FINAL EXAMINATION

GROUP IV

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2016

Paper- 18: CORPORATE FINANCIAL REPORTING

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

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

All workings must form part of your answer. Assumptions, if any must be clearly indicated.

Answer Question No. 1 (carrying 20 marks) which is compulsory and also answer any five (5) questions (carrying 16 marks each) from Q. No. 2 to Q. No. 8.

1. Answer *any four* questions (carrying 5 marks each) from the following: 4×5 = 20

(a) The fair value of plan assets of Prantick Ltd. was ₹2,00,000 in respect of employee benefit pension plan as on 1st April, 2015. On 30th September, 2015, the plan paid out benefits of ₹ 38,000 and received inward contributions of ₹ 98,000. On 31st March, 2016, the fair value of plan assets was ₹3,00,000. On 1st April, 2015, the reporting company made the following estimates, based on market studies and prevailing prices:

	%
Interest and dividend income after tax payable by the fund	9.25
Realised gains on plan assets (after tax)	2.00
Fund Administrative costs	(1.00)
Expected rate of return	10.25

Required:

Calculate the Actual and Expected Returns on Plan Assets as on 31st March, 2016, as per AS-15.

(b) Global Ltd. is showing an intangible asset at ₹ 90 lakhs as on 01-04-2015. This asset was acquired for ₹ 120 lakhs on 01-04-2012 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

(c) A Ltd. has acquired 80% share in B Ltd. for ₹ 30 lakhs. The net assets of B Ltd. on the day are ₹ 25 lakhs. During the year, A Ltd. sold the investment for ₹ 35 lakhs and net assets of B Ltd. on the date of disposal were ₹ 40 lakhs. Calculate the profit or loss on disposal of this investment to be recognised in the consolidated financial statements.

(d) What are the functions of the Committee on Public Undertakings?

(e) While closing its books of account on 31st March, 2016, a Non- Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	**15,600**
Sub-standard assets	**1,250**
Secured positions of doubtful debts	
— upto one year	**350**
— one year to three years	**80**
— more than three years	**40**
Unsecured portions of doubtful debts	**85**
Loss assets	**47**

Calculate the amount of provision, which must be made against the advances as per prudential norms.

Answer 1:

(a)

	Particulars	₹
A.	Closing Balance of Fair Value of Plan Assets	3,00,000
B.	Add: Benefit paid	38,000
C.	Less: Contributions Received	(98,000)
D.	Less: Opening Balance of Fair Value of Plan Assets	(2,00,000)
E.	**Actual Return on Plan Assets**	40,000

	Particulars	₹
A.	Return on Opening Balance of Fair Value of Plan Assets (₹2,00,000 × 0.1025)	20,500
B.	Return on Net Contribution Received [Contribution -Benefits paid] [98,000 – 38,000]× 0.05	3,000
C.	**Expected Return on Plan Assets**	23,500

Note: Equivalent half yearly Compounding Interest rate

$= \sqrt{1 + \text{Expected rate of Return}} - 1$

$= \sqrt{(1 + 0.1025)} - 1 = 0.05 \text{ or } 5\%$

(b) As per AS 26 'Intangible Assets' the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use.

Global Ltd. has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, Global Ltd. would be required to restate the carrying amount of intangible asset as on 01-04-2015 at ₹ 120 lakhs less ₹ 36 lakhs (₹120 lakhs /10 years × 3 years) = ₹ 84 lakhs. The difference of ₹6 lakhs i.e. (₹ 90 lakhs – ₹ 84 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 84 lakhs would be amortized over remaining 7 years by ₹ 12 lakhs per year.

(c) Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹	₹
Net Assets of B Ltd. on the date of disposal		40,00,000
Less: Minority Interest (₹ 40 lakhs × 20%)		8,00,000
A Ltd.'s share in Net Assets		32,00,000
Proceeds from sale of Investment		35,00,000
Less: A Ltd.'s share in net assets		32,00,000
		3,00,000
Less: Goodwill in the consolidated Financial Statement		
Cost of investment	30,00,000	
Less: A ltd.'s share in net asset on the date (₹25 lakhs × 80%)	20,00,000	10,00,000
Loss on sale of investment		7,00,000

(d) The functions of the Committee on Public Undertakings 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 objectives 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.

(e) Calculation of provision required on advances as on 31st March, 2016

	Amount ₹ in lakhs	Percentages of provision	Amount ₹ in lakhs
Standard assets	15,600	0.25**	39
Sub-standard assets	1,250	10	125
Secured portion of doubtful debts -			
- Upto one year	350	20	70
- One year to three years	80	30	24
- More than three years	40	50	20
Unsecured portions of doubtful debts	85	100	85
Loss assets	47	100	47
			410

** RBI vide its notification dated January 17, 2011 has introduced 0.25% provisioning for standard assets of NBFCs.

2. Anu Ltd. and Minu Ltd. decided to amalgamate and to form a new company Amuin Ltd. The following are their summarized Balance Sheets as on March 31, 2016.

(Amount in ₹ lakhs)

		Anu Ltd.	Minu Ltd.
	Equity and Liabilities:		
1.	**Shareholders' funds:**		

	(a) Share Capital:		
	Equity shares of ₹ 100/- each	1,760	1,650
	12% Preference shares of ₹ 100 each	660	440
	(b) Reserves and Surplus:		
	Profit and Loss Account	110	66
	General Reserve	374	330
	Revaluation Reserve	330	220
	Investment Allowance Reserve	110	110
2.	Non-current Liabilities:		
	10% Debentures (₹ 100 each)	132	66
3.	Current Liabilities:		
	Trade payables	924	418
	Total	4,400	3,300
	Assets:		
1.	Non-current assets		
	(a) Fixed Assets:		
	Land and Building	1,210	880
	Plant and Machinery	770	550
	(b) Non-current Investments		
	Investments	330	110
2.	Current Assets:		
	(a) Inventories	770	550
	(b) Trade Receivables	660	770
	(c) Cash and Cash equivalents	660	440
	Total	4,400	3,300

Additional Information:

(i) Amuin Ltd. will issue 5 equity shares for each equity share of Anu Ltd. and 4 equity shares for each equity share of Minu Ltd. The shares are to be issued @ ₹30 each, having a face value of ₹ 10 per share.

(ii) 10% debenture holders of Anu Ltd. and Minu Ltd. are discharged by Amuin Ltd. issuing such numbers of its 15% Debentures of ₹ 100 each, so as to maintain the same amount of interest.

(iii) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of Amuin Ltd. at a price of ₹ 150 per share (face value ₹ 100).

(iv) Investment allowance reserve is to be maintained for 4 more years.

Required:

Prepare the Balance Sheet of Amuin Ltd. as on 1st April, 2016 as per Schedule-III of the Companies Act, 2013, after the amalgamation has been carried out on the basis of amalgamation in the nature of purchase.

(Notes to Balance Sheet need not be given) 16

Answer 2:

Balance Sheet of Amuin Ltd. as at April, 2016

(Amount in ₹ Lakh)

	Particulars	Note	Amount (₹)
I.	Equity and Liabilities		
	1. Shareholders' Funds:		
	(a) Share Capital	1	2640

	(b) Reserves and Surplus	2	3850
	2. Non-current liabilities		
	15% debentures **[W.N. 4]**		132
	3. Current Liabilities		
	(a) Trade payables		1342
	Total		7964
II.	Assets:		
	1. Non-current assets		
	(a) Tangible Fixed Assets		3410
	(b) Intangible Fixed Assets		44
	(c) Non-current investment		440
	(d) Amalgamation adjustment Account		220
	2. Current assets		
	(a) Inventories (770 + 550)		1320
	(b) Trade Receivables		1430
	(c) Cash and Cash equivalents		1100
	Total		7964

Notes to Balance Sheet:

1. Share Capital	
Particulars	**Amount (₹)**
(+)Equity Shares of ₹10 each (880 + 660)	1,540
(+) Preference Shares of ₹100 each (660+440)	1,100
Total	2,640

2. Reserves and Surplus	
Particulars	**Amount (₹)**
Securities Premium (330+220+1,760+1,320)	3,630
Less: Investment Allowance Reserve (110+110)	(220)
Total	3,850

Working Notes:

1. Computation of Purchase Consideration

(Amount in ₹ Lakh)

Particulars	**Anu Ltd.**	**Minu Ltd.**
(a) Preference Shareholders		
6,60,000 × 1 × ₹150 each	990	
4,40,000 × 1 × ₹150 each		660
(b) Equity Shareholders		
17,60,000 × 5 × ₹30 each	2,640	
16,50,000 × 4 × ₹30 each		1,980
Amount of Purchase Consideration	3,630	2,640

2. Computation of Net Assets Value:

(Amount in ₹ Lakh)

Particulars	Anu Ltd.	Minu Ltd.
Total Assets	4,400	3,300
Less: 10% Debentures [Face Value / 0.15]	(88)	(44)
Trade Payables	(924)	(418)
Net Assets	3,388	2,838

3. Net Assets less Purchase Consideration:

(Amount in ₹ Lakh)

Particulars	Anu Ltd.	Minu Ltd.
Net Assets	3,388	2,838
Purchase Consideration	3,630	2,640
Goodwill / Capital Reserve	(242)	198
Goodwill	(242 – 198) =44	

4. Discharge of Debentures

(Amount in ₹ Lakh)

Particulars	Anu Ltd.	Minu Ltd.
Issue of 15% Debentures:		
$\frac{132 \times 10\%}{15\%}$	88	
$\frac{66 \times 10\%}{15\%}$		44

3. The following are Balance Sheet of Amtek Group of Companies as at March 31, 2016

(Amount in ₹ lakhs)

	Amtek Ltd.	Bentek Ltd.	Pamu Ltd.
Equity and Liabilities:			
Shareholder's funds:			
Share Capital:			
Equity Shares of ₹ 10 each	**2,500**	**1,000**	**500**
Reserves and Surplus:			
General Reserve	**500**	**250**	**150**
Profit and Loss Account	**1,000**	**500**	**250**
Current Liabilities:			
Trade payables-creditors	**1,500**	**1,000**	**500**
Total	**5,500**	**2,750**	**1,400**
Assets:			
Non-current Assets:			
Fixed Assets	**3,875**	**2,050**	**1,175**
Others	**125**	**-**	**75**
Non-current Investments			
Investments:			
80,00,000 shares in Bentek Ltd.	**1,000**		

30,00,000 shares in Pamu Ltd.		450	
Current Assets	500	250	150
Total	5,500	2,750	1,400

Notes:

(i) **The investment in Bentek Ltd. was made on April 1, 2009 and that in Pamu Ltd. was made on April 1,2011.**

(ii) **The Balance in Reserves and Profit & Loss Account on relevant dates are as under:**

(Amount in ₹ lakhs)

Bentek Ltd.	April 1, 2009	April 1,2011
General Reserve Profit and Loss Account	100 300	110 340
Pamu Ltd.	**April 1, 2009**	**April 1,2011**
General Reserve Profit and Loss Account	40 85	50 100

(iii) **Current assets of Pamu Ltd. includes inventories of ₹54 lakh which was invoiced by Amtek Ltd. at 20% above cost.**

Required:

Prepare the consolidated Balance Sheet of Amtek group as at March 31, 2016 as per requirement of Schedule – III. **16**

Answer 3:

Consolidated Balance Sheet of Amtek Ltd. with its subsidiary Bentek Ltd. and Pamu Ltd. as on 1 April,2016

	Particulars	Note	Amount
I.	**Equity and liabilities**		
	1. Shareholders' Funds:		
	a. Share Capital	1	2,500
	b. Reserves and Surplus	2	1,933
	c. Minority interest (W.N. 3)		758
	2. Current liabilities		
	(a) Trade payables	3	3,000
	Total		8,191
II.	**Assets:**		
	1. Non- current Assets		
	(a) Fixed Assets		
	(i) Tangible Assets	4	7,100
	(ii) Other non- current assets	5	200
	2. Current Assets	6	891
	Total		8,191

Notes to the financial statements (₹ In lakh)

	Particulars		
1.	Share Capital Authorised, issued, subscribed and fully paid up 250,00,000 shares of ₹10 each		2,500
2.	Reserves and Surplus General Reserves (WN 5) Capital Reserves (WN 4) Profit &Loss A/c (WN 5)	 668 42 1,223	 1,933

3.	Trade payable Amtek Ltd. Bentek Ltd. Pamu Ltd.	 1,500 1,000 500	 3,000
4.	Tangible assets Amtek Ltd. Bentek Ltd. Pamu Ltd.	 3,875 2,050 1,175	 7,100
5.	Other non-current assets Amtek Ltd. Pamu Ltd.	 125 75	 200
6.	**Current assets :** Amtek Ltd. Bentek Ltd. Pamu Ltd. Less: Unrealised profit on downstream transaction (54 × 20/120)	 500 250 150 (9)	 891

Working Notes:

1. **Apportionment of Reserves & Profits of PAMU Ltd.** **(₹ In lakhs)**

Particulars	Pre-acquisition	Post acquisition	
	Capital Profit	Reserves	P&L
Profit and Loss A/c	100	-	150
General Reserves	50	100	----
Total	150	100	150
Bentek Ltd. share (60%)	90	60	90
Minority interest (40%)	60	40	60

2. **Apportionment of Reserve & Profits of Bentek Ltd.** (indirect method) (₹ In lakh)

Particulars	Pre-acquisition	Post acquisition	
	Capital Profit	Reserves	P&L
Share from Pamu Ltd.	90	60	90
Profits and Loss A/c	300	-	200
Reserves	100	150	----
Total	490	210	290
AmtekLtd. share (80%)	392	168	232
Minority,interest (20%)	98	42	58

3. **Calculation of Minority Interest** **(₹ in lakh)**

Particulars	**Bentek (20%)**	**Pamu Ltd. (40%)**
Equity share capital	200	200
Capital profit	98	60
Revenue profit	58	60
Revenue reserve	42	40
Total	398	360
Total	758	

4. Calculation of Cost of Control

Particulars	Amtek Ltd. in Bentek Ltd(80%)	Bentek Ltd. in Pamu Ltd. (60%)
Cost of investment:	1,000	450
Less: Share of net assets as on the date of acquisition:		
Share capital	(800)	
Capital profit	(392)	(300)
Goodwill (Capital reserves)	(192)	150
Capital reserves for consolidated Balance Sheet	42	

5. Consolidated reserves & P/L (Post acquisition)

Particulars	Reserves (₹)	Profit & Loss A/c
Amtek Ltd. Balance as per its balance sheet	500	1000
Add: Share of post acquisition Reserves/P&L of Bentek Ltd.	168	232
Less: Unrealised profit on downstream transaction	-	(9)
Reserves for consolidated balance sheet	668	1,223

4. (a) 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.	**₹ 60,000**	**₹ 40,000**
(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**

8

(b) Venus Ltd. has provided the following Profit and Loss Account for the year ended March 31, 2016: **(Amount in ₹ lakhs)**

Income:		
Sales less returns and sales tax	**1,530**	
Miscellaneous income	**70**	**1,600**
Expenditure:		
Production and Operational expenses	**1,030**	
Administration expenses	**50**	
Interest and other charges	**52**	
Depreciation	**32**	
Provision for Taxes	**164**	**1.328**
Profit after taxes		**272**
General Reserve		**92**
Proposed Dividend		**44**
Retained profit		**136**
Other Information:		
(i) Production and Operational Expenses include:		
Consumption of Raw materials	**662**	
Consumption of Stores	**46**	

Salaries, Wages, etc.	84	
Cess and local taxes	20	
Other manufacturing expenses	218	
	1030	
(ii) Administration Expenses:		
Salaries and commission to Directors	16	
Other manufacturing expenses	34	
	50	
(iii) Interest and other charges:		
Interest on short term loan from Bank	12	
Interest on long term loan	22	
Interest on Debentures	18	
	52	

Required:

(i) Prepare a VALUE ADDED Statement for the year ended March 31, 2016 and also show the Reconciliation between Value Added and Profit before Taxation.

(ii) Calculate the value added per employee on the basis that 150 employees work in Venus Ltd. (4+3) + 1 = 8

Answer 4:

(a) Value of Employee as per Lev and Schwartz method

Value of Skilled employees $V = \sum_{t=n}^{t} \frac{1(t)}{(1+r)^{t-n}}$

Where V = the human capital value of person years old.

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

r = a discount rate specific to the person.

t = retirement age.

$$= \frac{60,000}{(1+0.15)^{65-62}} + \frac{60,000}{(1+0.15)^{65-63}} + \frac{60,000}{(10.15)^{65-64}}$$

$$= \frac{60,000}{(1+0.15)^{3}} + \frac{60,000}{(1+0.15)^{2}} + \frac{60,000}{(10.15)^{1}}$$

= ₹39,450.97 + ₹45,368.62 + ₹52,173.91 = ₹1,36,993.50

Total Value of Skilled Employees = ₹ 1,36,993.50 × 30 employees = ₹41,09,805

Value of Unskilled Employees: $= \frac{40,000}{(1+0.15)^{62-60}} + \frac{40,000}{(1+0.15)^{62-61}} = \frac{40,000}{(1+0.15)^{2}} + \frac{40,000}{(1+0.15)^{1}}$

= ₹30,245.75 + ₹34,782.61 = ₹65,028.35

Total value of Unskilled Employees = ₹65,028.35 × 40 employees = ₹26,01,134

Therefore, Total value of human resource (skilled and unskilled) = ₹41,09,805 + ₹26,01,134

= ₹67,10,939

(b) **VENUS LTD.**

(i) Value Added statement for the year ended March 31, 2016 (Amount in ₹ lakh)

Particulars			
Sales (less return and sales tax)			1530
Less: Cost of bought in materials and services:			
Production and Operational expenses (662+46+218)	926		
Administration Expenses (50-16)	34		
Interest on Short Term Loan	12		972
Value Added by manufacturing and trading activities			558
Add: Miscellaneous Income			70
Total Value added			**628**

Application of value Added: **(Amount in ₹ Lakh)**

Particulars		
(1) To pay employees: Salaries, wages, bonus and other benefits		84
(2) To pay Directors: Salaries and Commission		16
(3) To pay Government Cess & Local Taxes Income Tax	 20 164	 184
(4) To pay financers as interest on borrowing Interest on Debentures Interest on Long Term Loan	 18 22	 40
(5) To pay Shareholders as Dividend		44
(6) To provide for Maintenance and expansion of the company: Depreciation General reserve Retained Profit	 32 92 136	 260
Total Application		**628**

Reconciliation between total value Added and profit before taxation:

(₹ in lakh)

Profit before tax (272 + 164)		436
Add: Depreciation Salaries, wages, bonus and others Directors' salaries and commission Cess and local taxes Interest on Debentures Interest on Long Term Loan	32 84 16 20 18 22	 192
Total Value Added		628

(ii) Value Added per Employee. (628/150) = ₹4.19 lakh

5. (a) The Balance Sheet of Venture Ltd. as on 31.03.2016 is given below:

Liabilities	₹	₹	**Assets**	₹
1,00,000 Equity Shares of ₹10 each fully paid		**10,00,000**	**Freehold Property**	**5,50,000**
4,000, 8% Cumulative preference shares of ₹ 100 each fully paid		**4,00,000**	**Plant and Machinery**	**2,00,000**

6% Debentures (secured by freehold property) Arrear of interest	4,00,000 24,000	4,24,000	Trade investments (at cost)	2,00,000
Sundry Creditors		1,01,000	Sundry Debtors	4,50,000
Director's Loan		3,00,000	Stock in trade	3,00,000
			Deferred revenue expenditure	50,000
			Profit and Loss Account	4,75,000
		22,25,000		22,25,000

The court approved a scheme of internal reconstruction to take effect on 1st April, 2016 on the following terms:

(i) Preference shares are to be written down to ₹75 each and equity shares to ₹ 2 each.

(ii) Preference dividend in arrear for 4 years to be waived by 75% and for the balance, equity shares of ₹ 2 each to be allotted.

(iii) Arrear of debenture interest to be paid in cash.

(iv) Debenture Holders agreed to take one freehold property (book value ₹3,00,000) at a valuation of ₹3,00,000 in part payment of their holding. Balance debentures to remain as liability of the company.

(v) Deferred revenue expenditure to be written off.

(vi) Stock value to be written off by 80%.

(vii) 40% of Sundry Debtors to be written off as bad debt.

(viii) Remaining freehold property (after taken over by debenture holders) to be valued at ₹3,50,000.

(ix) Investments are sold out at ₹2,50,000.

(x) 80% of Director's Loan to be waived and for the balance, equity shares of ₹ 2 each to be issued.

(xi) Company's contractual commitments amounting to ₹6,00,000 to be cancelled by paying penalty at 3% of contract value.

(xii) Cost of reconstruction scheme is ₹25,000.

Show the Journal Entries (with narration) to be passed for giving effect to the above transactions. 10

(b) Eagle Ltd. has acquired 51% in Sparrow Ltd. for ₹ 75.80 lakhs on April 1st, 2014. On date of the acquisition, Sparrow Ltd's Assets stood at ₹ 196 lakhs and Liabilities at ₹ 16 lakhs. The net assets position of Sparrow Ltd. as on 31st March, 2015 and 30th September, 2015 were ₹ 280 lakhs and ₹ 395 lakhs respectively, the increase resulting from profits earned during the period. On 01.10.2015, 25.5% holdings were sold for the ₹125 lakhs.

Required:

(i) State the nature of the relationship between the two companies on the relevant dates.

(ii) Calculate the profit arising on part sale of investment.

(iii) Calculate the Carrying value of the portion unsold.

(iv) Calculate the Goodwill/Capital reserve that arises on change in nature of the investment. 6

Answer 5:

(a) **In the Books of venture Ltd.**

Journal entries

	Particulars	Debit (₹)	Credit(₹)
1	8% Preference Share Capital A/c (₹100) Dr. To, 8% Preference Share Capital A/c (₹75) To, Capital Reduction A/c (Being the preference shares of ₹100 each reduced to ₹75 as per scheme)	4,00,000	 3,00,000 1,00,000
2	Equity Share Capital A/c (₹10) Dr. To, Equity Share Capital A/c (₹2) To, Capital Reduction A/c (Being the equity shares of ₹10 each reduced to ₹2 as per scheme)	10,00,000	 2,00,000 8,00,000
3	Capital Reduction A/c Dr. To, Equity Share Capital A/c (Arrears of preference share dividend of one year to be satisfied by issue of 16000 equity shares of ₹2 each i.e. to the extent of 25% of arrear dividend)	32,000	 32,000
4	Accrued Debenture Interest A/c Dr. To, Bank A/c (Accrued debenture interest paid)	24,000	 24,000
5	6% Debenture A/c To, Freehold Property A/c (Claim settled in part by transfer of freehold property as per scheme)	3,00,000	 3,00,000
6	Capital Reduction A/c To, Profit and Loss A/c To, Deferred Revenue Expenses A/c To, Stock A/c To, Sundry Debtors A/c (Being the various assets written off as per scheme)	9,45,000	 4,75,000 50,000 2,4,0,000 1,80,000
7	Freehold Property A/c Dr. To, Capital Reduction A/c (Appreciation in the value of property i.e., (₹3,50,000 - 2,50,000)	1,00,000	 1,00,000
8	Bank A/c Dr. To, Trade Investment A/c To, Capital Reduction A/c (Trade investment sold and profit made)	2,50,000	 2,00,000 50,000
9	Director's Loan A/c Dr. To, Equity Share Capital A/c To, Capital Reduction A/c (Directors loan reduced by 80%and remaining balance discharged by issue of equity shares of ₹2 each)	3,00,000	 60,000 2,40,000
10	Capital Reduction A/c Dr. To, Bank A/c (Payment of 3% penalty for cancellation of contractual Commitments)	18,000	 18,000
11	Capital Reduction A/c Dr. To, Bank A/c (Reconstruction expenses paid)	25,000	 25,000

12	Capital Reduction A/c Dr. To, Capital Reserve A/c (Being balance of capital reduction account transferred)	2,70,000	2,70,000

(b) (i) Nature of Relationship with Sparrow Ltd.

01.04.2014 – 30.09.2015	From 01.10.2015
Subsidiary	Associate

(ii) Calculation of Gain or Loss on the Disposal of the Part of Investment in Sparrow Ltd.

Particulars	(₹ In lakhs)
A. Sale Proceeds on Disposal of holding	125.00
B. Less: Carrying value of investment disposed off [185.45 lakhs × 25.5%/51%]	(92.725)
C. Profit on Sale of Investments [A- B]	32.275

(iii) Carrying Value of Unsold Portion of the Investment Retained in the Consolidated Financial Statements

Particulars	(₹ in lakhs)
A. Total Value of Investment in CFS of Eagle Ltd.	185.450
B. Less: Carrying Value of Investment disposed off	(92.725)
C. Carrying Value of the Investment retained in CFS (Including Capital Reserve) [A - B]	92.725

(iv) Goodwill/Capital Reserve Arising on the Carrying Value of Unsold Portion of the Investment

Particulars	(₹ in lakhs)
A. Carrying Value Investments Retained as at 1.10.2015	92.725
B. Less: Share in Value of Equity of S Ltd., as at 1.10.2015 (395 lakhs × 25.5%)	(100.725)
C. Capital Reserve arising on Retained Investment under Equity Method as per AS 23	8.000

Working Notes:

(i) Calculation of Goodwill/Capital Reserve on Acquisition [₹ In lakhs]

A. Share of Holding Co. in Net Assets on Acquisition date [51% (₹196 lacs - ₹16 lacs)]	91.80
B. Less: Cost of Investments	(75.80)
C. Capital Reserve on Acquisition [A - B]	16

(ii) Total Value of Investment in Consolidated Financial Statement of Eagle Ltd.

A. Share of Holding Co. in Net Assets of Subsidiary on date of disposal [395 lakhs × 51%]	201.45
B. Less: Capital Reserve on acquisition [WN(i)]	(16.00)
C. Total Value of Investment in CFS of Eagle Ltd.	185.45

6. (a) **Merlin Ltd. grants 1,000 employees stock options on 01.04.2012 at ₹50, when the market price is ₹200. The vesting period is 3 years and the maximum exercise period is one year. 300 unvested options lapse on 01.05.2014. 600 options are exercised on 30.06.2015. 100 vested options lapse at the end of the exercise period.**
Required:
Pass journal entries in the book of Merlin Ltd. giving suitable narrations. 8

(b) **A Ltd. has its financial year ended 31-03-2016, fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated the probable outcomes as below:**

Result	Probability	Amount of Loss (₹)
For first ten cases:		
Win	**0.5**	**--**
Loss — low damages	**0.3**	**80,000**
Loss — high damages	**0.2**	**1,00,000**
For remaining five cases:		
Win	**0.6**	**--**
Loss — low damages	**0.3**	**70,000**
Loss — high damages	**0.1**	**2,00,000**

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss. 8

Answer 6:

(a)

MERLIN LTD.
Journal Entries

Date	Particular	Debit (₹)	Credit (₹)
01.04.2012	Deferred Employees Compensation Expense A/c Dr. To Employee Stock Options Outstanding A/c (Being granting of 1000 equity shares,under Employees stock option scheme at an issue price of ₹ 50 against the current market price of ₹ 200. Option valued at ₹150 i.e. difference between the Fair Market Value and the option issue price. Option cost to be amortized over the vesting period of 3 years)	1,50,000	 1,50,000
31.03.2013	Employee Compensation Expenses A/c Dr. To Deferred Employee Compensation Expenses A/c (Being amortization of Employee compensation expenses i.e. Option cost to the extent of expense relating to Financial Year 2011-12 = (1,50,000 × 1)/3 years)	50,000	 50,000
31.03.2014	Employee Compensation Expense A/c Dr. To Deferred Employee Compensation Expenses A/c (Being amortization of Employee compensation expense i.e. option cost to the extent of expense relating to Financial Year 2012-13 = (₹ 1,50,000 × 1) / 3 years)	50,000	 50,000
01.05.2014	Employee Stock Options Outstanding A/c Dr. To Deferred Employee Compensation Expenses A/c To General Reserve A/c	45,000	 15,000 30,000

	(Being Lapse of 300 unvested Options, to the extent of Employees Compensation expenses amortized (i.e. 30000= (1,00,000 × 300) / 1,000) transferred to General Reserve, to the extent not amortized (₹15,000 = 50,000 × 300/1,000 shares), reversed against Employees Stock Options outstanding) [Also see Note]		
31.03.2015	Employee Compensation Expense A/c Dr. To Deferred Employee Compensation Expenses A/c (Being amortization of Employee Compensation expense on eligible unvested options of the end of vesting period i.e. Option cost to the extent of expense relating to F.Y. 2013-14 = [(1,50,000 ×1)/3 years ×(700 share/1000) shares)]	35,000	 35,000
30.06.2015	Bank A/c (600 shares × Exercise price ₹50) Dr. Employee Stock Option Outstanding A/c (600 ×150) Dr. To Paid up Equity Share Capital A/c (600 × 10) To Security Premium A/c (Being exercise of 600 options at ₹50 per share. Shares deemed to be issued at Fair Value of ₹150 per share, per ₹10 shares. ₹190 per share transferred to securities premium account)	30,000 90,000	 6,000 1,14,000
31.03.2016	Employee Stock Options Outstanding A/c Dr. To General Reserve A/c (Being 100 vested options-lapsed at the end of expiry period, balance in stock options outstanding transferred to General Reserve)	15,000	 15,000

Note:

1. The above journal entries have been proposed based on the Guidance Note on Accounting for Employee Share Based Payment (2011).
2. Lapse during Vesting Period: Under para 18, lapse of options during the vesting period (i.e. between 01.04.2011. to 31.03.2014) should be adjusted cumulatively i.e. accounted for by suitably reducing the amount to be expensed off subsequent to the date of lapsing. In the instant case, option cost amortized already is in excess of the option cost on eligible options. Therefore, the difference is transferred to General Reserve, applying the guidance in Para 22 (i.e. Lapse of options after the vesting date).

   Lapse after vesting date: As per para 22, lapse of options after the vesting date (during the exercise period), the balance standing to the credit of stock options outstanding should be transferred to General Reserve. In no case, the amount already amortized be written back to the Profit and Loss Account.

(b) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but recognised as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is not remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognised as provision.

In this case, the probability of winning first ten cases is 50% and for remaining five cases is 60%. In other words, probability of losing the cases is 50% and 40% respectively. According to AS 29, we make a provision if the loss is probable.

As the loss does not appear to be probable and the probability or possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore, disclosure by way of note of contingent liability amount may be calculated as under:

Expected loss in first ten cases	= [₹80,000 × 0.3 + ₹1,00,000 × 0.2] × 10
	= [₹ 24,000 + ₹20,000] × 10 = ₹4,40,000
Expected loss in remaining five cases	= [₹70,000 × 0.3 + ₹2,00,000 × 0.1] × 5
	= [₹21,000 + ₹20,000] × 5 = 2,05,000
Total contingent liability	= ₹4,40,000 + ₹2,05,000 = ₹6,45,000

7. (a) From the following information of Pilot Ltd. compute the Economic Value added (EVA):

(i)	**Equity Share Capital**	**₹ 1,000 lakhs**
(ii)	**Reserves and Surplus**	**₹ 2,000 lakhs**
(iii)	**Long-term debt**	**₹ 200 lakhs**
(iv)	**Interest**	**₹ 20 lakhs**
(v)	**Tax rate**	**35%**
(vi)	**Risk free rate**	**10%**
(vii)	**Market rate of return**	**15%**
(viii)	**Beta factor**	**1.4**
(ix)	**Profit before interest and tax**	**₹ 1,000 lakhs**

8

(b) ABC Ltd. has three segments viz. A, B and C. The total assets of the company is ₹ 20 crores. The assets of each of the above segments are as under:

	₹ in crores
Segment A	**2.10**
Segment B	**8.90**
Segment C	**9.00**
	20.00

Assets of each segment include deferred tax assets of ₹ 0.60 crores in A, ₹ 0.50 crores in B and ₹ 0.40 crores in C.

The accountant of ABC Ltd. contends that all the segments are reportable segments. Comment. **8**

Answer 7:

(a) Computation of Economic value Added

Particulars	₹ In lakhs
Profit after taxes (W.N. 5)	637.00
Add: Interest on long term borrowing adjusted for tax (W.N. 2)	13.00
Total Return to Providers of funds (NO PAT)	650.00
Less: Cost of Capital [3,200 × 16.34% j (W.N. 3)	522.88
Economic Value Added	127.12

Working Notes:

1. Cost of Equity = Risk free rate + Beta factor × (market rate – Risk Free rate)
   = 10% + 1.4 × (15% - 10%) = 10% + 7% = 17%

2. Cost of Debt (Post tax)

Particulars	₹ In lakhs
Interest	20.00
Less: Tax saving (20 × 35%)	7.00
Interest after tax savings	13.00

$$\text{Cost Debt} = \frac{\text{Interest on long term Debt}}{\text{Long term Debts}} = \frac{₹13}{₹200}$$

3. Weighted Average Cost of Capital

Particular		₹ In lakhs
a. Cost of Equity	3,000 × 17% (W. N. 1)	510.00
b. Cost of Debt	200 × 6.50% (W. N. 2)	13.00
c. Total (a + b)		523.00

$$\text{WACC} = \frac{523}{3,200} = 16.34\%$$

4. Total Capital Employed = Share Capital + Reserves & Surplus + Long term Debts
= ₹1,000 lakhs + ₹2,000 lakhs + ₹200 lakhs =₹3,200 lakhs

5. Profit after tax

Profit before interest & Tax	₹1,000 lakhs	
Less: Interest	₹20 lakhs	₹980 lakhs
Less: tax (980 × 35%)		₹343 lakhs
Profit after tax		₹637 lakhs

(b)

Particulars	**Segments**			
	A	**B**	**C**	**Total**
	₹ In crores	₹ In crores	₹ In crores	₹ In crores
Segment Assets	2.10	8.90	9.00	20.00
Less: Deferred Tax Assets	(0.60)	(0.50)	(0.40)	(1.50)
Net Segment Assets	1.50	8.40	8.60	18.50
Percentage to total net segment assets	8.11%	45.40%	46.49%	100%

As per AS 17 'Segment Reporting', one of the criteria for identification of a business segment as a reportable segment is, when its segment assets are 10% or more of the total assets of all segments accordingly the following are reportable segments B & C.

8. (a) Discuss the role of Comptroller and Auditor General (CAG) in the context of Government Accounting in India. 8

(b) Write a note on Indian Government Accounting Standard (IGAS)-5 relating to Loans and Advances made by the Governments. 8

Answer 8:

(a) **CAG's Role**

(1) 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.

(b) IGAS 3 —
Loans and Advances made by Governments

- The Government of India has been empowered under proviso (2) of Article 293 of the Constitution of India to make loans to the States, subject to such conditions as may be laid down by or under any law made by Parliament, any sums required for the purpose of making such loans being chargeable to the Consolidated Fund of India.
- The Union Government has been providing financial assistance to the State Governments, a substantial portion of which is in the form of loans. These loans are advanced to the States both in the form of plan and non-plan assistance intended for both developmental and non-developmental purposes. Loans are also provided by the Union Government to Foreign Governments, Government

companies and Corporations, Non-Government institutions and Local bodies. The Union Government also disburses recoverable advances to Government servants.

- The State Governments disburse loans to Government Companies, Corporations, Local Bodies, Autonomous Bodies, Cooperative Institutions, Statutory Corporations, quasi-public bodies and other non-Government/private institutions. The State Governments also disburse recoverable advances to Government servants.
- The objective of the Standard is to lay down the norms for Recognition, Measurement, Valuation and Reporting in respect of Loans and Advances made by the Union and the State Governments in their respective Financial Statements to ensure complete, accurate, realistic and uniform accounting practices, and to ensure adequate disclosure on Loans and Advances made by the Governments consistent with best international practices.
- This Standard applies to Loans and Advances given by the Government for incorporation and presentation in the Financial Statements of the Government. Financial Statements shall not be described as complying with this Standard unless they comply with all the requirements contained therein. This standard shall apply only to government accounts being maintained on a cash basis.