

**MOCK TEST PAPER**  
**FINAL (OLD) COURSE: GROUP – I**  
**PAPER – 1: FINANCIAL REPORTING**

**ANSWERS**

1. (a) As per para 46A of the standard, the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

**Calculation of Exchange Difference:**

Foreign currency loan =	₹ 24,00,000/60 = 40,000 US Dollars
Exchange difference =	40,000 US Dollars × (62.50-60.00) = ₹1,00,000
(including exchange loss on payment of first instalment)	

Accordingly, in case Chance Ltd. opts for capitalizing the exchange difference, then the entire amount of exchange difference of ₹ 1,00,000 will be capitalized to 'Equipment account'. This capitalized exchange difference will be depreciated over the useful life of the asset.

**Cost of the asset on the reporting date**

Initial cost of Equipment	₹ 24,00,000
Add: Exchange difference as on 31.3.2020	₹ 1,00,000
Total cost on the reporting date	₹ 25,00,000

- (b) In the case of a company, the following computations will be made:

**2018-2019**

In this year, depreciation for both accounting and taxation purposes would be ₹ 25,000 (25 per cent of ₹ 1,00,000). Accordingly, no timing difference arises on this account.

**2019-2020**

Depreciation for the year would be ₹ 18,750 (25 percent of ₹ 75,000) as per the books of account, while for tax purposes it would be ₹ 16,250 as sale proceeds of ₹ 10,000 would be reduced from the block of assets prior to the computation of depreciation. Accordingly, the following timing differences arise:

- Depreciation for tax purposes is ₹ 16,250 and for accounting purposes ₹ 18,750 giving rise to a timing difference of ₹ 2,500.
- Profit on sale of property, plant and equipment amounting to ₹ 7,188 (₹ 10,000 - ₹ 2,812 being the WDV of the asset as on 31<sup>st</sup> March, 2020) is recognized for accounting purposes. However, for tax purposes this income is not considered. This will result in a timing difference of ₹ 7,188.

The net timing difference would be ₹ 4,688 (₹ 7,188 – ₹ 2,500) by which the accounting income would exceed the taxable income, thus requiring creation of a deferred tax liability of ₹ 1,875 (4,688 X 0.4).

The difference of ₹ 4,688 would reverse in future years when depreciation for accounting purposes would be higher as compared to depreciation for tax purposes because depreciation for accounting purposes would be computed on higher carrying amount of

property, plant and equipment as compared to carrying amount of those assets for tax purposes.

**(c) Computation of earnings per share**

	Earnings (₹)	Shares	Earnings per share (₹)
Net profit for the year 2019-2020	12,00,000		
Weighted average number of shares outstanding during year 2019-2020		5,00,000	
Basic earnings per share			2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: $(100,000 \times 15.00)/20.00$	*	(75,000)	
Diluted earnings per share	12,00,000	5,25,000	2.29

\*The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

**(d) Shilpa Ltd.**

Month	Actual Expenditure (₹)	Interest capitalized (₹)	Cumulative amount (₹)
October, 2019	4,00,000	5,000	4,05,000
November, 2019	7,95,000	15,000	12,15,000
December, 2019	-	15,188	12,30,188
January, 2020	50,000	-	12,80,188
February, 2020	2,00,000	17,500	14,97,688
March, 2020	<u>12,00,000</u>	<u>33,721</u>	27,31,409
	<u>26,45,000</u>	<u>86,409</u>	

**Note:**

- As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
- During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.
- During February, actual overdraft (borrowings) was ₹ 14 lakhs only. Hence, interest of ₹ 17,500 on ₹ 14,00,000 has been calculated even though actual expenditure on project exceed ₹ 14 lakhs.

2. **Note:** It is assumed that Preference shares given in the question are non-convertible in nature.

**Consolidated Balance Sheet of Eagle Ltd.,  
and its subsidiaries Garuda Ltd., and Bird Ltd.  
as on 31<sup>st</sup> March, 2020**

Particulars	Note No.	(₹ in lakhs)
<b>I. Equity and Liabilities</b>		
<b>(1) Shareholder's Funds</b>		
(a) Share Capital	1	65.00
(b) Reserves and Surplus	2	31.94
<b>(2) Minority Interest</b>	3	44.06
<b>(3) Non-current liabilities</b>		
Long term borrowings	4	319.00
<b>(4) Current Liabilities</b>		
Other current liabilities (314+125+72)		511.00
<b>Total</b>		971.00
<b>II. Assets</b>		
<b>(1) Non-current assets</b>		
(i) Property, plant and equipment (272+104+42)		418.00
(ii) Intangible assets	5	1.00
<b>(2) Current assets [353+123+112-15-9-12]</b>		552.00
<b>Total</b>		971.00

**Notes to Accounts**

			₹
1.	Share Capital		
	6,00,000 Equity shares of ₹ 10 each fully paid	60.00	
	5,000 [15,000 – 10,000], 7-1/2% preference share of ₹ 100 each	<u>5.00</u>	65.00
2.	Reserves and Surplus		
	Capital Reserve (Given in balance sheet)	120.00	
	Less: Profit & Loss Accounts (W.N. iii)	<u>(88.06)</u>	31.94
3.	Minority Interest		
	Garuda	23.00	
	Bird	<u>16.00</u>	
		39.00	
	Loss in subsidiaries		
	Garuda [WN (ii)]	(12.94)	
	Bird [ WN (i)](6-2)	<u>(4.00)</u>	
		<u>(16.94)</u>	
		22.06	
	Preference share [12 +10]	<u>22.00</u>	44.06

4.	Long term borrowings		
	Secured		
	8% Mortgage Debentures [25 – 15]	10.00	
	Loan & Advances from banks (153+71+52)	<u>276.00</u>	286.00
	Unsecured		
	Public Deposits (18+12+3)	<u>33.00</u>	<u>33.00</u>
			<u>319.00</u>
5.	Intangible assets		
	Goodwill (W.N iv)		1.00

**Note:** Preference Dividends were in arrears for eight years in Eagle Ltd. and four years in subsidiaries.

**Working Notes:**

	<i>Garuda</i>	<i>Bird</i>
Total Shares	4,80,000	4,00,000
Held by Eagle Ltd.	2,50,000 i.e. 25/48 <sup>th</sup>	80,000 i.e. 1/5 <sup>th</sup>
Held by Garuda Ltd.	NA	1,60,000 i.e. 2/5 <sup>th</sup>
Minority Interest	2,30,000 i.e. 23/48 <sup>th</sup>	1,60,000 i.e. 2/5 <sup>th</sup>

Garuda Ltd. is the subsidiary of Eagle Ltd. since the issue of shares by Garuda Ltd.

Bird Ltd. is subsidiary of Eagle Ltd. after the acquisition of 80,000 shares from Garuda Ltd. from the market. Thereafter, both Garuda and Bird Ltd. become the subsidiary of Eagle Ltd. Hence, the capital profit will be ₹ 5 lakhs

**(i) Analysis of Profits of Bird Ltd.**

		(₹ in lakhs)
Loss after adjusting Reserve and Profit on Debenture in Eagle Ltd.		10
	<i>Capital Profit*</i>	<i>Revenue Loss</i>
Share of Eagle Ltd. [1/5 <sup>th</sup> ]	1	3
Share of Garuda Ltd. [2/5 <sup>th</sup> ]	2	6
Share of Minority [2/5 <sup>th</sup> ]	<u>2</u>	<u>6</u>
	<u>5</u>	<u>15</u>

**(ii) Analysis of Garuda Ltd.**

Loss, less Reserve [36-15]	21
Add : Loss in Bird Ltd.	<u>6</u>
	<u>27</u>
Share of Eagle Ltd. 25/48	14.06
Share of Minority [23/48]	<u>12.94</u>

(iii) **Profit & Loss A/c Eagle Ltd.**

Loss less Reserve [96-25]		71.00
Loss in Garuda Ltd.	14.06	
Loss in Bird Ltd.	<u>3.00</u>	<u>17.06</u>
		<u>88.06</u>

(iv) **Cost of Control**

Cost of Investments in Garuda Ltd.		25
Cost of Investments in Bird Ltd. [8 + 20]		<u>28</u>
		53
Paid up value of shares in:		
Garuda Ltd.	25	
Bird Ltd. [8+16]	24	
Capital profit in Bird Ltd. [1+2]	<u>3</u>	<u>52</u>
		<u>1</u>

**Note:** In accordance with para 15 of AS 21, the consolidated financial statements have been presented from the date on which holding subsidiary relationship comes in existence.

3. **Balance Sheet of Atharv Ltd. as at 30<sup>th</sup> April, 2020 (after demerger)**

Particulars	Note No.	(₹)
<b>I. Equity and Liabilities</b>		
<b>(1) Shareholder's Funds</b>		
(a) Share Capital	1	8,00,000
(b) Reserves and Surplus	2	20,54,000
<b>(2) Non-current Liabilities</b>		
Long-term borrowings	3	5,00,000
<b>(3) Current Liabilities</b>		
Trade payables		<u>1,50,000</u>
<b>Total</b>		<u>35,04,000</u>
<b>II. Assets</b>		
<b>(1) Non-current assets</b>		
Fixed assets		
Tangible assets	4	14,60,000
<b>(2) Current assets</b>		
(a) Trade receivables (8,00,000-2,00,000)		6,00,000
(b) Current investment		9,50,000
(c) Cash and cash equivalents (W.N.2)		<u>4,94,000</u>
<b>Total</b>		<u>35,04,000</u>

## Notes to Accounts

		₹	₹
1.	<b>Share Capital</b>		
	Authorised share capital:		
	10,000 Equity shares of ₹ 100 each	10,00,000	
	Issued share capital:		
	8,000 Equity shares of ₹ 100 each		8,00,000
2.	<b>Reserves and surplus</b>		
	Revaluation reserve (W.N.6)	5,00,000	
	General reserve	5,00,000	
	Capital reserve (W.N.3)	11,00,000	
	Securities Premium	4,00,000	
	Profit and Loss Account (W.N.1)	(4,46,000)	20,54,000
3.	<b>Long-term Borrowings</b>		
	Secured borrowings		
	11% Debentures secured against the assets of the Co.		5,00,000
4.	<b>Tangible Assets</b>		
	Plant & Machinery at depreciated value (8,60,000 - 4,00,000)	4,60,000	
	Land (W.N.6)	10,00,000	14,60,000

## Working Notes:

### 1. Computation of Profit and Loss Account as on 30<sup>th</sup> April, 2020

		₹
Balance as on 31 <sup>st</sup> March, 2020		3,60,000
Add: Profit earned during the month of April, 2020 (W.N.4)	1,44,000	1,44,000
		5,04,000
Less: Expenses on sale of department (share of Atharv Ltd.) (₹ 8,00,000 x 50%)	4,00,000	
Patents, trademarks and copyrights written off (W.N.5)	2,50,000	
Diminution in the value of investment (W.N.7)	2,50,000	
Loss due to on foreign exchange translation difference (W.N.8)	50,000	(9,50,000)
		(4,46,000)

### 2. Cash and bank

		₹
Cash received from Overseas buyer on 30 <sup>th</sup> April, 2020 (£ 10,000 x ₹ 75)		7,50,000
Add: Cash reimbursed by overseas buyer (₹ 8,00,000 x 50%)		4,00,000
Cash profit earned during the month of April, 2020 by		

Atharv Ltd. (See Note)		<u>2,40,000</u>
		13,90,000
Less: Expenses on sale of department to overseas buyer	8,00,000	
Share of profit (for April, 2020) paid to overseas buyer (W.N.4)	<u>96,000</u>	<u>(8,96,000)</u>
		<u>4,94,000</u>

### 3. Calculation of gain on sale of department and discharge of purchase consideration

	₹
Purchase consideration	20,00,000
Less: Net assets sold	<u>9,00,000</u>
Gain on sale of department transferred to capital reserve	<u>11,00,000</u>
Purchase consideration	20,00,000
Less: Discharged by issue of Overseas Buyer's Equity shares of ₹ 10,00,000 at 20% premium	<u>12,00,000</u>
Balance discharged in cash i.e. (8,00,000/80) = ₹ 10,000	<u>8,00,000</u>

### 4. Profit earned during the month of April, 2020

	₹
Total profit earned by Atharv Ltd. during the month of April, 2020	2,40,000
Less: 40% Profit of the sold department	<u>96,000</u>
Profit of Atharv Ltd. on the retained department	<u>1,44,000</u>

### 5. Patents, trademarks and copyrights written off

	₹
Patents, trademarks and copyrights as per balance sheet of Atharv Ltd.	6,00,000
Less: Patents, trademarks and copyrights taken over by Overseas buyer	<u>(3,50,000)</u>
Patents, trademarks and copyrights written off (charged to Profit and Loss Account)	<u>2,50,000</u>

### 6. Land

	₹
Land as per balance sheet of Atharv Ltd.	7,00,000
Less: Land taken over by Overseas buyer	<u>(2,00,000)</u>
Book value of land retained by Atharv Ltd.	<u>5,00,000</u>
Revalued value (200% of book value)	<u>10,00,000</u>
Revaluation reserve (10,00,000-5,00,000)	5,00,000

### 7. Diminution in the market value of equity shares of Overseas Buyer

	₹
Nominal value of shares	<u>10,00,000</u>
Issued at 20% Premium	12,00,000

Market value of shares on 30 <sup>th</sup> April, 2020 is 95% of nominal value (10,00,000 x 95%)	<u>9,50,000</u>
Diminution charged to Profit and Loss Account	<u>2,50,000</u>

#### 8. Loss due to foreign exchange translation difference

	₹
Cash payment by overseas buyer £ 10,000 due on 31 <sup>st</sup> March, 2020 @ ₹ 80 per £	8,00,000
Exchange rate on 30 <sup>th</sup> April, 2020 is ₹ 75 per £	
Less: Amount remitted in Indian Currency (£ 10,000 x ₹ 75)	<u>(7,50,000)</u>
Loss on foreign exchange translation transferred to Profit and Loss Account	<u>50,000</u>

#### Note:

- The above solution has been given on the assumption that Atharv Ltd intends to hold investment in shares of overseas buyer as temporary investment. Therefore, its carrying value has been shown in the balance sheet at market value and reduction to market value has been included in the profit and loss account. In case it is assumed as long term investment, then investment in shares of Overseas buyer will be shown at cost i.e. ₹ 12,00,000 and Profit and Loss account balance will be ₹ 9,04,000. The Balance Sheet total will be ₹ 37,54,000.
- It is also assumed that the profit earned during the month of April, 2020 is entirely the cash profit and also the amount of current assets and current liabilities of Atharv Ltd. has been same as on 31.3.2020.

#### 4. Calculation of intrinsic value of equity shares of Authentic Ltd.

##### 1. Calculation of Goodwill

- Capital employed

	₹	₹
Assets		
Building	24,00,000	
Machinery (₹ 22,00,000 + ₹ 1,45,800)	23,45,800	
Furniture	10,00,000	
Vehicles	<u>18,00,000</u>	
	75,45,800	
Add: 30% increase	<u>22,63,740</u>	
Tangible assets	98,09,540	
Trade investments (₹ 16,00,000 × 10% × 90%)	1,44,000	
Trade Receivables (₹ 18,00,000 – ₹ 20,000)	17,80,000	
Inventory (₹ 11,00,000 – ₹ 1,00,000)	10,00,000	
Bank balance	<u>3,20,000</u>	1,30,53,540
Less: Outside liabilities		
Bank Loan	12,00,000	
Trade Payables	<u>37,00,000</u>	<u>(49,00,000)</u>
Capital employed		<u>81,53,540</u>



- (ii) Future maintainable profit

**Calculation of average profit**

	2016-2017 ₹	2017-2018 ₹	2018-2019 ₹	2019-2020 ₹
Profit given	16,00,000	18,00,000	21,00,000	22,00,000
Add: Capital expenditure of machinery charged to revenue		2,00,000		
Loss on sale of furniture			40,000	
	<u>16,00,000</u>	<u>20,00,000</u>	<u>21,40,000</u>	<u>22,00,000</u>
Less: Depreciation on machinery		(20,000)	(18,000)	(16,200)
Income from non-trade investments		(1,08,000)	(2,16,000)	(2,16,000)
Reduction in value of inventory				(1,00,000)
Bad debts				(20,000)
Adjusted profit	<u>16,00,000</u>	<u>18,72,000</u>	<u>19,06,000</u>	<u>18,47,800</u>
				₹
Total adjusted profit for four years (2016-2017 to 2019-2020)				<u>72,25,800</u>
Average profit (₹ 72,25,800/4)				18,06,450
Less: Depreciation at 10% on additional value of machinery (22,00,000 + 1,45,800) × 30/100 i.e. ₹ 7,03,740				<u>(70,374)</u>
Adjusted average profit				<u>17,36,076</u>

- (iii) Normal Profit: 20% on capital employed i.e. 20% on ₹ 81,53,540 = ₹ 16,30,708

- (iv) Super profit: Expected profit – normal profit

$$₹ 17,36,076 - ₹ 16,30,708 = ₹ 1,05,368$$

- (v) Goodwill: 2 years' purchase of super profit

$$₹ 1,05,368 \times 2 = ₹ 2,10,736$$

**2. Net assets available to equity shareholders**

	₹	₹
Goodwill as calculated in 1(v) above		2,10,736
Tangible assets		98,09,540
Trade and Non-trade investments		15,84,000
Trade Receivables		17,80,000
Inventory		10,00,000
Bank balance		<u>3,20,000</u>
		1,47,04,276
Less: Outside liabilities		
Bank loan	12,00,000	

Trade Payables	37,00,000	(49,00,000)
Preference share capital		(20,00,000)
Net assets for equity shareholders		78,04,276

### 3. Valuation of equity shares

$$\begin{aligned}\text{Value of equity share} &= \frac{\text{Net assets available to equity shareholder}}{\text{Number of equity shares}} \\ &= \frac{\text{₹ 78,04,276}}{4,00,000} = \text{₹ 19.51}\end{aligned}$$

#### Note:

1. Depreciation on the overall increased value of assets (worth 30% more than book value) has not been considered. Depreciation on the additional value of only plant and machinery has been considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.
2. Loss on sale of furniture has been taken as non-recurring or extraordinary item.
3. It has been assumed that preference dividend has been paid till date.

### 5. (a) (i) Calculation of initial recognition amount of loan to employees

Year end	Cash Inflow		Total ₹	P.V. factor @10%	Present value ₹
	Principal ₹	Interest @ 5% ₹			
2020	3,20,000	80,000	4,00,000	0.909	3,63,600
2021	3,20,000	64,000	3,84,000	0.827	3,17,568
2022	3,20,000	48,000	3,68,000	0.751	2,76,368
2023	3,20,000	32,000	3,52,000	0.683	2,40,416
2024	3,20,000	16,000	3,36,000	0.620	2,08,320
Present value or Fair value					14,06,272

### (ii) Calculation of amortised cost of loan to employees

Year	Amortised cost (Opening balance) [1] ₹	Interest to be recognised@10% [2] ₹	Repayment (including interest) [3] ₹	Amortised Cost (Closing balance) [4]=[1]+ [2]-[3] ₹
2020	14,06,272	1,40,627	4,00,000	11,46,899
2021	11,46,899	1,14,690	3,84,000	8,77,589
2022	8,77,589	87,759	3,68,000	5,97,348
2023	5,97,348	59,735	3,52,000	3,05,083
2024	3,05,083	30,917*	3,36,000	Nil

\* ₹ 3,05,083 x 10% = ₹ 30,508. The difference of ₹ 409 (₹ 30,917 – ₹ 30,508) is due to approximation in computation.

(iii)

**Journal Entries in the books of Y Ltd.****For the year ended 31st December, 2020 (regarding loan to employees)**

	Dr. Amount (₹)	Cr. Amount (₹)
Staff loan A/c Dr. To Bank A/c (Being the disbursement of loans to staff)	16,00,000	16,00,000
Staff cost A/c ₹ (16,00,000 – 14,06,272) [Refer part (ii)] Dr. To Staff loan A/c (Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of ₹ 14,06,272)	1,93,728	1,93,728
Staff loan A/c Dr. To Interest on staff loan A/c (Being the charge of interest @ market rate of 10% on the loan)	1,40,627	1,40,627
Bank A/c Dr. To Staff loan A/c (Being the repayment of first instalment with interest for the year)	4,00,000	4,00,000
Interest on staff loan A/c Dr. To Profit and loss A/c (Being transfer of balance of staff loan Interest account to profit and loss account)	1,40,627	1,40,627

**(b) Expense to be recognized during 4 years' vesting period**

Year	Calculation	Expenses for the period ₹	Cumulative expenses ₹
1	690 employees x 180 options x 70% x ₹ 15 x 1/4	3,26,025	3,26,025
2	[690 employees x 180 options x 70% x ₹ 15 x 2/4 years] – ₹ 3,26,025	3,26,025	6,52,050
3	[690 employees x 180 options x 70% x ₹ 15 x 3/4 years] – ₹ 6,52,050	3,26,025	9,78,075
4	[690 employees x 180 options x 70% x ₹ 15 x 4/4 years] – ₹ 9,78,075	3,26,025	13,04,100

Total amount of the expenses to be recognized during 4 years' vesting period will be ₹13,04,100.

**6. (a) Calculation of Closing per unit of NAV of the fund**

	₹ in lakhs
Net Assets of Kingship Fortunes	
Closing cash balance (W.N.2)	79.99

Closing market value of investments	1,120.23
Accrued dividends (collectable)	<u>0.25</u>
	1,200.47
Less: Current liabilities	
Outstanding management fee (payable)	<u>(0.47)</u>
Closing net assets (A)	<u>1,200.00</u>
Units outstanding (in lakhs) (B)	100.00
NAV per unit (A/B)	12.00

**Working Notes:**

		₹ in lakhs
<b>1. Computation of opening cash balance</b>		
Proceeds of NFO in full including underwriters commitment		1000.00
Less: Initial purchase of securities		<u>(892.50)</u>
		107.50
Less: Underwriting commission	15.00	
Marketing expenses	11.25	<u>(26.25)</u>
Opening cash balance		81.25
<b>2. Computation of closing cash balance</b>		
Opening bank balance (W.N.1)		81.25
Add: Proceeds from sale of securities	141.25	
Dividends received on investment	<u>2.26</u>	<u>143.51</u>
		224.76
Less: Cost of securities purchased	130.00	
Management expenses (W.N.3)	1.76	
Capital gains distributed ₹ (141.25 - 127.25 x 80%)	11.20	
Dividends distributed ₹ (2.26 x 80%)	<u>1.81</u>	<u>(144.77)</u>
Closing cash balance		<u>79.99</u>
<b>3. Computation of Management Expenses Chargeable</b>		
Actual expense incurred [A]		2.47
Opening investment made	892.50	
Closing funds invested (892.50 - 127.25 + 130)	<u>895.25</u>	
Total	<u>1,787.75</u>	
Average funds invested (1,787.75/2)	<u>893.875</u>	
0.25% of Average funds invested [B]		2.23
Lower of A or B		2.23
Less: Amount unpaid		<u>(0.47)</u>
Management expenses paid		1.76

(b)

**Strong Limited**  
**Value Added Statement**  
**for the year ended 31st March, 2020**

	₹ in lakhs	₹ in lakhs %
Sales		610
Less: Cost of bought-in material and services:		
Production and operational expenses	413	
Administration expenses	14	
Interest on working capital loans	<u>8</u>	<u>(435)</u>
Value added by manufacturing and trading activities		175
Add : Other income		<u>25</u>
Total Value Added		<u>200</u>

**Application of Value Added:**

<i>To Pay Employees :</i>		
Salaries, Wages, Bonus and Other Benefits	41	20.50
<i>To Pay Directors :</i>		
Salaries and Commission	5	2.50
<i>To Pay Government</i>		
Cess and Local Taxes	11	
Income Tax	<u>16</u>	
	<u>27</u>	13.50
<i>To Pay Providers of Capital</i>		
Interest on Debentures	7	
Interest on Fixed Loans	12	
Dividend	<u>11</u>	
	30	15.00
<i>To Provide for Maintenance and Expansion of the Company:</i>		
Depreciation	14	
General Reserve	60	
Retained Profit (30-7)	<u>23</u>	
	<u>97</u>	<u>48.50</u>
Grand Total	<u>200</u>	<u>100.00</u>

**Reconciliation between Total Value Added and Profit Before Taxation:**

	₹ in lakhs	₹ in lakhs
Profit before Tax		110
Add back :		
Depreciation	14	
Salaries, Wages, Bonus and other Benefits	41	
Directors' Remuneration	5	
Cess and Local Taxes	11	

Interest on Debentures	7	
Interest on Fixed Loans	<u>12</u>	
<i>Total Value Added</i>		<u>90</u> <u>200</u>

7. (a) Statement showing computation of 'Net Owned Fund'

		₹ in 000
Paid up Equity Capital		100
Free Reserves		<u>500</u>
		600
Less: Deferred expenditure		<u>(200)</u>
	A	<u>400</u>
Investments		
In shares of subsidiaries and group companies		100
In debentures of subsidiaries and group companies		<u>100</u>
	B	<u>200</u>
10% of A		40
Excess of Investment over 10% of A (200-40)	C	160
Net Owned Fund [(A) - (C)] (400-160)		240

(b)

**Prahlad Limited**

**Computation of Economic Value Added**

Economic Value Added	₹ in lakhs
Net Operating Profit after Tax (Refer Working Note 5)	1,372.00
Add: Interest on Long-term Fund (Refer Working Note 2)	<u>28.00</u>
	1,400.00
Less: Cost of Capital [₹6,400 lakhs × 15.77% (Refer working notes 3 and 4)]	<u>(1,009.28)</u>
Economic Value Added	<u>390.72</u>

**Working Notes:**

1.	<b>Cost of Equity</b> = Risk free Rate + Beta Factor (Market Rate – Risk Free Rate) 9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%		
2.	<b>Cost of Debt</b>		
	Interest	₹ 40 lakhs	
	Less: Tax (30%)	(₹ <u>12 lakhs</u> )	
	Interest after Tax	₹ <u>28 lakhs</u>	
	Cost of Debt = $\frac{28}{400} \times 100 = 7\%$		
3.	<b>Weighted Average Cost of Capital</b>		
	Cost of Equity	₹6,000 lakhs × 16.35% (W.N.1)	₹981 lakhs
	Cost of Debt	₹400 lakhs × 7% (W.N.2)	₹ <u>28 lakhs</u>

	₹1,009 lakhs
	WACC = $\frac{1,009}{6,400} \times 100 = 15.77\%$ (approx.)

#### 4. Capital Employed

	₹ in Lakhs
Share Capital	2,000
Reserves and Surplus	4,000
Long term debts	<u>400</u>
	<u>6,400</u>

#### 5. Net Operating Profit after Tax

Profit before Interest and Tax	2,000
Less: Interest	<u>(40)</u>
	1,960
Less: Tax 30% on 1,960 Lakhs	<u>(588)</u>
Net Operating Profit after Tax	<u>1,372</u>

#### (c) Calculation of Capital base

	₹
Equity Share Capital paid up (8,00,000 shares of ₹ 8 each)	64,00,000
Less: Calls in arrears	<u>(1,00,000)</u>
	63,00,000
General Reserve	7,50,000
Loss for the year	(2,50,000)
9% Debentures	<u>50,00,000</u>
Capital base	<u>1,18,00,000</u>
Target Profit 12.5% of capital base	14,75,000

Expected profits to be achieved by taking the services of Mr. Raman is ₹ 16,22,500 (i.e. 14,75,000 + 10% of 14,75,000). Therefore, the maximum salary that can be paid to Mr. Raman will be ₹ 16,22,500 p.a.

- (d) While formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as

Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in application of accounting principles and practices and economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as '**Carve-outs**'.

In Ind AS 103 "Business Combination", an additional guidance on "Accounting of Business Combinations of Entities under Common Control" is given which is over and above what is given in IFRS. This is termed as '**Carve-in**'.

- (e) Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Allen Ltd.)

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is ₹ 6,14,400 [ $₹ 1,00,000 \times 6.144$  (Annuity factor of Re. 1 @10% for 10 years)] and amounts to at least substantially all of the fair value (sale price i.e. ₹ 6,14,460) of the leased equipment. Thus lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 5,14,460 (Sale value ₹ 6,14,460 less carrying amount ₹ 1,00,000) will not be recognized as income in the year of sale in the books of lessee i.e. Allen Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that depreciation is charged on straight line basis, Allen Ltd. will recognize depreciation of ₹ 61,446 per annum for 10 years ( $₹ 6,14,460 / 10$ ) and amortise profit of ₹ 5,14,460 over the lease term of 10 years, i.e. ₹ 51,446 p.a. The net effect is a debit of ( $₹ 61,446 - ₹ 51,446$ ) ₹ 10,000 p.a. to the Statement of Profit and Loss, for 10 years as covered under the lease term.

Note: Had there been no sale and lease back transaction, the Statement of Profit and Loss for each year (covered in the lease term) would have been charged by ( $₹ 1,00,000 / 10$ ) ₹ 10,000, towards depreciation. Thus, the sale and lease back transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.