PAPER –1: FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, NOTIFICATIONS AND ANNOUNCEMENTS

A.	Applicable for November, 2018 Examination

1. Applicability of Amendments to Ind AS 7 and Ind AS 102 issued by the MCA dated 17th March 2017

To align Ind AS with IFRS, the recent amendments made in IAS 7 and IFRS 2 by the IASB have been incorporated in Ind AS 7 'Statement of Cash Flows' and Ind AS 102 'Share-based Payment' by way of a notification issued by the Ministry of Corporate Affairs on 17th March, 2017.

I. Amendments in Ind AS 7 'Statement of Cash Flows'

(i) Disclosure requirements

The amendments made to Ind AS 7 require certain additional disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

In addition to the above, the disclosure is required for changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

As per the amendment, one of the way for disclosure is providing a reconciliation between the opening and closing balances in the balance sheet for liabilities arising from financing activities, including the changes identified, by linking items included in the reconciliation to the balance sheet and the statement of cash flows for the sake of information to the users.

If an entity provides disclosures of changes in other assets and liabilities besides changes in liabilities arising from financing activities, it shall disclose the later changes separately from changes in those other assets and liabilities.

(ii) Transitional provisions and applicability of the amendment

Further, with respect to these amendments, an entity is not required to provide comparative information for preceding periods since these amendments will be applicable for the annual periods beginning on or after 1 April, 2017.

II. Amendments in Ind AS 102 'Share-based Payment'

(i) The amendments cover following accounting areas:

"Measurement of cash-settled share-based payments

Under Ind AS 102, the measurement basis for an equity-settled share-based payment should not be 'fair value' in accordance with Ind AS 113, 'Fair value measurement'. However, 'fair value' was not defined in connection with a cash-settled share-based payment. The amendment clarifies that the fair value of a cash-settled award is determined on a basis consistent with that used for equity-settled awards. Market-based performance conditions and non-vesting conditions are reflected in the 'fair value', but non-market performance conditions and service conditions are reflected in the estimate of the number of awards expected to vest.

The amendment to Ind AS 102 with respect to measurement of cash-settled awards has most impact where an award vests (or does not vest) based on a non-marketing condition. Absent this clarification, it may be argued that the fair value of a cash-settled award is to be determined using the guidance in Ind AS 113 and reflecting the probability that non-market and service vesting conditions would be met. The amendment clarifies that non-market and service vesting conditions are ignored in the measurement of fair value.

"Classification of share-based payments settled net of tax withholdings

Tax laws or regulations may require the employer to withhold some of the shares to which an employee is entitled under a share-based payment, and to remit the tax payable on it to the tax authority.

Ind AS 102 would require such share based payment to be split into a cash settled component for the tax payment and an equity settled component for the net shares issued to the employee. The amendment now adds an exception that requires the share based payment to be treated as equity-settled in its entirety. The cash payment to the tax authority is treated as if it was part of an equity settlement. The exception would not apply to any equity instruments that the entity withholds in excess of the employee's tax obligation associated with the share-based payment.

"Accounting for a modification of a share-based payment from cash-settled to equity-settled

As per the amendment, if the terms and conditions of a cash-settled share-based payment transactions are modified with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as such from the date of the modification. Specifically:

- o The equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted at the modification date. The equity-settled share-based payment transaction is recognised in equity on the modification date to the extent to which goods or services have been received.
- o The liability for the cash-settled share-based payment transaction as at the modification date is derecognised on that date.

- o Any difference between the carrying amount of the liability derecognised and the amount of equity recognised on the modification date is recognised immediately in profit or loss.
- o The amendment requires any change in value to be dealt with before the change in classification. Accordingly, the cash-settled award is remeasured, with any difference recognised in the statement of profit and loss before the remeasured liability is reclassified into equity.

(ii) Transitional provisions

The transition provisions specify that the amendments apply to share based payment that are not settled as at the date of first application or to modifications that happen after the date of first application, without restatement of prior periods. There is no income statement impact as a result of any reclassification from liability to equity in respect of 'net settled awards'; the recognised liability is reclassified to equity without any adjustment.

The amendments can be applied retrospectively, provided that this is possible without hindsight and that the retrospective treatment is applied to all of the amendments.

(iii) Applicability date of the amendment

The amendment rules shall be applicable from annual periods beginning on or after 1 April 2017. Accordingly, these amendments are not applicable to Phase I entities preparing their first Ind AS financial statements for the year ended 31 March 2017. However, such entities would need to provide relevant disclosures under Ind AS 8, 'Accounting policies, changes in accounting estimates and errors' in their first Ind AS financial statements.

2. Applicability of Guidance Notes

Following Guidance Note not given in January, 2017 edition of the study is applicable to students for the forthcoming examinations

1. Guidance Note on Accounting for Real Estate Transactions (Revised 2012).

For full text of it, students are advised to refer the following link:

1. https://resource.cdn.icai.org/25896asb15443.pdf

3. Relevant Sections of the Companies Act, 2013

The relevant Sections of the Companies Act, 2013 notified up to 30th April, 2018 are applicable for November, 2018 Examination.

B. Not applicable for November, 2018 Examination

I. Following Guidance Notes given in January, 2017 edition of the study are not applicable to students for the forthcoming examinations:

1. Guidance Note on Accounting Treatment for Excise Duty.
2. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
3. Guidance Note on Accounting for Depreciation in Companies in the context of Schedule II to the Companies Act, 2013.

II. Ind AS 115 notified on 28.3.2018 alongwith the amendments made in other Ind AS as on 28.3.2018 by MCA is not applicable for November, 2018 examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

AS 1

1. (a) State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(v) There is no single list of accounting policies which are applicable to all circumstances.

AS 2

(b) In a manufacturing process of Atharv Ltd., one by-product BP emerges besides two main products MP 1 and MP 2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount (₹)	Output (unit)	Closing inventory
Raw material	7,500	80,000	MP1-6,250	800
Wages	-	41,000	MP2- 5,000	200
Fixed overhead	-	29,000	BP-1,600	-
Variable overhead	-	20,000	-	-

Average market price of MP 1 and MP 2 is ₹ 40 per unit and ₹ 25 per unit respectively, by-product is sold @ ₹ 12.5 per unit. There is a profit of ₹ 2,500 on sale of by-product after incurring separate processing charges of ₹ 2,000 and packing charges of ₹ 3,000. ₹ 3,000 was realised from sale of scrap.

Calculate the value of closing inventory of MP 1 and MP 2.

AS 3

2. (a) How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS 3 for the year ended 31st March, 2018?

(i) 10% Debentures issued: As on 01-04-2017 ₹ 1,10,000
As on 31-03-2018 ₹ 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii) Unpaid Interest on Debentures: As on 01-04-2017 ₹ 275
As on 31-03-2018 ₹ 1,175

(iv) Debtors of ₹ 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v) 10% Bonds (Investments): As on 01-04-2017 ₹ 3,50,000
As on 31-03-2018 ₹ 3,50,000

(vi) Accrued Interest on Investments: As on 31-03-2018 ₹ 10,500

AS 4

(b) A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain goods, for the year 2016-2017. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 2017. Shall company account for such tax in the year 2016-2017 or shall it account for in the year 2017-2018?

AS 7

3. A construction company spend ₹ 180 thousand for tendering and incidental expenses for securing a contract. The contract price is ₹ 55,000 thousand. The construction is expected to be completed in 2 years time.

   The company has incurred the following expenses and has worked out the additional revenue.

			₹ 000's
	Year 0 Actual	Year 1 Actual	Year 2 Budgeted
Expenses:			
Tendering Costs	180		
Employee benefits: Site Costs		4,000	3,700
Transport charges		120	110
Depreciation		800	800
Materials		15,000	19,100
Contract overhead (10%)			
Insurance		2,000	2,200
Design and Technical Assistance		1,000	1,200
Contract Administration expenses		2,000	2,400
Additional Revenue:			
Claims		350	500
Variations		700	200
Incentives			500

   Find out the estimated contract revenue and contract costs. Also calculate contract profit or loss.

AS 10

4. (a) ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?

AS 12

(b) ABC Ltd. has received the following grants from the Government of Delhi for its newly started pharmaceutical business:

- ₹ 20 lakh received for immediate start-up of business without any condition.
- ₹ 50 lakh received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
  - that drugs should be available to the public at 20% cheaper from current market price: and
  - the drugs should be in accordance with quality prescribed by the World Health Organisation [WHO].
- Two acres of land received for set up of plant.
- ₹ 2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis.

How should ABC Ltd. recognise the government grants in its books of accounts?

AS 14

5. (a) Som Ltd. agreed to takeover Dove Ltd. on 1st April, 2018. The terms and conditions of takeover were as follows:

(i) Som Ltd. issued 56,000 equity shares of ₹100 each at a premium of ₹15 per share to the equity shareholders of Dove Ltd.

(ii) Cash payment of ₹ 39,000 was made to equity shareholders of Dove Ltd.

(iii) 24,000 fully paid preference shares of ₹ 50 each issued at par to discharge the preference shareholders of Dove Ltd.

(iv) The 8% Debentures of Dove Ltd. (₹ 78,000) converted into equivalent value of 9% debentures in Som Ltd.

(v) The actual cost of liquidation of Dove Ltd. was ₹ 23,000. Liquidation cost is to be reimbursed by Som Ltd. to the extent of ₹15,000.

You are required to:

(1) Calculate the amount of purchase consideration as per the provisions of AS 14 and

(2) Pass Journal Entry relating to discharge of purchase consideration in books of Som Ltd.

AS 29

(b) A Ltd. manufactures engineering goods, provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following the policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	*Amount (₹)*
19th January, 2016	80,000
29th January, 2017	50,000
15th October, 2017	1,80,000

Calculate the provision to be made for warranty under AS 29 as at 31st March, 2017 and 31st March, 2018. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March. 2018.

AS 19

6. (a) A Ltd. leased a machinery to B Ltd. on the following terms:

	(₹ in lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries to be passed in the books of the Lessee in the First year.

AS 22

(b) Akshara Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹ 400 lakhs and ₹ 800 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 20 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

AS 25

7. (a) To comply with listing requirements and other statutory obligations, Prateek Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of ₹ 350 lakhs under Income-tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No deferred tax asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of ₹ 350 lakhs and ₹ 150 lakhs respectively for the first two quarters of financial year 2017-2018 and anticipates net earnings of ₹ 400 lakhs in the coming half year ended March 2018 of which ₹ 50 lakhs will be the loss in the quarter ended December, 2017. The tax rate for the company is 30% with a 10% surcharge. You are required to calculate the amount of tax expense to be reported for each quarter of financial year 2017-2018.

AS 26

(b) Change Ltd. acquired a patent at a cost of ₹ 2,40,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹ 48,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years.

AS 28

8. M Ltd. has three cash-generating units: A, B and C. Due to adverse changes in the technological environment, M Ltd. conducted impairment tests of each of its cash-generating units. On 31st March, 2018, the carrying amounts of A, B and C are ₹ 100 lakhs, ₹ 150 lakhs and ₹ 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is ₹ 200 lakhs: a headquarter building of ₹ 150 lakhs and a research centre of ₹ 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

Following is the remaining estimated useful life of:

	A	*B*	*C*	*Head quarter assets*
Remaining estimated useful life	10	20	20	20

The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use since net selling price for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	*B*	*C*	*M Ltd. as a whole*
Recoverable amount	199	164	271	720*

*The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.

Calculate and show allocation of impairment loss as per AS 28. Ignore tax effects.

AS 16

9. DLF Limited has borrowed a sum of US$ 20,00,000 at the beginning of financial year 2017-18 for its residential project at LIBOR + 3%. The interest is payable at the end of the financial year.

   At the time of availment exchange rate was ₹ 61 per US $ and the rate as on 31st March, 2018 was ₹ 65 per US $. If DLF Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been @ 10.50%.

   Compute borrowing cost and exchange difference for the year ending 31st March, 2018 as per AS 16. (Applicable LIBOR is 1%).

Indian Accounting Standards (Ind AS)

10. Explain

    (a) Carve Out in Ind AS 17 vis-à-vis IAS 17 alongwith the reason.

    (b) Differences between Ind AS 21 vis-à-vis AS 11.

Accounting for Corporate Restructuring

11. The following are the summarized Balance Sheets of H Ltd. and S Ltd. as at 31.03.2018:

				₹ in lakhs	
	H Ltd. (₹)	*S Ltd. (₹)*		*H Ltd. (₹)*	*S Ltd. (₹)*
Share capital			Fixed assets	240	72
Share of ₹ 10 each	200	40	Investment in S Ltd. (2,40,000 shares)	24	-
General reserve	200	80	Trade receivables	140	20
Profit and Loss	80	60	Inventories	120	100
Secured loan	80	12	Cash at Bank	156	8
Current liabilities	120	8			
	680	200		680	200

H Ltd. holds 60% of the paid up capital of S Ltd. and balance is held by a foreign company. The foreign company agreed with H Ltd. as under:

(i) The shares held by the foreign company will be sold to H Ltd. at ₹ 50 above than nominal value of per share.

(ii) The actual cost per share to the Foreign Company was ₹ 11, gain accruing to Foreign Company is taxable @ 20%. The tax payable will be deducted from the sale proceeds and paid to Government by H Ltd. 50% of the consideration (after payment of tax) will be remitted to Foreign Company by H Ltd. and also any cash for fractional shares allotted.

(iii) For the Balance of consideration H Ltd. would issue its shares at their intrinsic value.

It was also decided that H Ltd. would also absorb S Ltd. simultaneously by writing down the fixed assets of S Ltd. by 10%. The Balance Sheet figure included a sum of ₹ 4 lakh due by S Ltd. to H Ltd, included inventory of ₹ 6 lakhs purchased from S Ltd. who sold them at cost plus 20%.

Pass Journal entries in the books of H Ltd. to record the above arrangement on 31.03.2018. Also prepare Balance Sheet of H Ltd. after absorption. Workings should form part of your answer.

Consolidated Financial Statements

12. The following information relates to the results of the parent and subsidiary (jointly) and the investment in associate and joint venture: (All figures are in rupees)

Summarised Balance Sheet as at 31.3.2018

	Holding and subsidiary	*Associate*	*Joint Venture*
Equity and Liabilities			
Called up equity shares of ₹ 1 each	1,00,000	40,000	10,000
General reserve	40,000		-
Profit and loss account	37,000	27,000	83,000
Minority Interest	20,000	-	-
Current Liabilities			
Trade payables	20,000	32,000	6,000
Provision for tax	19,000	11,000	11,000
	2,36,000	1,10,000	1,10,000

Assets			
Non-current assets			
Fixed assets- Tangible assets	1,95,000	74,000	41,000
Investments:			
8,000 shares in Associate	15,000	-	-
5,000 shares in Joint Venture	5,000	-	-
Current assets	21,000	36,000	69,000
	2,36,000	1,10,000	1,10,000

Details of Profit and Loss account for the year ended 31.3.2018

	Holding and subsidiary	*Associate*	*Joint Venture*
Retained profit for the year	15,000	11,000	23,000
Add: Retained profit brought forward	22,000	16,000	60,000
Retained profit carried forward	37,000	27,000	83,000

You are given the following additional information:

(a) The parent company purchased its investment in the associate two years ago when the balance on the profit and loss account was ₹ 17,000. There are no signs of impairment of the goodwill.

(b) The parent company entered into a joint venture to access a lucrative market in the former East Germany. It set up a company two years ago and has 50 per cent of the voting rights of the company set up for this joint venture.

Prepare the consolidated balance sheet for the Group as per relevant Accounting Standards for the year ended 31.3.2018.

Accounting and Reporting of Financial Instruments

13. S Limited issued redeemable preference shares to its Holding Company -H Limited. The terms of the instrument have been summarized below. Analyse the given situation, applying the guidance in Ind AS 109 'Financial Instruments', and account for this in the books of H Limited.

Nature	*Non-cumulative redeemable preference shares*
Repayment	Redeemable after 3 years
Date of Allotment	1st April 2015
Date of Repayment	31st March 2018

Total Period	3 Years
Value of Preference Shares issued	5,00,00,000
Dividend Rate	0.0001% Per Annum
Market rate of interest	12% Per Annum
Present value factor	0.7118

Accounting for Share Based Payments

14. An enterprise grants to an employee the right to choose either a cash payment equal to the value of 1,000 shares, or 1,200 shares. The grant is conditional upon the completion of three years' service. If the employee chooses the equity alternative, the shares must be held for three years after vesting date. The face value of shares is ₹ 10 per share. At grant date, the fair value of the shares of the enterprise (without considering post-vesting restrictions) is ₹ 50 per share. At the end of years 1, 2 and 3, the said fair value is ₹ 52, ₹ 55 and ₹ 60 per share respectively.

    The enterprise does not expect to pay dividends in the next three years.

    After taking into account the effects of the post-vesting transfer restrictions, the enterprise estimates that the grant date fair value of the equity alternative is ₹ 48 per share. At the end of year 3, the employee chooses:

    Scenario 1: The cash alternative

    Scenario 2: The equity alternative

    Pass necessary journal entries to account for the above options under both the alternatives.

Mutual Funds

15. On 1.4.2017, a mutual fund scheme had 54 lakh units of face value of ₹ 10 each was outstanding. The scheme earned ₹ 486 lakhs in 2017-2018, out of which ₹ 270 lakhs was earned in the first half of the year. On 30.9.2017, 6 lakh units were sold at a "NAV" of ₹ 70.

    Pass Journal entries for sale of units and distribution of dividend at the end of 2017-2018.

Valuation of Shares

16. The following abridged Balance Sheet as at 31st March, 2018 pertains to Supreme Ltd.

Liabilities	₹ in lakhs	Assets	₹ in lakhs
Share Capital:		Fixed Assets	3,862
60 lakhs Equity shares of ₹ 10 each, fully paid up	600	Current Assets	970
30 lakhs Equity shares of ₹ 10		Loans and Advances	311

each, ₹ 8 paid up	240		
50 lakh Equity shares of ₹ 5 each, fully paid-up	250		
Reserves and Surplus	1,819		
Secured Loans	1,500		
Current Liabilities	414		
Provisions	320		
	5,143		5,143

You are required to calculate the following for each one of the three categories of equity shares appearing in the above mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Assets and Liabilities;

(ii) Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industry is 15%, whereas Supreme Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2018 the company has earned ₹ 457 lakhs as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹ 10 of a Company in the same industry is ₹ 2.

Valuation of Business

17. From the following information of Nishtha Ltd. ascertain the value of business:

(1) The company's equity share capital is ₹ 200 lakh, divided into shares of ₹ 50 each.

(2) The company earned a profit after tax of ₹ 60 lakh for the year ended March 2018.

(3) The rate for the year 2017-2018 is 40%. Future tax rate is estimated at 45%.

(4) The company's equity shares are quoted at ₹ 120 at the balance sheet date.

The profits for the year 2017-2018 have been calculated after considering the following in the Profit and Loss Account:

(i) Subsidy of ₹ 4 lakh is received from the Government towards fulfillment of certain social obligations. The Government has withdrawn this subsidy and hence, this amount will not be received in future.

(ii) Interest of ₹ 10 lakh is on term loan. The final instalment of this term loan was fully settled in this year.

(iii) Managerial remuneration is ₹ 18 lakhs. The shareholders have approved an increase of ₹ 8 lakh in the overall managerial remuneration, from the next year onwards.

(iv) Loss on sale of fixed assets amounting to ₹ 10 lakh.

Value Added Statement

18. Piramal Enterprises Limited (PEL) has been consistently preparing Value Added Statement (VAS) as part of Financial Reporting. The Human Resource department of the Company has come up with a new scheme to link employee incentive with 'Value Added' as per VAS. As per the scheme an Annual Index of Employee cost to Value Added annually (% of employee cost to Value Added rounded off to nearest whole number) shall be prepared for the last 5 years and the best index out of results of the last 5 years shall be selected as the 'Target Index'. The Target Index percentage shall be applied to the figure of 'Value Added' for a given year to ascertain the target employee cost. Any saving in the actual employee cost for the given year compared to the target employee cost will be rewarded as 'Variable incentive' to the extent of 70% of the savings. From the given data, you are requested to ascertain the eligibility of 'Variable Incentive' for the year 2017-2018 for the employees of the PEL.

Value added statement of PEL for last 5 years (₹ in lakhs)

Year	*2012-13*	*2013-14*	*2014-15*	*2015-16*	*2016-17*
Sales	3,200	3,250	2,900	3,800	4,900
Less: Bought out goods and services	2,100	2,080	1,940	2,510	3,200
Value added	1,100	1,170	960	1,290	1,700

Application of Value Added

Year	*2012-13*	*2013-14*	*2014-15*	*2015-16*	*2016-17*
To Pay Employees	520	480	450	600	750
To Providers of Capital	160	170	120	190	210
To Government Tax	210	190	220	300	250
For Maintenance and expansion	210	330	170	200	490

Summarized Profit and Loss Account of the PEL for 2017-2018 (₹ in lakhs)

Sales		5,970
Less: Material consumed	1,950	
Wages	400	
Production salaries	130	
Production expenses	500	

Production depreciation	150	
Administrative salaries	150	
Administrative expenses	200	
Administrative depreciation	100	
Interest	150	
Selling and distribution salaries	120	
Selling expenses	350	
Selling depreciation	120	4,320
Profit		1,650

Economic Value Added

19. Able Bank will give loans to companies that have an "Economic Value Added" greater than zero for the past three years on an average. The bank is considering lending money to a small company that has the economic value characteristics shown below. The data relating to the company is as follows:

    (i) Average operating income after tax equals ₹ 25,00,000 per year for the last three years.

    (ii) Average total assets over the last three years equals ₹ 75,00,000.

    (iii) Weighted average cost of capital appropriate for the company is 10% which is applicable for all three years.

    (iv) The company's average current liabilities over the last three years are ₹ 15,00,000.

    Does the company meet the bank's criterion for a positive economic value added?

Human Resource Accounting

20 The following information is supplied to you about Great Ltd.

Capital & Reserves	
Equity Shares of ₹ 100 each of which ₹ 75 has been called up	5,00,000
Equity Shares in respect of which calls are in arrear @ 25 per share	₹ 1,00,000
General Reserve	₹ 10,00,000
Profit & Loss account (balance at beginning of the year)	(₹ 25,00,000)
Profit/(loss) for the year	(₹ 1,80,000)
Industry Average Profitability	12.50%
8% Debentures of ₹ 10 each	8,00,000
Great Ltd. is proposing to hire the services of Mr. ABC to turn the company around.	

Minimum take home salary per month demanded by Mr. ABC	₹ 4,00,000
Average Income tax rate on salaries after considering the impact of ₹ 3 lakhs p.a. i.e., the exemption amount	25%
Provident Fund contribution by Employer per month	₹ 50,000
Profits over and above target expected by hiring Mr. ABC	10%

You are required to analyze the proposal and see whether it is worthwhile to employ Mr. ABC and also suggest the maximum emoluments that could be paid to him.

Note:

(i) PF contributions are tax exempt.

(ii) Take home salary is that remaining after employee's contribution to PF @ ₹ 50,000 per month and after deduction of Income-tax on salary.

ANSWERS

1. (a) (i) False: As per AS 1 “Disclosure of Accounting Policies”, certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) False: As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(iii) True: To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.

(iv) False: Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

(v) True: As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

(b) As per para 10 of AS 2 'Valuation of Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1. Calculation of net realizable value of by-product, BP

		₹
Selling price of by-product BP	(1,600 units x ₹ 12.5 per unit)	20,000
Less: Separate processing charges of by-product BP		(2,000)
Packing charges		(3,000)
Net realizable value of by-product BP		15,000

2. Calculation of cost of conversion for allocation between joint products MP 1 and MP 2

	₹	₹
Raw material		80,000
Wages		41,000
Fixed overhead		29,000
Variable overhead		20,000
		1,70,000
Less: NRV of by-product BP (See calculation 1)	(15,000)	
Sale value of scrap	(3,000)	(18,000)
Joint cost to be allocated between MP1 and MP2		1,52,000

3. Determination of "basis for allocation" and allocation of joint cost to MP 1 and MP 2

	MP 1	MP 2
Output in units (a)	6,250 units	5,000 units
Sales price per unit (b)	₹ 40	₹ 25
Sales value (a x b)	₹ 2,50,000	₹ 1,25,000
Ratio of allocation	2	1
Joint cost of ₹ 1,52,000 allocated in the ratio of 2:1 (c)	₹ 1,01,333	₹ 50,667
Cost per unit [c/a]	₹ 16.21	₹ 10.13

4. Determination of value of closing inventory of MP 1 and MP 2

	MP 1	MP 2
Closing inventory in units	800 units	200 units
Cost per unit	₹ 16.21	₹ 10.13
Value of closing inventory	₹ 12,968	₹ 2,026

2. (a) Cash Flow Statement of Gagan Ltd. for the year ended March 31, 2018

A	**Cash Flow from Operating Activities**	
	Net Profit as per Profit & Loss A/c	------
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	**Cash Flow from Investing Activities**	
	Interest on Investments [35,000-10,500]	24,500
C	**Cash Flow from Financing Activities**	
	Interest on Debentures paid [11,000 - (1,175 - 275)]	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) + 5% premium]	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

(b) To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Here both the conditions are satisfied. Court order is a conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. The event will be considered as an adjusting event and accordingly the amounts will be adjusted in accounts of 2016-2017.

3. Analysis of Contract Revenue, Contract Costs and Profit/Loss

Particulars	Year 0 Actual	Year 1 Actual	Year 2 Budgeted	Total
Contract Revenue: Initial Revenue				55,000

Variations		700	200	900
Claims		350	500	850
Incentives			500	500
Total Estimated Revenue (A)		1,050	1,200	57,250
Contract Costs:				
Tendering Costs	180			180
Direct Costs				
Employee Benefits: Site Cost		4,000	3,700	7,700
Transport charges		120	110	230
Depreciation		800	800	1,600
Material after Inventory Adjustments		15,000	19,100	34,100
Total Direct Costs (B)	180	19,920	23,710	43,810
Contract Overheads				
Insurance		2,000	2,200	4,200
Design and Technical Assistance		1,000	1,200	2,200
Contract Administration		2,000	2,400	4,400
Total Contract Overhead		5,000	5,800	10,800
Allocation @ 10% (C)		500	580	1,080
Total Costs (B) + (C) = (D)	180	20,420	24,290	44,890
Stage of Completion (By ratio of costs incurred)		45.89%	54.11%	
Estimated Profit (A) - (D)				12,360
Proportionate Contract Revenue 45.89% of (55,000 – 1,050)		25,721	31,529	57,250
Less: Actual Costs (180 + 20,420)		20,600	24,290	44,890
Profit for the Year ended		5,121	7,239	12,360

4. (a) Paragraph 7 of AS 10 states that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, paragraph 9 provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances.

Paragraph 17, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 45 and 47 of AS 10, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment.

The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation

These assets should be presented within the class of asset to which they relate.

(b) ABC Ltd. should recognise the grants in the following manner:

- As per para 6.4 of AS 12, in certain circumstances, a government grant is awarded for the purpose of giving immediate financial support to an enterprise rather than as an incentive to undertake specific expenditure. Such grants may be confined to an individual enterprise and may not be available to a whole class of enterprises. These circumstances may warrant taking the grant to income in the period in which the enterprise qualifies to receive it, as an extraordinary item if appropriate (see AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies). Therefore, ₹ 20 lakhs has been received for immediate start-up of business. This should be recognised in Statement of Profit and Loss immediately as there are no conditions attached to the grant.

- As per para 9.1, grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense. ₹ 50 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate provided that there is reasonable assurance that ABC Ltd. will comply with the conditions attached to the grant.
- As per para 7.1, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per para 8.3 and 8.4 of the standard. Under first method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as follows:

  ₹ 8 lakhs/ 5 years = ₹ 1.60 lakhs per year.

  Under the second method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged.

  ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this cases, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

5. **(a)** As per AS 14, 'Accounting for Amalgamations' consideration for the amalgamation means the aggregate of shares and other securities issued and payment made in form of cash or other assets by the transferee company to the shareholders of the transferor company.

(i) Computation of Purchase Consideration:

	₹
(a) Preference Shares: ₹ 50 per share	
24,000 Preference shares in Som Ltd. @ ₹ 50 per share	12,00,000
(b) Cash	39,000
(c) Equity shares: 56,000 equity shares in Som Ltd. @ ₹ 115 per share	64,40,000
	76,79,000

(ii) **Journal entry**

		₹	₹
Liquidator of Dove Ltd.	Dr.	76,79,000	
To Cash			39,000
To Preference Share Capital A/c			12,00,000
To Equity Share Capital A/c			56,00,000
To Securities Premium A/c [56,000 x 15 (115-100)]			8,40,000
(Payment of cash and issue of shares to the shareholders of Dove Ltd. as purchase consideration)			

(b) **Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'**

As at 31st March, 2017 = ₹ 80,000 x .02 + ₹ 50,000 x .03

= ₹ 1,600 + ₹ 1,500 = ₹ 3,100

As at 31st March, 2018 = ₹ 50,000 x .02 + ₹ 1,80,000 x .03

= ₹ 1,000 + ₹ 5,400 = ₹ 6,400

Amount debited to Profit and Loss Account for year ended 31st March, 2018

	₹
Provision required as on 31.03.2018	6,400

Less: Opening Balance of provision as on 1.4.2017	(3,100)
Amount debited to Profit and Loss account	3,300

Note: No provision will be made on 31st March, 2018 in respect of sales amounting ₹ 80,000 made on 19th January, 2016 as the warranty period of 2 years has already expired.

6. (a) Computation of Unearned Finance Income

As per AS 19 on Leases,

Unearned finance income = Gross investment in the lease – Present value of (minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor)

Where, Gross investment = Minimum lease payments + Unguaranteed residual value

= (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

= [(₹ 5,00,000 × 5 years) + ₹ 1,00,000] + ₹ 1,00,000

= ₹ 27,00,000

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

Year	MLP inclusive of URV	Internal rate of return (Discount factor 15%)	Present Value	
	₹		₹	
1	5,00,000	0.8696	4,34,800	
2	5,00,000	0.7561	3,78,050	
3	5,00,000	0.6575	3,28,750	
4	5,00,000	0.5718	2,85,900	
5	5,00,000	0.4972	2,48,600	
	1,00,000 (guaranteed residual value)	0.4972	49,720	
			17,25,820	(i)
	1,00,000 (unguaranteed residual value)	.4972	49,720	(ii)
		(i) + (ii)	17,75,540	(b)

Unearned Finance Income = (a) – (b)

= ₹ 27,00,000–₹ 17,75,540 = ₹ 9,24,460

Journal Entries in the books of B Ltd.

		₹	₹
At the inception of lease			
Machinery account	Dr.	17,25,820*	
To A Ltd.'s account			17,25,820*
(Being lease of machinery recorded at present value of MLP)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			
A Ltd.'s account	Dr.	5,00,000	
To Bank account			5,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)			
Depreciation account	Dr.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			

*As per para 11 of AS 19, the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of ₹ 20,00,000 is more than the present value amounting ₹ 17,25,820, the machinery has been recorded at ₹ 17,25,820 in the books of B Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

Profit and loss account	Dr.	4,31,455	
To Depreciation account			1,72,582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

Year	Outstanding liability (opening balance) ₹	Lease rent ₹	Finance charge ₹	Reduction in outstanding liability ₹	Outstanding liability (closing balance) ₹
(a)	(b)	(c)	(b) x 15% = (d)	(c)-(d) = (e)	(f) = (b)- (e)
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	78,267	4,21,733	1,00,050*
			8,74,230	16,25,770	

*The difference between this figure and guaranteed residual value (₹ 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

(b) As per an Explanation to para 13 of AS 22 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in AS 22. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹ 400 lakhs depreciation timing difference, amount of ₹ 160 lakhs (₹ 20 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for ₹ 240 lakhs (₹ 400 lakhs – ₹ 160 lakhs), deferred tax liability will be recognised for ₹ 96 lakhs (40% of ₹ 240 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 800 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting ₹ 320 lakhs (40% of ₹ 800 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 416 lakhs (96 lakhs + 320 lakhs).

7. (a) Estimated tax liability on annual income = [Income ₹ 900 lakhs – b/f losses ₹ 315 lakhs (90% of 350)] x 33% = 33% of ₹ 585 lakhs = ₹ 193.05 lakhs

As per para 29(c) of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Thus, estimated weighted average annual income tax rate = ₹ 193.05 lakhs divided by ₹ 900 lakhs=21.45%

Tax expense to be recognised in each quarter	**₹ in lakhs**
Quarter I – ₹ 350 lakhs x 21.45%	75.075
Quarter II – ₹ 150 lakhs x 21.45%	32.175
Quarter III – (₹ 50 lakhs) x 21.45%	(10.725)
Quarter IV – ₹ 450 lakhs x 21.45%	96.525
	193.05

(b) Change Limited amortised ₹ 48,00,000 per annum for the first two years i.e. ₹ 96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	**Net cash flows ₹**	**Amortization Ratio**	**Amortization Amount ₹**
I	-	0.20	48,00,000
II	-	0.20	48,00,000
III	36,00,000	0.180	25,92,000

IV	46,00,000	0.230	33,12,000
V	44,00,000	0.220	31,68,000
VI	40,00,000	0.200	28,80,000
VII	34,00,000	0.170	24,48,000
Total	2,00,00,000	1.000	2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 1,44,00,000 has been amortized in the ratio of net cash flows arising from the product of Change Ltd.

Note: The answer has been given on the basis that the patent is renewable and Change Ltd. got it renewed after expiry of five years.

8. 1. **Identification of Corporate Assets of M Ltd.**

Here, the corporate assets are the headquarter building and the research centre.

For corporate building

Since, the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a 'bottom-up' test is necessary.

For research centre

Since the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual CGU under review. Therefore, a 'top-down' test will be applied **in addition to** the 'bottom-up' test.

2. **Allocation of Corporate Assets**

Since the estimated remaining useful life of A's CGU is 10 years, whereas the estimated remaining useful lives of B and C's CGU are 20 years, the carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit on weight basis.

3. **Calculation of a weighted allocation of the carrying amount of the headquarter building** **(Amount in ₹ lakhs)**

On 31st March, 2018	A	B	C	Total
Carrying amount **(A)**	100	150	200	450
Useful life	10 years	20 years	20 years	
Weight based on useful life	1	2	2	
Carrying amount after weight	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%
	(100/800)	(300/800)	(400/800)	

Allocation of the carrying amount of the building (based on pro-rata above) (**B**)	18.75	56.25	75	150
Carrying amount (after allocation of the building)	118.75	206.25	275	600

4. Calculation of Impairment Losses

(i) Application of 'bottom-up' test **(Amount in ₹ lakhs)**

31st March, 2018	A	B	C
Carrying amount (after allocation of the building) (Refer point 3 above)	118.75	206.25	275
Recoverable amount (given in the question)	199	164	271
Impairment loss	0	(42)	(4)

(ii) Allocation of the impairment losses for cash-generating units B and C

(Amount in ₹ lakhs)

Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

Since the research centre could not be allocated on a reasonable and consistent basis to A, B and C's CGU, M Ltd. compares the carrying amount of the smallest CGU to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount, in accordance with the 'top-down' test.

(iii) Application of the 'top-down' test (Amount in ₹ lakhs)

31st March, 2018	A	B	C	Building	Research centre	M Ltd.
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the 'bottom-up' test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the 'bottom-up' test	100	120	197	137	50	604
Recoverable amount						720

Since recoverable amount is more than the carrying amount of M Ltd., no additional impairment loss has been resulted from the application of the 'top-down' test. Only an impairment loss of ₹ 46 lakhs will be recognized as a result of the application of the 'bottom-up' test.

9. (i) Interest for the period 2017-2018

= US \$ 20 lakhs x 4% × ₹ 65 per US \$ = ₹ 52 lakhs

(ii) Increase in the liability towards the principal amount

= US \$ 20 lakhs × ₹ (65 - 61) = ₹ 80 lakhs.

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US \$ 20 lakhs × ₹ 61 x 10.5% = ₹ 128.1 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing= ₹ 128.1 lakhs - ₹ 52 lakhs = ₹ 76.1 lakhs.

Therefore, out of ₹ 80 lakhs increase in the liability towards principal amount, only ₹ 76.1 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹128.1 lakhs being the aggregate of interest of ₹ 52 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 76.1 lakhs.

Hence, ₹ 128.1 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 3.9 lakhs (₹ 80 lakhs– ₹ 76.1 lakhs) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

10. **(a)** Major Changes in Ind AS 17 vis-à-vis IAS 17 resulting into Carve Out

As per IFRS: IAS 17 requires all leases rentals to be charged to statement of profit and loss on straight-line basis in case of operating leases unless another systematic basis is more representative of the time pattern of the user's benefit even if the payments to the lessor are not on that basis.

Carve out: A carve-out has been made in Ind AS 17 to provide that lease rentals, in case of operating leases, shall be charged to the statement of profit and loss in accordance with the lease agreement unless the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this condition is not met.

Reason: Companies enter into various kinds of lease agreements to get the right to use an asset of the lessor. Considering the Indian inflationary situation, lease agreements contain periodic rent escalation. Accordingly, where there is periodic rent escalation in line with the expected inflation so as to compensate the lessor for expected inflationary cost increases, the rentals shall not be straight-lined.

(b) Major Changes in Ind AS 21 vis-à-vis Notified AS 11

(i) ***Forward Exchange Contracts and other similar Financial Instruments:*** Ind AS 21 excludes from its scope forward exchange contracts and other similar financial instruments, which are treated in accordance with Ind AS 109. AS 11 does not exclude accounting for such contracts.

(ii) ***Exchange Differences arising on Translation of Certain Long-term Monetary Items from Foreign Currency to Functional Currency:*** AS 11, gives an option to recognise exchange differences arising on translation of certain long-term monetary items from foreign currency to functional currency directly in equity, to be transferred to profit or loss over the life of the relevant liability/asset if such items are not related to acquisition of fixed assets. Where such items are related to acquisition of fixed assets, the foreign exchange differences can be recognised as part of the cost of the asset.

Ind AS 21 does not give the above option. However, Ind AS 21 does not apply to long-term foreign currency monetary items recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP, i.e. AS 11. However, as provided in Ind AS 101, such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items as per the previous GAAP.

(iii) ***Approach for Translation:*** AS 11 is based on integral foreign operations and non-integral foreign operations approach for accounting for a foreign operation, whereas Ind AS 21 is based on the functional currency approach.

(iv) ***Presentation Currency:*** As per Ind AS 21, presentation currency can be different from local currency and it gives detailed guidance in this regard, whereas AS 11 does not explicitly state so.

(v) ***Additional Guidance:*** Ind AS 21 includes Appendix B which gives guidance on foreign Currency Transactions and Advance Consideration whereas AS 11 does not contain such guidance.

11. **Journal Entries in the books of H Ltd.**

			₹	₹
1.	Business Purchase A/c	Dr.	96,00,000	
	To Foreign Company (W.N.1)			96,00,000
	(Being business purchased)			
2.	Foreign Company	Dr.	96,00,000	
	To Tax Payable A/c			15,68,000
	To Bank A/c (₹ 40,16,000 + ₹ 20)			40,16,020*
	To Equity Share Capital A/c			13,38,660

* It is assumed that payment of fractional shares has also been routed through Bank A/c along with 50% payment remitted to Foreign Company.

	To Securities Premium A/c			26,77,320
	(Being payment made to foreign company)			
3.	Fixed Assets A/c [72,00,000 – 10%]	Dr.	64,80,000	
	Trade receivables A/c	Dr.	20,00,000	
	Inventories A/c	Dr.	1,00,00,000	
	Cash at Bank A/c	Dr.	8,00,000	
	To Current Liabilities A/c			8,00,000
	To Secured Loan A/c			12,00,000
	To Investment in S Ltd. A/c			24,00,000
	To Business Purchase A/c			96,00,000
	To Capital Reserve A/c (B.F.)			52,80,000
	(Being various assets and liabilities taken over)			
4.	Profit and Loss A/c	Dr.	1,00,000	
	To Inventories A/c			1,00,000
	(Being elimination of unrealized profit i.e. $\frac{6,00,000}{(100+20)} \times 20$ = ₹ 1,00,000)			
5.	Current Liabilities A/c	Dr.	4,00,000	
	To Trade Receivable A/c			4,00,000
	(Being elimination of mutual owing)			
6.	Tax Payable A/c	Dr.	15,68,000	
	To Bank A/c			15,68,000
	(Being tax paid to Government)			

Balance Sheet of H Ltd. (After Absorption)

Particulars	Note No.	(₹)
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	2,13,38,660
(b) Reserves and Surplus	2	3,58,57,320

	(2) **Non-Current Liabilities**		
	Long-term borrowings	3	92,00,000
	(3) **Current Liabilities** ₹ (1,20,00,000 + 8,00,000 – 4,00,000)		1,24,00,000
	Total		7,87,95,980
II.	**Assets**		
	(1) **Non-current assets**		
	(a) Fixed assets		
	Tangible assets	4	3,04,80,000
	(2) **Current assets**		
	(a) Inventories (₹ 1,20,00,000 - ₹ 1,00,000 + ₹ 1,00,00,000)		2,19,00,000
	(b) Trade receivables (₹ 1,40,00,000 – ₹ 4,00,000 + ₹ 20,00,000)		1,56,00,000
	(c) Cash and cash equivalents	5	1,08,15,980
	Total		7,87,95,980

Notes to Accounts

		(₹)	(₹)
1.	Share Capital		
	21,33,866 Shares of ₹ 10 each (out of above, 1,33,866 shares issued for consideration other than cash)		2,13,38,660
2.	Reserves and surplus		
	General Reserve	2,00,00,000	
	Profit & Loss (₹ 80,00,000 – ₹ 1,00,000)	79,00,000	
	Capital Reserve	52,80,000	
	Securities Premium	26,77,320	3,58,57,320
3.	Long Term Borrowings		
	Secured Loan (₹ 80,00,000+₹ 12,00,000)		92,00,000
4.	Tangible Assets		
	Fixed Assets (₹ 2,40,00,000+ ₹ 64,80,000)		3,04,80,000

5.	Cash and cash equivalents Cash at Bank (₹ 1,56,00,000 + ₹ 8,00,000 – ₹ 40,16,020 – ₹ 15,68,000)		1,08,15,980

Working Notes:

1. Amount payable to foreign company & Capital Gain of Foreign Company

Price per share of S Ltd.=₹ 50 + ₹ 10 (Nominal value) = ₹ 60

Value of 40% shares held by foreign company = 40,00,000 x 40% x$\frac{60}{10}$ = ₹ 96,00,000

Capital gain = ₹ 96,00,000 – $\left[16,00,000 \times \frac{11}{10}\right]$ = ₹ 78,40,000

Tax on capital gain = ₹ 78,40,000 × 20% = ₹ 15,68,000

Amount payable to Foreign Company after tax = ₹ 96,00,000 – ₹ 15,68,000
= ₹ 80,32,000

50% of ₹ 80,32,000 = ₹ 40,16,000 to be remitted to foreign company.

2. Intrinsic value of shares of H Ltd. and balance payment to foreign company

	₹	₹
Total assets (Excluding Investment in S Ltd.)		6,56,00,000
Add: Investment in S Ltd. (2,40,000 shares x ₹ 60) (Since they have been purchased from Foreign Co.)		1,44,00,000
		8,00,00,000
Less: Liabilities:		
Secured Loan	80,00,000	
Current Liability	1,20,00,000	(2,00,00,000)
Net Assets		6,00,00,000
No. of equity shares		20,00,000
Intrinsic value per share		₹ 30

Number of shares to be issued for payment of 50% balance amount

$\frac{₹40,16,000}{30} = 1,33,866$ shares

Cash for fractional shares = ₹ 40,16,000 – (1,33,866 x ₹ 30) = ₹ 20

12. Consolidated Balance Sheet as on 31.3.2018

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,00,000
(b) Reserves and Surplus	2	1,20,700
(2) Minority Interest		20,000
(3) Current Liabilities		
(a) Trade Payables	3	23,000
(b) Short Term Provisions	4	24,500
Total		2,88,200
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	2,15,500
(b) Non-current investment	6	17,200
(2) Current assets	7	55,500
Total		2,88,200

Notes to Accounts

			₹
1.	Share Capital		
	Called up equity shares of ₹ 1 each		1,00,000
2.	Reserves and Surplus		
	General Reserve	40,000	
	Profit and Loss A/c (W.N.3)	80,700	1,20,700
3.	Trade Payables		
	Holding & Subsidiary	20,000	
	Joint Venture (50%)	3,000	23,000
4.	Short term provisions		
	Provisions for Tax		
	Holding & Subsidiary	19,000	
	Joint Venture (50%)	5,500	24,500

5.	Tangibles Assets		
	Holding & Subsidiary	1,95,000	
	Joint Venture (50%)	20,500	2,15,500
6.	Non-current investment		
	Investment in Associate (W.N.4)		17,200
7.	Current Asset		
	Holding & Subsidiary	21,000	
	Joint Venture (50%)	34,500	55,500

Working Notes:

1. Analysis of Profit & Loss of Associate / Joint Venture

	Pre-acquisition	Post-acquisition
	₹	₹
Profit as on 31.3.2018 27,000	16,000	11,000
Share of Associate company (20%)	3,200	2,200
Analysis of Profit and Loss of Joint Venture	Nil	83,000
Share of Joint Venture (50%)		41,500

2. Calculation of Goodwill/Capital Reserve

	Associate		Joint Venture	
		₹		₹
Investment		15,000		5,000
Less: Nominal Value	8,000		5,000	
Capital Profit	3,200	(11,200)	-	(5,000)
Goodwill		3,800		Nil

3. Calculation of Consolidated Profit and Loss Account

	₹
Profit and Loss Account of Holding & Subsidiary	37,000
Add: Share of Associate (W.N.1)	2,200
Joint Venture (W.N.1)	41,500
	80,700

4. **Calculation of Investment in Associate**

	₹
Goodwill (W.N.2)	3,800
Net worth	11,200
Cost	15,000
Add: Share of Revenue Profit	2,200
	17,200

Note: Out of ₹ 17,000 existed at the time of acquisition, only ₹ 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, ₹ 16,000 is taken as capital profit assuming that it is a part of that ₹ 17,000 existed at the time of acquisition.

13. 1. **Analysis of the financial instrument issued by S Ltd. to its holding company H Ltd.**

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (i.e., different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since S Ltd has issued preference shares to its Holding Company – H Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by H Ltd. in its subsidiary. This can further be substantiated by the nominal rate of dividend i.e. 0.0001% mentioned in the terms of the instrument issued.

Computations on initial recognition: ₹

Transaction value of the Redeemable preference shares	5,00,00,000
Less: Present value of loan component @ 12% (5,00,00,000 x .7118)	(3,55,90,000)
Investment in subsidiary	1,44,10,000

Subsequently, such preference shares shall be carried at amortised cost at each reporting date as follows:

Year	Date	Opening Balance	Interest @ 12%	Closing balance
	1st April, 2015	3,55,90,000	-	3,55,90,000
1	31st March, 2016	3,55,90,000	42,70,800	3,98,60,800
2	31st March, 2017	3,98,60,800	47,83,296	4,46,44,096
3	31st March, 2018	4,46,44,096	53,55,904*	5,00,00,000

* ₹ 4,46,44,096 x 12% = ₹ 53,57,292. The difference of ₹ 1,388 (₹ 53,57,292 – ₹ 53,55,904) is due to approximation in present value factor.

2. In the books of H Ltd.

Journal Entries to be done at every reporting date

Date	Particulars		Amount	Amount
1st April, 2015	Investment (Equity portion)	Dr.	1,44,10,000	
	Redeemable Preference Shares	Dr.	3,55,90,000	
	To Bank			5,00,00,000
	(Being initial recognition of transaction recorded)			
31st March, 2016	Redeemable Preference Shares	Dr.	42,70,800	
	To Interest income			42,70,800
	(Interest income on loan component recognized)			
31st March, 2017	Redeemable Preference Shares	Dr.	47,83,296	
	To Interest income			47,83,296
	(Interest income on loan component recognized)			
31st March, 2018	Redeemable Preference Shares	Dr.	53,55,904	
	To Interest income			53,55,904
	(Interest income on loan component recognized)			

31st March, 2018	Bank	Dr.	5,00,00,000	
	To Redeemable Preference Shares			5,00,00,000
	(Being settlement of transaction done at the end of the third year)			

14. The employee share-based payment plan granted by the enterprise has two components, viz., (i) a liability component, i.e., the employees' right to demand settlement in cash, and (ii) an equity component, i.e., the employees' right to demand settlement in shares rather than in cash. The enterprise measures, on the grant date, the fair value of two components as below:

Fair value under equity settlement	
1,200 shares x ₹ 48 =	₹ 57,600
Fair value under cash settlement	
1,000 shares x ₹ 50 =	₹ 50,000
Fair value of the equity component	
(₹ 57,600 – ₹ 50,000) =	₹ 7,600
Fair value of the liability component	₹ 50,000

Calculation of expenses to be recognised in respect of the liability component at the end of each year as below:

Year 1	
Provision required at the year-end	
1,000 x ₹ 52.00 x 1/3 =	₹ 17,333
Less: provision at the beginning of the year	Nil
Expense for the year	₹ 17,333
Year 2	
Provision required at the year-end	
1,000 x ₹ 55.00 x 2/3 =	₹ 36,667
Less: provision at the beginning of the year	₹ 17,333
Expense for the year	₹ 19,334
Year 3	
Provision required at the year-end	
1,000 x ₹ 60.00 =	₹ 60,000

Less: provision at the beginning of the year	₹ 36,667
Expense for the year	₹ 23,333

The expense to be recognised in respect of the equity component at the end of each year is one third of the fair value (₹ 7,600) determined at (1) above.

Journal Entries

Year 1	Employee compensation expense A/c	Dr.	17,333	
	To Provision for liability component of employee share-based payment plan			17,333
	(Being compensation expense recognised in respect of liability component of employee share-based payment plan with cash alternative)			
	Employee compensation expense A/c	Dr.	2,533	
	To Stock Options Outstanding A/c			2,533
	(Being compensation expense recognised in respect of equity component of employee share-based payment plan with cash alternative)			
Year 2	Employee compensation expense A/c	Dr.	19,334	
	To Provision for liability component of employee share-based payment plan			19,334
	(Being compensation expense recognised in respect of liability component of employee share-based payment plan with cash alternative)			
	Employee compensation expense A/c	Dr.	2,533	
	To Stock Options Outstanding A/c			2,533
	(Being compensation expense recognised in respect of equity component of employee share-based payment plan with cash alternative)			
Year 3	Employee compensation expense A/c	Dr.	23,333	
	To Provision for liability component of employee share-based payment plan			23,333
	(Being compensation expense recognised in respect of liability component of employee share-based payment plan with cash alternative)			
	Employee compensation expense A/c	Dr.	2,533	
	To Stock Options Outstanding A/c			2,533

	(Being compensation expense recognised in respect of equity component of employee share-based payment plan with cash alternative)			
On settlement of the employee share-based payment plan				
	Scenario 1: The cash alternative			
	Provision for liability component of employee share-based payment plan	Dr	60,000	
	To Bank A/c			60,000
	(Being cash paid on exercise of cash alternative under the employee share-based payment plan)			
	Stock Options Outstanding A/c	Dr.	7,600	
	To General Reserve			7,600
	(Being the balance standing to the credit of the Stock Options Outstanding Account transferred to the general reserve upon exercise of cash alternative)			
	Scenario 2: The equity alternative			
	Stock Options Outstanding A/c	Dr.	7,600	
	Provision for liability component of employee share-based payment plan	Dr.	60,000	
	To Share Capital A/c (1,200 shares x ₹ 10)			12,000
	To Securities Premium A/c			55,600
	(Being shares issued on exercise of equity alternative under the employee share-based payment plan)			

15.

Allocation of Earnings	**Old Unit Holders**	**New Unit Holders**	**Total**
	[54 lakhs units]	**[6 lakhs units]**	
	₹ in lakhs	**₹ in lakhs**	**₹ in lakhs**
First half year (₹ 5 per unit)	270.00	Nil	270.00
Second half year (₹ 3.60 per unit)	194.40	21.60	216.00
	464.40	21.60	486.00
Add: Equalization payment recovered	-	-	30.00

Total available for distribution @ ₹ 8.60 per unit Equalization Payment - ₹ 270 lakhs ÷54 lakhs = ₹ 5 per unit			516.00
		Old Unit Holders ₹	**New Unit Holders ₹**
Dividend distributed		8.60	8.60
Less: Equalization payment		-	(5.00)
		8.60	3.60

Journal Entries

			(₹ in lakhs)
30.9.2017	Bank A/c Dr.	450.00	
	To Unit Capital		60.00
	To Reserve		360.00
	To Dividend Equalization		30.00
	(Being the amount received on sale of 6 lakhs unit at a NAV of ₹ 70 per unit)		
31.3.2018	Dividend Equalization Dr.	30.00	
	To Revenue A/c		30.00
	(Being the amount transferred to Revenue Account)		
30.9.2018	Revenue A/c Dr.	516.00	
	To Bank		516.00
	(Being the amount distributed among 60 lakhs unit holders @ ₹ 8.60 per unit)		

16. (i) Intrinsic value on the basis of book values

	₹ in lakhs	₹ in lakhs
Fixed Assets		3,862
Current Assets		970
Loans and Advances		311
		5,143
Less: Secured loans	1,500	

Current liabilities	414	
Provisions	320	(2,234)
		2,909
Add: Notional call on 30 lakhs equity shares @ ₹ 2 per share		60
		2,969

Equivalent number of equity shares of ₹ 10 each.

	No. of Equity shares
Fully paid shares of ₹ 10 each	60
Partly-paid shares after notional call	30
Fully paid shares of ₹ 5 each $\left[\frac{50\text{ lakhs}}{10} \times 5\right]$	25
	115

Value per equivalent share of ₹ 10 each = $\frac{2{,}969 \text{ lakhs}}{115 \text{ lakhs}}$ = ₹ 25.82

Hence, intrinsic values of each equity share are as follows:

Value of fully paid share of ₹ 10 = ₹ 25.82 per equity share.

Value of share of ₹ 10, ₹ 8 paid-up = ₹ 25.82 – ₹ 2 = ₹ 23.82 per equity share.

Value of fully paid share of ₹ 5 = $\frac{25.82}{2}$ = ₹ 12.91 per equity share.

(ii) Valuation on dividend yield basis:

Value of fully paid share of ₹ 10 = $\frac{20}{15} \times 10 =$ ₹ 13.33

Value of share of ₹ 10, ₹ 8 paid-up = $\frac{20}{15} \times 8 =$ ₹ 10.67

Value of fully paid share of ₹ 5 = $\frac{20}{15} \times 5 =$ ₹ 6.67

(iii) Valuation on the basis of EPS:

Profit after tax = ₹ 457 lakhs

Total share capital = ₹ (600 + 240 + 250) lakhs = ₹ 1,090 lakhs

Earning per rupee of share capital = $\frac{457 \text{ lakhs}}{1{,}090 \text{ lakhs}}$ ₹ 0.419

Earning per fully paid share of ₹ 10 = ₹ 0.419 × 10 = ₹ 4.19

Earning per share of ₹ 10 each, ₹ 8 paid-up = ₹ 0.419 × 8 = ₹ 3.35

Earning per share of ₹ 5, fully paid-up = ₹ 0.419 × 5 = ₹ 2.10

Value of fully paid share of ₹ 10 = $\frac{4.19}{2} \times 10 =$ ₹ 20.95

Value of share of ₹ 10, ₹ 8 paid-up = $\frac{3.35}{2} \times 10 =$ ₹ 16.75

Value of fully paid share of ₹ 5 = $\frac{2.10}{2} \times 10 =$ ₹ 10.50

17. Computation of value of business of Nishtha Ltd.

Particulars	**₹**
Profit before tax for the year ended 31.3.2018 = $\frac{60,00,000}{100\% - 40\%}$	1,00,00,000
Adjustments in respect of non-recurring items	
Less: Subsidy income not receivable in future	(4,00,000)
Add: Interest on term loan not payable in future	10,00,000
Less: Additional managerial remuneration	(8,00,000)
Add: Loss on sale of fixed assets and investments (non-recurring)	10,00,000
Future Maintainable Profits before Tax	1,08,00,000
Less: Tax expense @ 45%	(48,60,000)
Future Maintainable Profit after Tax attributable to Equity	59,40,000
Value of business = $\frac{\text{Future Maintainable Profits}}{\text{Capitalisation Rate}} = \frac{59,40,000}{12.5\%}$	4,75,20,000

Working Note:

Computation of Capitalisation Rate		**₹**
(a)	Profit after tax for the year ended 31.3.2018	60 lakh
(b)	Number of equity shares $\frac{₹\ 200\ \text{lakh}}{₹\ 50\ \text{per share}}$	4 lakh
(c)	Earnings per share (EPS) = $\frac{\text{PAT}}{\text{Number of equity shares}}$	15
(d)	Market Price per share (MPS) on balance sheet date	120

(e)	Price earnings ratio= $\frac{MPS}{EPS} = \frac{120}{15}$	8
(f)	Capitalisation rate = $\frac{1}{\text{PE Ratio}} \times 100 = \frac{1}{8} \times 100$	12.5%

18. 1. Calculation of Target index

	(₹ in lakhs)				
Year	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Employees cost	520	480	450	600	750
Value added	1,100	1,170	960	1,290	1,700
Percentage of 'Employee cost' to 'Value added' (to the nearest whole number)	47%	41%	47%	47%	44%

Target index percentage is taken as least of the above from companies viewpoint on conservative basis i.e. 41%.

2. Value Added Statement for the year 2017-2018

	(₹ in lakhs)	**(₹ in lakhs)**
Sales		5,970
Less: Cost of bought in goods & services		
Material consumed	1,950	
Production expenses	500	
Administrative expenses	200	
Selling expenses	350	(3,000)
Added value		2,970

3. Employee cost for 2017-2018

	(₹ in lakhs)
Wages	400
Production salaries	130
Administrative salaries	150
Selling salaries	120
	800

4. Calculation of target employee cost = Target Index Percentage x Value added

= 41% x ₹ 2,970 lakhs = ₹ 1217.70 lakhs

5. **Calculation of savings**

Target employee cost	=	₹ 1,217.70 lakhs
Less: Actual Cost	=	₹ 800.00 lakhs
Saving	=	₹ 417.70 lakhs

6. **Calculation of Variable incentive for the year 2016-17:**

70% of saving is variable incentive = 70% x ₹ 417.70 lakhs = ₹ 292.39 lakhs.

19. **Calculation of Economic Value Added**

	₹
Net Operating Profit After Tax	25,00,000
Less: Cost of capital employed (Refer W.N.)	(6,00,000)
Economic Value Added	19,00,000

Economic value added is greater than zero. Therefore, the company qualifies for the loan.

Working Note:

Calculation of Cost of Capital employed	₹
Average total assets	75,00,000
Less: Average current liabilities	(15,00,000)
Capital employed	60,00,000

Cost of capital = Capital employed x Weighted average cost of capital

$$= ₹\ 60,00,000 \times \frac{10}{100} = ₹\ 6,00,000$$

20. **Cost to Company in employing Mr. ABC**

	₹
Salary before tax ₹ 4,00,000 x 12 = $\frac{48,00,000}{0.75}$	64,00,000*
Add: Employee's PF contribution (50,000 x 12)	6,00,000
	70,00,000
Add: Employer's PF contribution (50,000 x 12)	6,00,000
	76,00,000

Capital base

	₹
Equity Share Capital paid up (5,00,000 shares of ₹ 75 each)	3,75,00,000
Less: Calls in arrears	(1,00,000)
	3,74,00,000
General Reserve	10,00,000
Profit & Loss A/c (balance) at the beginning of the year	(25,00,000)
Loss for the year	(1,80,000)
8% Debentures	80,00,000
Capital base	4,37,20,000
Target Profit 12.5% of capital base (4,37,20,000)	54,65,000
Profits achieved due to Mr. ABC 54,65,000 + 10% (54,65,000)	60,11,500

Maximum emoluments that can be paid to Mr. ABC = 60,11,500

Thus, the company is advised not to hire him as his CTC ₹ 76,00,000 is more than ₹ 60,11,500.