit , to Statutory Reserves A/c
C. General Reserves A/c debit, to Amalgamation Adjustment A/c
D. None of the above.

Answer:

A. A — Statutory Reserves A/c debit , to Amalgamation Adjustment A/c

The entry will be —

Statutory Reserves A/c	Dr.	₹15,000	
To Amalgamation Adjustment A/c			₹15,000

(vii) Uday Ltd. presents interim financial report quarterly. On 1-4-2014. Uday Ltd. has carried forward loss of ₹800 lakhs for income-tax purpose for which deferred tax asset has not been recognized. The Uday Ltd. earns ₹ 1,000 lakhs in each for quarter ending on 30-6-2014,30-9-2014,31-12-2014 and 31-3-2015 excluding the loss carried forward. Income-tax rate is expected to be 40% Calculate the amount of tax expense to be reported in each quarter.

A. ₹1,000

B. ₹1,280

C. ₹320

D. ₹3,200

Answer:

C — ₹320

The estimated payment of the annual tax on ₹ 4,000 lakhs earnings for the current year.

(4,000 lakhs - ₹ 800 lakhs) = ₹ 3,200 lakhs

₹ 3,200 × 40/100 = ₹ 1,280 lakhs.

Average annual effective tax rate = (1,280/4,000) × 100 = 32%

Tax expense to be shown each quarter will be 1,000 × 32/100 = ₹ 320 lakhs.

(viii) Best Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2015 at ₹ 2,400 lakh. As at that date value in use is ₹ 1,600 lakh. If the net selling price is ₹ 1,800 lakh, Recoverable amount of the asset as per AS-28 will be

A. ₹ 1,800 lakh

B. ₹ 600 lakh

C. ₹ 200 lakh

D. None of the above

Answer:

A — ₹1,800 lakh

Recoverable amount is higher of Value in use ₹1,600 lakh and net selling price ₹1,800 lakh.
Recoverable amount = ₹1,800 lakh.

(ix) The fair value of Plan assets of Tulip Ltd. at beginning and end of the year 2013-2014 were ₹ 4,00,000 and ₹ 5,70,000 respectively. The employer's contribution to the plan during the year was ₹ 1,40,000. If benefit payments to retirees were ₹ 1,00,000 what would be the actual return on plan assets (as per AS- 15) ?

A. ₹ 1,50,000 lakhs

B. ₹ 1,30,000 lakhs

C. ₹ 1,20,000 lakhs

D. Insufficient Information

Answer:

B — ₹ 1,30,000.

Actual Return = Fair value of assets (end of year) - Fair Value of assets (beginning of year) - Employer's contribution + benefit payments = (5,70,000 – 4,00,000 – 1,40,000 + 1,00,000) = ₹ 1,30,000.

(x) Vishal Construction Ltd. undertook a contract on 1st January, 2013 to construct a building for ₹ 80 lakhs. The company found on 31st March, 2013 that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000. Contract Value to be recognized as turnover in the final accounts for the year ended 31st March, 2013 as per AS 7 (revised) will be:
A. ₹ 80 lakhs
B. ₹ 10 lakhs
C. ₹ 52 lakhs
D. None of these

Answer:

C — ₹ 52 lakhs.

Contract work in progress (58,50,000/90,00,000) × 100 = 65% .
Proportion of total contract value to be recognized as turnover
= 65% of ₹ 80,00,000 = ₹ 52,00,000.

(b) What are the recognition criteria of share Based Payment under International Financial Reporting Standard (IFRS) – 2 ? [5]

Answer:

Recognition of Share Based Payment

The following are recognition criteria under Paras 7-9 of IFRS-2:

(i) The goods or services received or acquired in a share-based payment transaction are recognised when the goods are obtained or as the services are received. The entity shall recognise a corresponding increase in equity is recognised if the goods or services were received in an equity-settled transaction.

(ii) The goods or services received or acquired in a share-based payment transaction are recognised when the goods are obtained or as the services are received. The entity shall recognise a corresponding increase in liability if the goods or services were acquired in a cash-settled transaction. For example, in case of employee stock option, it is difficult to assess the fair value of the service rendered, and therefore, the transaction should be measured at fair value of the equity.

(iii) The goods or services received in a share-based payment transaction may qualify for recognition as an asset. If they are not so qualified then they are recognised as expense.

Part B (75 marks)

2. The following is the Balance Sheet of Winners Ltd as on 30th June-

Equity and Liabilities	₹
(1) Shareholders' Funds:	
(a) Share Capital – 20,000 Shares of ₹ 10 each	2,00,000
(b) Reserves & Surplus – General Reserve	20,000
(2) Non-Current Liabilities:	
Long Term Borrowings (i) 10% Debentures	1,00,000
(ii) Loan from bank	40,000
(3) Current Liabilities:	
Trade Payables – Sundry Creditors	80,000
Total	4,40,000
Assets	
(1) Non-Current Assets:	
(a) Fixed Assets: (i) Tangible Assets	
- Land & Building	1,00,000
- Plant & Machinery	1,45,000
(ii) Intangible Assets – Goodwill	25,000
(b) Other Non-Current Assets	
- Preliminary expenses	16,000
(2) Current Assets:	
(a) Inventories	55,000
(b) Trade Receivables	65,000
(c) Cash & Cash Equivalents	34,000
Total	4,40,000

The balance of Winners Ltd is taken over by Superb Ltd as on that date on the following terms:

(i) All Assets except cash and Bank are taken over at Book Value less 10% subject to (b) below.
(ii) Goodwill is to be valued at 4 years' Purchase of the excess of average (five years) Profits over 8% of the combined account of Share Capital and General Reserve.
(iii) Trade Creditors are to be taken over subject to a discount of 5%.
(iv) Loan from Bank is to be repaid by Winners Ltd.
(v) The Purchase Consideration is to be discharged in Cash to the extent of ₹ 1,50,000 and the balance is fully paid Equity Shares of ₹ 10 each valued at ₹ 12.50 per share.

The average of the five years profit is ₹ 30,100. The expenses of Liquidation amount to ₹ 2,000. Prior to 30th June, Winners Ltd sold goods costing ₹ 30,000 to Superb Ltd for ₹ 40,000. Debtors include ₹ 20,000 still due from Superb Ltd. on the date of absorption, ₹ 25,000 worth of Goods were still in Stock of Superb Ltd.

Show the:

A. Realisation Account, Bank Account, Sundry Shareholders Account and Shares in Superb Ltd and

B. Journal Entries in the books of Superb Ltd. [15]

Answer:

1. Basic Information

Selling Co: Winners Ltd	Date of B/S: 30th June	Nature of Amalgamation:
Buying Co: Superb Ltd	Date of Amalgm: 30th June	Purchase (since the Assets are not taken over at Book Value & Purchase consideration discharged is by other than shares)

2. Purchase Consideration

	Particulars		₹
1.	Calculation of Goodwill	Average of 5 years Profit (given)	30,100
	Less:	Normal Profit 8% of Capital + Reserves i.e., ₹ 2,20,000	17,600
		Super Profit	12,500
		Goodwill at 4 years purchase 12,500 × 4	50,000
2.	Calculation of purchase consideration		
	Assets taken over -	Land & Building	1,00,000
		Plant & Machinery	1,45,000
		Stock	55,000
		Debtors	65,000
		Total Assets Taken Over	3,65,000
	Less:	Allowance at 10% of Assets Value	36,500
		Balance Assets Value	3,28,500
	Add:	Goodwill as calculated above	50,000
		Total value of Assets taken over	3,78,500
	Less:	Sundry Creditors less 5% discount =(80,000–5% thereon)	76,000
		Net Purchase Consideration	3,02,500
3.	Discharge of Purchase Consideration: (a) Payable in cash		1,50,000
	(b) Given in Shares – 12,200 Shares of ₹ 10 each valued at ₹ 12.50 per share		1,52,500

3. In the Books of Winners Ltd.
(a) Realisation Account

Particulars	₹	Particulars	₹
To Sundry Assets transferred: Goodwill	25,000	By Sundry Creditors	80,000
Land & Building	1,00,000	By Superb Ltd. – Purc. Consideration	3,02,500
Plant & Machinery	1,45,000	By Sundry Shareholders A/c (Loss)	9,500
Stock	55,000		
Debtors	65,000		
To Bank (Expenses)	2,000		
Total	3,92,000	Total	3,92,000

(b) Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	34,000	By Realisation A/c – Expenses	2,000
To Superb Ltd. – amount paid	1,50,000	By 10% Debentures	1,00,000
		By Loan from Bank	40,000
		By Sundry Shareholders	42,000
Total	1,84,000	Total	1,84,000

(c) Sundry Shareholders Account

Particulars	₹	Particulars	₹
To Preliminary Expenses	16,000	By Share Capital	2,00,000
To Loss-on Realisation	9,500	By General Reserve	20,000
To Bank	42,000		
To Shares in Superb Ltd.	1,52,500		
Total	2,20,000	Total	2,20,000

(d) Shares in Superb Ltd. Account

Particulars	₹	Particulars	₹
To Superb Ltd.	1,52,500	By Sundry Shareholders (transfer)	1,52,500

3. **(a) Mayukh Ltd. wanted to buy 30% equity shares of Omkar Ltd. with an intention to establish an associate relationship between the two on 01.04.2013 Mayukh Ltd. purchased such percentage of equity shares at a cost of ₹15 Lakhs. On that date the balance sheet of Omkar Ltd. Was as under:**

Name of the Company: Omkar Ltd.
Balance Sheet as at: 1st April, 2013

(₹ in lakh)

Ref No.		Note No.	As at 1st April, 2013	As at 1st April, 2012
	EQUITY AND LIABILITIES			
	Shareholder's Fund			
	(a) Share capital	1	30.00	
	(b) Reserves and surplus	2	9.00	
	Current Liabilities			
	(a) Short-term borrowings	3	1.00	
	(b) Trade payables	4	3.00	
	Total		43.00	
	ASSETS			
	Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets	5	36.00	
	Current assets			

	(b) Inventories	6	3.00	
	(c) Trade receivables	7	3.00	
	(d) Cash and cash equivalents	8	1.00	
	Total (1+2)		43.00	

(₹ in lakh)

Note 1. Share Capital	As at 1st April, 2013	As at 1st April, 2012
Authorized, Issued, Subscribed and paid-up Share capital:		
30,000 Equity share of ₹ 100 each	30.00	
Note 2. Reserve & Surplus		
Reserves & Surplus	9.00	
Note 3. Short term borrowings		
Bank Overdraft	1.00	
Note 4. Trade Payables		
Sundry Creditors	3.00	
Note 5. Tangible Assets		
Tangible Assets	36.00	
Note 6. Inventories		
Stock in trade	3.00	
Note 7. Trade Receivables		
Sundry debtors	3.00	
Note 8. Cash and cash equivalents		
Balance at Bank	1.00	

During the year 2013-14 Omkar Ltd. earned a profit of ₹15 lakhs and on 2014 – 15 it suffered a loss of ₹90 lakhs. Mayukh Ltd. did not have any subsidiary during 2013-14 but on 01.04.2014 it purchased 60% equity shares of Umang Ltd. for ₹160 lakhs.

Discuss the impact of the associate relationship on the balance sheet of 2013-14 & 2014-15 of Mayukh Ltd. [12]

Answer:

As per AS-23 investment in associates will be accounted for as per equity method in consolidated financial statements of the investor. Therefore, Mayukh Ltd. should show the investment as under:

Cost of purchase ₹15 lakhs. 30% of equity fund of Omkar Ltd. 30/100 x ₹(30 + 9) lakhs = ₹11.7 lakhs.

Goodwill identified: ₹15 lakhs – ₹11.7 lakhs = ₹3.3 lakhs. Carrying amount of investment on 31.3.2014 as per equity method ₹15 lakhs + (30/100 x ₹15 lakhs) = ₹19.5 lakhs (including Goodwill).

But here Mayukh Ltd. did not prepared the consolidated balance sheet by Mayukh Ltd. as it did not have any subsidiary at that time i.e., on 31.03.2014.

The amount of investment will be shown in the balance sheet of Mayukh Ltd. at cost i.e. at ₹15 lakhs (as per AS – 13).

On the other hand during 2014-15 Omkar Ltd. suffered a loss of ₹90 lakhs i.e., carrying amount of investment as per equity method will be ₹19.5 lakhs – (30 / 100 x ₹90 lakhs) = (-)₹7.5 lakhs. As the carrying amount of investment (as per equity method) is (-)₹7.5 lakhs, investment will be reported at Nil value in the consolidated balance sheet and any further loss of associates will not be recognized by Mayukh Ltd.

Name of the Company: Consolidated Balance Sheet (Extract) of Mayukh Ltd. and its Subsidiary Umang Ltd.
Balance Sheet as at: 31st March, 2015

(₹ in lakh)

Ref No.		Particulars	Note No.	As at 31st March, 2015	As at 31st March, 2014
		ASSETS			
		Non-current assets			
		(b) Non-current investments		NIL	

3. (b) Explain Negative Goodwill in case of amalgamation in the nature of purchase. [3]

Answer:

If the consideration paid for amalgamation is less than the Net Assets of the transferor company, the difference is called Negative Goodwill. This should be recognised in the transferee company's financial statements as Capital Reserve,

Example:

Mitra Ltd. acquired the Net Assets of Uma Ltd. for a total consideration of ₹500 lakhs. The fair value of Net Assets of Uma Ltd. is ₹800 lakhs. In the above case, the difference of ₹300 lakhs constitutes Negative Goodwill. This should be recognised as Capital Reserve in the Financial Statement of Mitra Ltd.

4. (a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

Particulars		₹ in Lakhs	₹ in Lakhs
Net Profit			**60,000**
Add:	**Sale of Investments**		**70,000**
	Depreciation on Assets		**11,000**
	Issue of Preference Shares		**9,000**
	Loan raised		**4,500**
	Decrease in Stock		**12,000**
			1,66,500
Less:	**Purchase of Fixed Assets**	**65,000**	
	Decrease in Creditors	**8,000**	
	Increase in Debtors	**6,000**	
	Exchange gain	**8,000**	
	Profit on sale of investments	**12,000**	
	Redemption of Debenture	**5,700**	
	Dividend paid	**1,400**	
	Interest paid	**945**	**1,07,045**
			59,455
Add:	**Opening cash and cash equivalent**		**12,345**
Closing cash and cash equivalent			**71,800**

[10]

Answer:

Cash Flow Statement

Particulars	(₹ in Lakhs)	(₹ in Lakhs)
Cash flows from operating activities		
Net profit		60,000

Less: Exchange gain		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
(-) Increase in debtors	(6,000)	
(+) Decrease in stock	12,000	
(-) Decrease in creditors	(8,000)	(2,000)
Net cash from operating activities		49,000
Cash flows from investing activities		
Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from Investing activities		5,000
Cash flows from financing activities		
Issue of preference shares	9,000	
Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		5,455
Net increase in cash & cash equivalents		59,455
Add: Opening cash and cash equivalents		12,345
Closing cash and cash equivalents		71,800

4. (b) State the disclosure requirement of Contingent liabilities and Assets under AS 29 "Provisions, Contingent liabilities and Contingent Assets". [5]

Answer:

Disclosure of contingent liability:

An enterprise should disclose for each class of contingent liability at the balance sheet date-

- A brief description of the nature of the contingent liability where practicable.
- An estimate of the amount as per measurement principles as prescribed for provision.
- Indications of the uncertainties relating to outflow.
- The possibility of any reimbursement.
- Where any of the information required as above is not disclosed because it is not practicable to do so, that fact should be stated.

An enterprise need not disclose of the disclosure requirement if disclosure of any of this information is expected to prejudice seriously the case of the enterprise in disputes with other party. However, it should be extremely rare case.

Disclosure of contingent assets:

Contingent assets are not required to disclosed in financial statement, generally Board of Directors report discloses such contingent assets.

5. (a) On 31st March, 2014 the balance sheet of Q Ltd. was as follows:

Equity and Liabilities	₹
(1) Shareholders' Funds:	
Share Capital Authorise and Issued 5,000 Equity Shares of ₹100 each fully paid	5,00,000
Reserves & Surplus – Profit and Loss A/c	1,03,000
(2) Current Liabilities:	
Trade Payables – Sundry Creditors	77,000
Other Current Liabilities	20,000
Short-term provisions [Provision for Taxation ₹45,000 + Proposed Dividend ₹75,000]	1,20,000
Total	8,20,000
Assets	
(2) Non-Current Assets:	
Fixed Assets: Tangible Assets	
- Land & Building	2,20,000
- Plant & Machinery	95,000
(2) Current Assets:	
Inventories	3,50,000
Trade Receivables	1,55,000
Total	8,20,000

The net profits of the company, after deducting all working charges and providing for depreciation and taxation, were as under:

Year ended 31st March	₹

2010	**85,000**
2011	**96,000**
2012	**90,000**
2013	**1,00,000**
2014	**95,000**

On 31st March,2014 , Land and Buildings were valued at ₹2,50,000 and Plant and Machinery ₹1,50,000.

In view of the nature of business, it is considered that 10% is a reasonable return on tangible capital.

Compute the value of the company's shares after taking into account the received values of fixed assets and the valuation of goodwill based on five year's purchase of the super profit based on the average profit of the last five years. [10]

Answer:

Valuation of shares

Particulars	₹
Net tangible assets	7,63,000
Add: Goodwill	84,500
Less: Proposed Dividend	(75,000)
Net assets available to equity shareholders	7,72,500
Number of shares outstanding	5,000
Value per share	154.50

Net tangible assets or Net trading assets as on 31.03.2014

Particulars	₹	₹
A. Assets		
(i) Land and Buildings	2,50,000	
(ii) Plant and Machinery	1,50,000	
(iii) Stock	3,50,000	
(iv) Sundry Debtors	1,55,000	9,05,000
B. Less: Liabilities		
(i) Bank Overdraft	20,000	
(ii) Creditors	77,000	
(iii) Provision for taxation	45,000	(1,42,000)
C. Net Tangible Assets	**7,63,000**	

Future Maintainable Profit:

$$\text{Average profits of 5 years} = \frac{85,000 + 96,000 + 90,000 + 1,00,000 + 95,000}{5}$$

$$= \frac{4,66,000}{5} = ₹93,200$$

Valuation of Goodwill (Super Profit Method)

Particulars	₹
A. Capital Employed	7,63,000
B. NRR	10%
C. Normal profit	76,300
D. Future maintainable profit	93,200
E. Super profits (D – C)	16,900
F. Number of years of purchase	5 years
G. Goodwill (E – F)	84,500

5. (b) Given- (i) Future Maintainable Profit before Interest- ₹ 125 Lakhs; (ii) Normal Rate of Return on Long Term Funds is 20% and on Equity Funds is 25%; (iii) Long Term Funds of the Company is ₹320 Lakhs of which Equity Funds is ₹ 210 Lakhs; (iv) Interest on loan Fund is 18%. Find out leverage effect on the Goodwill if tax rate is =30%. [5]

Answer:

A. Long Term Loan Funds= Total Long Term funds **Less** Equity Funds= ₹ (320-210) lakhs= ₹110 Lakhs
Interest at 18% thereon = ₹ 110 Lakhs X18% = ₹ 19.80 lakhs

B. Computation of Future Maintainable Profit

(₹ in Lakhs)

Particulars	Shareholders funds approach	Long Term Funds approach
Profit Before Interest Less: Interest on Long Term Loan	125.00 19.80	125.00 N.A
Future Maintainable Profits before tax Less : Tax Expense at 30%	105.20 31.56	125.00 37.50
Future Maintainable Profit after tax	73.64	87.50

C. Computation of Goodwill under different approaches

(₹ in Lakhs)

Particulars	Shareholders' funds approach	Long Term Funds approach
a. Future Maintainable Profit after tax	73.64	87.50
b. Normal Rate of Return	25%	20%
c. Normal Capital Employed =(a÷b)	294.56	437.50
d. Actual Capital Employed (given)	210.00	320.00
e. Goodwill = (c-d)	**84.56**	**117.50**

Hence, Leverage Effect on Goodwill = (₹ 117.50 – ₹ 84.56) Lakhs = ₹ 32.94 Lakhs.

6. (a) M Ltd. provides you the following data to calculate Economic Value Added (EVA):

Particulars	
60 crores Equity Shares of ₹10 each	
2 crores, 15% Preference Shares of ₹100 each	
16 crores, 15% Debentures of ₹100 each	
Tax Rate	**30%**
Beta Factor	**1.5**
Market Rate of Return	**15.5%**
Equity Market Risk Premium	**9%**
Financial Leverage	**1.5 times**
Immovable Property (held as Investment)	**₹200 crores**

[9]

Answer:

Particulars	₹ in crores
Net Operating Profit after Tax (NOPAT)	504
Less: Cost of Operating Capital Employed (COCE) [13.25% of ₹2,200]	291.50
Economic Value Added (EVA)	212.50

Working Notes:

A. Cost of Debt = Interest Rate (1- Tax Rate) = 15% (1-30) = 10.50%
B. Cost of Preference Share = 15%
C. Cost of Equity = Risk Free Rate + (Beta × Equity Market Risk Premium)
= (15.5% - 9%) + (1.5 × 9) = 20%

D. Total Capital Employed = 1,600 + 200 + 600 = 2,400 crores
E. WACC —

$$\left(\frac{1,600}{2,400}\times 10.50\%\right)+\left(\frac{200}{2,400}\times 15\%\right)+\left(\frac{600}{2,400}\times 20\%\right)$$

$$=7\%+1.25\%+5\%=13.25\%$$

F. Financial Leverage

$$=\frac{\text{EBIT}}{\text{EBIT - Interest}}=\frac{\text{EBIT}}{\text{EBIT - 240}}=1.5$$

EBIT = (240×1.5)/0.5 = 720

G. Net Operating Profit after Tax = 720 – 30% 720 = 504
H. Operating Capital Employed = Total Capital Employed – Non-Operating Capital Employed = 2,400 - 200 = 2,200.

6. (b) The draft Balance Sheets of S Ltd. and H Ltd. as on 31.3.2014 were as follows.

(₹ in Lakhs)

Liabilities		S Ltd.		H Ltd.
Equity Share capital		80		25
Reserves and surplus		400		75
10% 25,000 Debentures of ₹ 100 each		–		25
Other Liabilities		120		–
		600		125
Assets				
Fixed assets at cost	200		75	
Less: Depreciation	100	100	50	25
Investments in H Ltd.				
2 Lakhs Equity shares of ₹ 10				
each at cost	32			
10% 25,000 debentures of ₹ 100				
each at cost	24	56		
Current assets	800		300	
Less: Current liabilities	(356)	444	(200)	100
		600		125

In a scheme of absorption duly approved by the Court, the assets and liabilities of 'H' Ltd. were taken over at an agreed value of ₹ 130 lakhs. Debenture holders are to be discharged at per. Outside shareholders of 'H' Ltd. were allotted equity shares in S Ltd. at a premium of ₹ 90 per share in satisfaction of other claims in 'H' Ltd. for purposes of recording in the books of 'S' Ltd. Fixed assets taken over from 'H' Ltd. were revalued at ₹ 40 lakhs.

The scheme was put through on 1st April, 2014.

Compute the purchase consideration. And show the breakup. [2+4=6]

Answer:

Actual purchase consideration is already agreed as ₹130 lakhs.

Purchase Consideration ₹ 130 lakhs

Debentures
₹ 25 lakhs

Equity Share holders
₹ 105 lakhs

Worth of shares belonging to S Ltd.	Amount Pertaining to outsiders
[2/2.5]×₹105 = ₹84 lakhs	105-84 = ₹ 21 lakhs*

7. (a) Y Ltd. decides to absorb X Ltd. The draft Balance Sheet of X Ltd. is as follows:

Liabilities	Amount (₹)	Assets	Amount (₹)
3,000 Equity Shares of ₹100 each (fully paid)	**3,00,000**	**Fixed Assets**	**2,50,000**
Preference Shares @ ₹100 each	**60,000**	**Sundry Debtors**	**1,00,000**
Sundry Creditors	**60,000**	**Profit & Loss Account**	**70,000**
	4,20,000		**4,20,000**

Y Ltd. agrees to take over X Ltd. for this purpose an Equity Share of X Ltd. will be valued at ₹70 . Y Ltd. agrees to pay ₹60,000 in cash for payment to preference shareholders. Equity Shares will be issued at value of ₹120 each.

Calculate the Purchase Consideration. **[6]**

Answer:

Value of 3,000 shares of X Ltd. @ ₹70 = ₹2,10,000

The purchase consideration will be:

= ₹2,10,000 for Equity Shares + ₹60,000 for Liabilities towards Preference shareholders

=₹2,70,000

₹60,000 out of the above will be in cash and ₹2,10,000 in the form of Equity Shares of Y Ltd. issued at ₹120 per share;

The number of shares that will be issued = 2,10,000/120 = 1,750 Equity Shares.

7. (b) 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:

Particulars	Skilled	Unskilled
(i) Annual average earning of an employee till the retirement age.	**₹1,40,000**	**₹1,00,000**

(ii) Age of retirement	**65 years**	**62 years**
(iii) Discount rate	**15%**	**15%**
(iv) No. of employees in the group	**30**	**40**
(v) Average age	**62 years**	**60 years**

[9]

Answer:

According to Lev and Schwartz, the value of human capital embodied in a person of age τ is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following formula:

$$V = \sum_{t=r}^{t} \frac{I(t)}{(1+r)^{t-\tau}}$$

Where,

V = the human capital value of a person

I(t) = the person's annual earnings up to retirement.

r = a discount rate specific to the person.

t = retirement age.

Value of Skilled Employees:

$$= \frac{1,40,000}{(1+0.15)^{65-62}} + \frac{1,40,000}{(1+0.15)^{65-63}} + \frac{1,40,000}{(1+0.15)^{65-64}}$$

$$= \frac{1,40,000}{(1+0.15)^{3}} + \frac{1,40,000}{(1+0.15)^{2}} + \frac{1,40,000}{(1+0.15)^{1}}$$

=₹(92,052.27 + 1,05,860.11 + 1,21,739.13)

= ₹ 3,19,651.51.

Total value of skilled employees is

₹ 3,19,651.51 × 30 employees = ₹ 95,89,545.30.

Value of Unskilled Employees:

$$= \frac{80,000}{(1+0.15)^{62-60}} + \frac{80,000}{(1+0.15)^{62-61}}$$

$$= \frac{80,000}{(1+0.15)^{2}} + \frac{80,000}{(1+0.15)^{1}}$$

= ₹ (60,491.49 + 69,565.22) = ₹ 1,30,056.71

Total value of Unskilled employees is

=₹ 1,30,056.71 × 40 employees = ₹ 52,02,268.40.

Total value of human resources (Skilled and Unskilled)
= ₹(95,89,545.30 + 52,02,268.40)= ₹ 147,91,813.70.

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

(a) Market Value Added (MVA);
(b) Committee on Public Undertaking;
(c) Timing and Permanent Differences;
(d) Election Process of Public Accounts Committee.

Answer:

(a) Market Value Added (MVA):

Market value Added (MVA) is the difference between the current market value of a firm and the capital contributed by investors. If MVA is positive, the firm has added value. If it is negative the firm has destroyed value.
To find out whether management has created or destroyed value since its inception, the firm's MVA can be used:
MVA=Market value of capital – capital employed

This calculation shows the difference between the market value of a company and the capital contributed by investors (both bondholders and shareholders). In other words, it is the sum of all capital claims held against the company plus the market value of debt and equity.

The higher the MVA, the better. A high MVA indicates the company has created substantial wealth for the shareholders. A negative MVA means that the value of the actions and investments of management is less than the value of the capital contributed to the company by the capital markets, meaning wealth or value has been destroyed.
The aim of the company should be to maximize MVA. The aim should not be to maximize the value of the firm, since this can be easily accomplished by investing ever-increasing amounts of capital.

(b) Committee on Public Undertaking:

Answer:

The Committee on Public Undertakings exercises the same financial control on the public sector undertakings as the Public Accounts Committee exercises over the functioning of the Government Departments. The functions of the Committee are:
i. to examine the reports and accounts of public undertakings.
ii. to examine the reports of the Comptroller & Auditor General on public undertakings.
iii. to examine the efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, in doing so, is not to focus only on the individual irregularity, but on the defects in the system which led to such irregularity, and the need for correction of such systems and procedures.

Environmental Accounting can be defined as a system for measuring environmental performance and communicating the results of these measurements to user. It helps in presenting the utilization of natural resources by an enterprise, the costs incurred to use them and the income earned there from in a transparent manner. Environmental accounting is entirely a new concept and a faithful attempt to identify the resources exhausted and the costs rendered reciprocally to the enterprise by a business corporation. Thus environmental accounting stands for recording and documenting environmental performance to facilitate effectiveness of Environmental Management System with reference to compliance, safety and quality control. It provides a data base for taking corrective steps and future action for developing organisation's environmental strategy and for identifying environmentally based opportunities for gaining an edge over one's competitions. If proper environmental accounting system is established, the enterprise will be able to anticipate environmental damage and therefore can prevent it from happening.

(c) Timing and Permanent Differences:

As per AS 22 states that timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Unabsorbed depreciation and carry forward of losses which can be set off against future taxable income are also considered as timing differences and result in deferred tax assets subject to consideration of prudence i.e., deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

(d) Election Process of Public Accounts Committee.

In April each year a motion is moved in Lok Sabha by the Minister of Parliamentary Affairs or Chairman of the Committee, if in office, calling upon members of the House to elect from amongst themselves 15 members to the Public Accounts Committee. After the motion is adopted, a programme, fixing the dates for filing the nominations/withdrawal of candidatures and the election, if necessary, is notified in Lok Sabha Bulletin Part-II. On receipt of nominations, a list of persons who have filed nomination papers is put up on the Notice Boards. In case the number of members nominated is equal to the number of members to be elected, then, after expiry of time for withdrawal of candidatures, the members nominated are declared elected and the result published in Bulletin Part-II. If the number of members nominated after withdrawals is more than number of members to be elected, election is held on the stipulated date and result of election published in Bulletin Part-II.