PAPER – 1 : FINANCIAL REPORTING

*Question No.**1** is compulsory. Candidates are required to answer any **five** questions from the remaining **six** questions.*

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Question 1

(a) *U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and moderrnisation of its Factory on 1st April, 2018. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 2019. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets which were also received and installed before 30th April, 2019 and the balance loan of ₹ 56 lacs has been used for working capital purposes.*

The company has paid total interest of ₹ 68.20 lacs during financial year 2018-2019 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 2019? **(5 Marks)**

(b) *From the following information, prepare extract of Balance Sheet of A Limited along with notes making necessary compliance of Schedule III to the Companies Act, 2013:*

		Amount (₹)
Loan Funds		
(a) Secured Loans		18,12,000
(b) Unsecured Loan-Short term from bank		2,25,000
Other information is as under:		
Secured Loans		
Term Loans from:		
Banks		8,95,000
Others		9,17,000
		18,12,000
Current Maturities of long-term loan from Bank		1,24,000
Current Maturities of long- term loan from Others		85,000

There was no interest accrued / due as at the end of the year. **(5 Marks)** *(c) From the following information prepare the Cash Flow from Financing activities as per AS 3 'Cash Flow Statement' as the accountant of XYZ Limited is not able to decide and seeks your advice:*

(i) Received ₹ 4,00,000 as redemption of short-term deposit

(ii) Proceeds of ₹ 20,00,000 from issuance of equity share capital

(iii) Received Government Grant of ₹ 7,00,000 for capital project

(iv) An amount of ₹ 13,00,000 incurred for purchase of goodwill

(v) Proceeds of ₹ 5,00,000 from sale of patent.

(vi) Proceeds of ₹ 12,00,000 from long term borrowing.

(vii) Amount paid for redemption of debentures of ₹ 22,00,000

(viii) Underwriting commission of ₹ 40,000 paid on issue of equity share capital

(ix) Interest of ₹ 1,44,000 paid on long-term borrowing

(x) Investment in marketable securities of ₹ 3,00,000 which are made for meeting short-term commitments. ***(5 Marks)***

(d) Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

(i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2020 failing which it will have to pay a penalty of ₹ 10 per item not supplied. On 31st March, 2020 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2020.

(ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

(iii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

(iv) The company gives a 1-year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

(5 Marks)

Answer

(a) Borrowing Cost: As per AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

Qualifying Asset: A qualifying asset is an asset that necessarily takes a substantial period of time (ordinarily, a period of twelve months unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case) to get ready for its intended use or sale.

(i) When construction of asset completed on 30th April, 2019

The treatment for total borrowing cost of ₹ 68.20 lakhs will be as follows:

Purpose	***Nature***	***Interest to be capitalised***	***Interest to be charged to profit and loss account***
		₹ in lakhs	***₹ in lakhs***
Modernisation and renovation of plant and machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to suppliers for additional assets	Assumed as Qualifying asset (Refer Note)	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset	____	[68.20 x (56/620)] = 6.16
		62.04	**6.16**

Note: Date of receipt of additional asset has not been given in the question. In such a case, it is assumed that the asset has taken substantial period of time in its installation. Hence, additional asset has also been considered as a qualifying asset.

Alternatively, the additional asset may be assumed to be non-qualifying asset on the basis that it was ready for use at the time of receipt and installation did not take substantial period of time.

(ii) When construction of assets is completed by 28th February, 2019

In the alternative scenario, when the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took substantial period of time for completing their construction) and the whole of interest will be required to be charged off / expensed off to Profit and loss account.

(b) **Extract of Balance Sheet of A Ltd.**

Particulars	Note No	Amount
Non - Current Liabilities		
Long term borrowings	1	16,03,000
Current Liabilities		
Short term borrowings	2	2,25,000
Other current liabilities	3	2,09,000

Notes to Accounts

1.	**Long-Term Borrowings**	
	Term loans – Secured	
	- From banks	8,95,000
	- From other parties	9,17,000
		18,12,000
	Less: Current maturities of long-term debt (Refer Note 3)	(2,09,000)
		16,03,000
2.	**Short-Term Borrowings**	
	(Unsecured loan)	
	- from bank	2,25,000
3.	**Other Current Liabilities**	
	Current maturities of long-term debt	
	- From banks	1,24,000
	- From others	85,000
		2,09,000

Note: It is assumed that current maturities of long-term loans of Rs. 2,09,000 are included in the value of secured loans of Rs. 18,12,000.

(c) Statement showing Cash Flow from Financing Activities

		₹
Cash inflow from financing activity		
Proceeds from issuance of equity share capital	20,00,000	
Proceeds from long term borrowings	12,00,000	
Total cash inflow from financing activity		32,00,000
***Less:* Cash outflow from financing activity**		
Amount paid for redemption of debentures	22,00,000	
Underwriting commission paid	40,000	
Interest paid on long-term borrowings	1,44,000	(23,84,000)
Net cash inflow from financing activity		8,16,000

Note: In the above solution, it is assumed that the Government grant of ₹ 7,00,000 has been given for capital project. Hence the same has been treated as 'Investing Activity" and not included in the above statement. **Alternatively,** Government grant of ₹ 7,00,000 received by the company may be classified as cash flows from financing activities on the ground that the grant represents a source of financing for the entity and the government is acting as a capital provider. The above answer will change accordingly.

(d) Principles for recognition of provisions:

As per AS 29, "a provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

(i) In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2020 and there is no delay as at 31st March, 2020. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

(ii) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(iii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognised on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

(iv) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognised for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty case to be occurred to the entity as per past experience

= 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair / replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

Question 2

The summarized balance sheets of Truth Limited and Myth Limited as on 31.03.02019 is given below. Myth Limited is to be merged with Truth Limited from 1.04.2019. The merger is to be carried out in the nature of purchase.

Particulars	*Note No.*	*Truth Ltd. (₹)*	*Myth Ltd. (₹)*
*(1) **Equity and Liabilities***			
1. Shareholders' Funds			
(a) Share Capital	*1*	*10,00,000*	*4,00,000*
(b) Reserves and Surplus	*2*	*11,35,000*	*4,13,000*
2. Non -Current Liabilities	*3*	*-*	*1,50,000*
3. Current Liabilities	*4*	*1,40,000*	*1,82,000*
Total		*22,75,000*	*11,45,000*
*(2) **Assets***			
1. Non -Current Assets			
(a) Property, Plant & Equipment		*15,75,000*	*6,80,000*
(b) Investments		*1,87,500*	*1,00,000*
2. Current Assets	*5*	*5,12,500*	*3,65,000*
Total		*22,75,000*	*11,45,000*

Note No.	Particulars	Truth Limited (₹)	Myth Limited (₹)
1	**Share Capital**		
	Equity shares of ₹ 10 each	10,00,000	4,00,000
2	**Reserves & Surplus**		
	General Reserve	5,05,000	2,30,000
	Profit & Loss A/c	4,45,000	1,58,000
	Export Profit Reserve	1,85,000	25,000
		11,35,000	4,13,000
3	**Non- Current Liabilities**		
	14% Debentures	---	1,50,000
4	**Current Liabilities**		
	Trade Payables	90,000	1,42,000
	Other Current Liabilities	50,000	40,000
		1,40,000	1,82,000
5	**Current Assets**		
	Inventory	2,15,000	85,000
	Trade Receivables	2,02,500	1,75,000
	Cash and Cash equivalents	95,000	1,05,000
		5,12,500	3,65,000

Truth Limited would issue 12% debentures to discharge the claim of the debenture holders of Myth Limited so as to maintain their present annual interest income. Non-trade investment, which constitute 80% of their respective total investments yielded income of 20% to Truth Limited and 15% to Myth Limited. Profit before tax of both the companies during the last 3 years were as follows:

	Truth Limited (₹)	Myth Limited (₹)
2016-2017	8,20,000	2,55,000
2017-2018	7,45,000	2,15,000
2018-2019	6,04,000	2,14,000

Goodwill is to be calculated on the basis of Capitalization method taking 18% as normal rate of return. Ignore taxation. Purchase consideration is to be discharged by Truth Limited on the basis of intrinsic value per share. Prepare Balance Sheet of Truth Limited after the merger.

(16 Marks)

Answer

Balance Sheet of Truth Ltd. (after merger with Myth Ltd.) as at 1.4.2019

Particulars	*Note No.*	*(₹)*
I. **Equity and liabilities**		
(1) **Shareholder's funds**		
(a) Share capital	1	13,13,750
(b) Reserves and surplus	2	20,76,250
(2) **Non-current liabilities**		
12% Debentures	3	1,75,000
(3) **Current liabilities**		
(a) Trade payables	4	2,32,000
(b) Other current liabilities	5	90,000
Total		38,87,000
II. **Assets**		
(1) **Non-current assets**		
(a) Property, plant and equipment	6	22,55,000
(b) Intangible assets (Goodwill) [WN 1]		4,67,000
(c) Non-current investments	7	2,87,500
(2) **Current assets**		
(a) Inventories (2,15,000 + 85,000)		3,00,000
(b) Trade receivables (2,02,500 + 1,75,000)		3,77,500
(c) Cash & cash equivalents (95,000 + 1,05,000)		2,00,000
Total		38,87,000

Notes to Accounts

		(₹)	(₹)
1.	**Share Capital**		
	1,31,375 Equity Shares of ₹ 10 each [1,00,000+31,375]		13,13,750
	(of the above shares, 31,375 shares were issued to the vendors otherwise than for cash)		
2.	**Reserves and surplus**		
	General Reserve	5,05,000	
	Profit and Loss A/c	4,45,000	

	Securities Premium [31,375 x 30]		9,41,250	
	Export profit reserve	1,85,000		
	Add: Balance of Myth Ltd.	25,000	2,10,000	
	Amalgamation Adjustment Reserve		(25,000)	20,76,250
3.	**Long Term Borrowings**			
	12% Debentures issued to Myth Ltd.			1,75,000
4.	**Trade payables**			
	Trade payables		90,000	
	Add: Taken over		1,42,000	2,32,000
5	**Other Current Liabilities**			
	Truth Ltd.		50,000	
	Myth Ltd.		40,000	90,000
6.	**Property, Plant & Equipment**			
	Truth Ltd.		15,75,000	
	Myth Ltd.		6,80,000	22,55,000
7.	**Investment**			
	Truth Ltd.		1,87,500	
	Myth Ltd.		1,00,000	2,87,500

Working Notes:

(1) Valuation of Goodwill

(i) Capital Employed

		Truth Ltd.		**Myth Ltd.**
	₹	₹	₹	₹
Assets as per Balance Sheet		22,75,000		11,45,000
Less: Non-trade Investment		(1,50,000)		(80,000)
		21,25,000		10,65,000
Less: Liabilities:				
14% Debentures	-		1,50,000	
Trade payables	90,000		1,42,000	
Other current liabilities	50,000	(1,40,000)	40,000	(3,32,000)
Capital Employed		19,85,000		7,33,000

(ii) Average Profit before Tax

		Truth Ltd.		Myth Ltd.
2016-2017		8,20,000		2,55,000
2017-2018		7,45,000		2,15,000
2018-2019		6,04,000		2,14,000
Total profit of 3 years (a)		21,69,000		6,84,000
Simple Average [(a)/3]		7,23,000		2,28,000
Less: Non-trading income*		(30,000)		(12,000)
		6,93,000		2,16,000
(iii) *Goodwill*				
Capitalised value of average profit*	[(6,93,000 / 18) x 100]	38,50,000	[(2,16,000 / 18) x 100]	12,00,000
Less: Capital Employed [From (i) above]		(19,85,000)		(7,33,000)
Goodwill		18,65,000		4,67,000

* For Truth Ltd. = 1,87,500 x 80% x 20% = 30,000; and

Myth Ltd. = 1,00,000 x 80% x 15% = 12,000

***Note:** Simple average of three years profit has been capitalized to compute goodwill. Alternatively, weighted average of three years profit may be taken for computation of goodwill. The answer will change accordingly.

(2) Intrinsic Value per Share

		Truth Ltd. ₹		Myth Ltd. ₹
Goodwill [W.N. 1]	18,65,000		4,67,000	
Other Assets	22,75,000	41,40,000	11,45,000	16,12,000
Less: Liabilities				
12% Debentures	-		1,75,000**	
Trade payables	90,000		1,42,000	
Provision for Tax	50,000	(1,40,000)	40,000	(3,57,000)
Net Assets		40,00,000		12,55,000
Intrinsic value per share [Net Assets / No. of Shares]		40,00,000 / 1,00,000		12,55,000 / 40,000
		= ₹ 40		= ₹ 31.375

** $1,50,000 \times \frac{14\%}{12\%} = 1,75,000$

(3) Purchase Consideration & manner of its discharge

Intrinsic Value of Myth Ltd. [a]	₹ 31.375 per share
No. of shares [b]	40,000 shares
Purchase Consideration c= [a x b]	₹ 12,55,000
Intrinsic Value of Truth Ltd. [d]	₹ 40 per share
No. of shares to be issued [c / d]	31,375 shares

Question 3

The summarized Balance Sheets of Day Limited and Night Limited as on 31st March, 2020 are as under:

	Day Limited (₹)	**Night Limited (₹)**
Liabilities		
Equity shares of ₹ 10 each	*65,00,000*	*25,00,000*
General Reserve	*7,30,000*	*4,40,000*
Profit and Loss A/c	*10,20,000*	*8,20,000*
Trade Payables	*5,50,000*	*3,15,000*
	88,00,000	*40,75,000*
Assets		
Plant and Equipment	*20,50,000*	*8,40,000*
Furniture & Fittings	*10,00,000*	*5,10,000*
Investments	*36,25,000*	*11,50,000*
Inventory	*9,70,000*	*7,60,000*
Trade Receivables	*7,80,000*	*5,50,000*
Cash at Bank	*3,75,000*	*2,65,000*
	88,00,000	*40,75,000*

Day Limited acquired 30% of the paid-up share capital of Night Limited as on 1st April, 2018 at a price of ₹ 12 per share. The next lot of 40% shares were purchased on 1st April, 2019 from a foreign company.

The price per share for this purpose was calculated by capitalizing the yield @ 15%. The yield is to be taken as 50% of pre-tax profit for the last 3 years, which were ₹ 17,00,000 ₹ 15,50,000 and ₹ 12,50,000 respectively.*

Other information:

(1) On 1st April, 2019, General Reserve and Profit and Loss Account of Night Limited had credit balances of ₹ 3,50,000 and ₹ 6,00,000 respectively.

(2) Night Limited declared and paid dividend of 10% for the year 2018-2019 out of its Profit and Loss account balance as on 1st April, 2019. Day Limited credited the dividend received to Profit and Loss account.

(3) On 1st April, 2019, Plant and Machinery of Night Limited was undervalued by ₹ 1,80,000. Applicable depreciation rate is 10%.

Prepare a consolidated Balance Sheet of Day Limited as on 31st March, 2020. ***(16 Marks)***

Answer

Consolidated Balance Sheet of Day Ltd. and its subsidiary Night Ltd.

As on 31st March, 2020

Particulars	*Note No.*	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital	1	65,00,000
Reserves and Surplus	2	20,29,400
(2) Minority Interest (W.N.3)		11,76,600
(3) Current Liabilities		
Trade payable	3	8,65,000
Total		1,05,71,000
II. Assets		
(1) Non-current Assets		
Property, Plant and Equipment (W.N.6)	4	45,62,000
Intangible assets	5	4,34,000
Investment	6	18,75,000

* **PS:** Read '50% of pre-tax profit for the last 3 years' as '50% of average of pre-tax profit for the last 3 years'.

(2)	**Current assets**		
	Inventories	7	17,30,000
	Trade Receivables	8	13,30,000
	Cash and Cash equivalents	9	6,40,000
Total			1,05,71,000

Notes to Accounts

			₹
1.	**Share Capital**		
	Authorised, Issued, Subscribed and Paid up		
	6,50,000 Equity shares of ₹10 each		65,00,000
2.	**Reserves and Surplus**		
	General Reserve (W.N.5)	7,93,000	
	Profit & Loss Account (W.N.5)	12,36,400	20,29,400
3.	**Trade payables**		
	Day Ltd.	5,50,000	
	Night Ltd.	3,15,000	8,65,000
4.	**Property, plant and equipment**		
	Plant and Equipment (W.N.6)	30,52,000	
	Furniture and Fixtures (10,00,000 + 5,10,000)	15,10,000	45,62,000
5.	**Intangible assets**		
	Goodwill (W.N.4)		4,34,000
6.	**Investment**		
	Day Ltd. (36,25,000 – 29,00,000)	7,25,000	
	Night Ltd.	11,50,000	18,75,000
7.	**Inventories**		
	Day Ltd.	9,70,000	
	Night Ltd.	7,60,000	17,30,000
8.	**Trade Receivables**		
	Day Ltd.	7,80,000	
	Night Ltd.	5,50,000	13,30,000

9.	**Cash and Cash equivalents**		
	Day Ltd.	3,75,000	
	Night Ltd.	2,65,000	6,40,000

Working Notes:

1. Calculation of purchase consideration

1st lot of acquisition = 30% of 25,00,000 / 10 = 75,000 shares

Purchase consideration paid for acquiring 75,000 shares = 75,000 x ₹ 12 = ₹ 9,00,000

2nd lot of acquisition = 40% of 25,00,000/10 = 1,00,000 shares

Yield = 50% of average pre-tax profit of past three years

= [{(17,00,000 + 15,50,000 + 12,50,000)/3} x 50%] = 7,50,000

Total Price of 2,50,000 shares = Capitalisation of yield @ 15%

= 7,50,000 / 15% = 50,00,000

Price per share = 50,00,000 / 2,50,000 = ₹ 20 per share.

Purchase consideration paid for acquiring 1,00,000 shares = ₹ 20 x 1,00,000 = ₹ 20,00,000

Total consideration for 70% shares ie 1,75,000 shares (75,000 + 1,00,000)

= ₹ 9,00,000 + ₹ 20,00,000 = ₹ 29,00,000.

2. Analysis of Reserves and Surplus of Night Ltd.

			Pre-acquisition	Post-acquisition	
			Profits	General Reserve	Profit & Loss Account
			₹	₹	₹
General Reserve		4,40,000			
Less: Pre-acquisition		(3,50,000)	3,50,000		
Post-acquisition reserve		90,000		90,000	
Profit & Loss Account		8,20,000			
Less: Pre-acquisition	6,00,000				
Less: Dividend	(2,50,000)	(3,50,000)	3,50,000		
Post-acquisition profit		4,70,000			4,70,000
Revaluation of plant and machinery (upward)			1,80,000		

Additional depreciation due to upward revaluation			(18,000)
	8,80,000	90,000	4,52,000
Day Ltd. (70%)	6,16,000	63,000	3,16,400
Minority Interest (30%)	2,64,000	27,000	1,35,600

3. Minority Interest

	₹
Share Capital (30%)	7,50,000
Add: Share of pre-acquisition profit of Night Ltd.	2,64,000
Share of post-acquisition General Reserve	27,000
Share of post-acquisition Profit & Loss Account	1,35,600
	11,76,600

4. Cost of Control/Goodwill

			₹
Cost of investments (W.N.1)		29,00,000	
Less:	Dividend wrong credited to Profit and Loss A/c (25,00,000x 10% x 40%)	(1,00,000)	28,00,000
Less:	Share capital (70%)		(17,50,000)
	Share of pre-acquisition profit		(6,16,000)
Goodwill			4,34,000

5. Consolidated General Reserve & Profit and Loss Account

		General Reserve	*Profit and Loss*
		₹	₹
Day Ltd.		7,30,000	10,20,000
Less:	Share of dividend received by Night Ltd.		(1,00,000)
		7,30,000	9,20,000
Add:	Share in post-acquisition item of Night Ltd.	63,000	3,16,400
		7,93,000	12,36,400

6. Plant and Machinery as on 31st March, 2020

		₹
Balance in the books of Day Ltd.		20,50,000
Balance in the books of Night Ltd.	8,40,000	
Add: Upward Revaluation	1,80,000	
	10,20,000	
Less: Additional depreciation	(18,000)	10,02,000
		30,52,000

Question 4

(a) *Write short note on 'Financial Liability' as per Ind AS 32.* ***(4 Marks)***

(b) *What are the major changes in Ind AS 10 vis a vis AS 4?* ***(4 Marks)***

(c) *On 1st April, 2016, PS Limited issued 6,000, 9% convertible debentures with a face value of ₹ 100 each maturing on 31st March, 2021. The debentures are convertible into equity shares of PS Limited at a conversion price of ₹ 105 per share. Interest is payable annually in cash. At the date of issue, non-convertible debt could have been issued by the company at coupon rate of 13%. On 1st April, 2019, the convertible debentures have a fair value of ₹ 6,30,000. PS Limited makes a tender offer to debenture-holders to repurchase the debentures for ₹ 6,30,000 which the debenture holders accepted. At the date of repurchase, PS Limited could have issued non-convertible debt with a 2 year term bearing coupon interest @ 10%.*

Show accounting entries in the books of PS Limited for recording of equity and liability component:

(i) At the time of initial recognition

(ii) At the time of repurchase of the convertible debentures

The following present values of ₹ 1 at 9%, 10% and 13% are given:

Interest rate Year	***1***	***2***	***3***	***4***	***5***
9%	*0.917*	*0.842*	*0.772*	*0.708*	*0.650*
10%	*0.909*	*0.826*	*0.751*	*0.683*	*0.621*
13%	*0.885*	*0.783*	*0.693*	*0.613*	*0.543*

(8 Marks)

Answer

(a) A financial liability is any liability that is:

(a) A contractual obligation:

i to deliver **cash** or **another financial asset** to another entity; **or**

ii to exchange financial assets or financial liabilities with another entity under conditions that are **potentially unfavourable** to the entity; **or**

(b) a contract that will or may be settled in the entity's own equity instruments and is:

i. a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, it excludes rights, options or warrants used to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency since they are equity instruments if the entity offers the rights, options or warrants pro-rata to all of its existing owners of the same class of its own non-derivative equity instruments.

(b) Major Changes in Ind AS 10 vis-à-vis AS 4

S. No.	**Particular**	**Ind AS 10**	**AS 4**
1.	Non adjusting events if material	Material non-adjusting events are required to be disclosed in the financial statements.	Material non-adjusting events are required to be disclosed in the report of approving authority.
2.	Accounting treatment and disclosure in case of inappropriateness of fundamental accounting assumption of going concern	If, after the reporting date, it is determined that the fundamental accounting assumption of going concern is no longer appropriate, Ind AS 10 requires a fundamental change in the basis of accounting.	AS 4 requires assets and liabilities to be adjusted for events occurring after the balance sheet date that indicate that the fundamental accounting assumption of going concern is not appropriate.
		Ind AS 10 refers to Ind AS 1, which requires an entity to make the following disclosure: *"Disclose the fact that the financial statements are*	AS 4 does not require any such disclosure. However, AS 1 requires the disclosure of the fact in case going concern assumption is not followed.

		not prepared on a going concern basis (state with reason) together with the basis on which the financial statements are prepared."	
3.	In case of breach of a material provision of a long-term loan arrangement	In case of breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, if the lender, before the approval of the financial statements for issue, agrees to waive the breach, it shall be considered as an adjusting event.	AS 4 is silent on it.

(c) (i) At the time of initial recognition

	₹
Liability component	
Present value of 5 yearly interest payments of ₹ 54,000, discounted at 13% annuity (54,000 x 3.517)	1,89,918
Present value of ₹ 6,00,000 due at the end of 5 years, discounted at 13%, compounded yearly (6,00,000 x 0.543)	3,25,800
	5,15,718
Equity component	
(₹ 6,00,000 – ₹ 5,15,718)	84,282
Total proceeds	6,00,000

Note: Since ₹ 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ ₹ 100 each only.

Journal Entry

		₹	₹
Bank	Dr.	6,00,000	
To 9% Debentures (Liability component)			5,15,718
To 9% Debentures (Equity component)			84,282
(Being debentures initially recorded at fair value)			

(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 13%	*Fair Value @ 10%*	*Difference*
	₹	₹	₹
Liability component			
Present value of 2 remaining yearly interest payments of ₹ 54,000, discounted at 13% and 10%, respectively	90,072	93,690	
Present value of ₹ 6,00,000 due in 2 years, discounted at 13% and 10%, compounded yearly, respectively	4,69,800	4,95,600	
Liability component	5,59,872	5,89,290	(29,418)
Equity component	84,282*	40,710**	43,572
Total	6,44,154	6,30,000	14,154

*See Note (i)

**6,30,000 – 5,89,290 = 40,710

Journal Entries

		₹	₹
9% Debentures (Liability component)	Dr.	5,59,872	
Profit and loss A/c (Debt settlement expense)	Dr.	29,418	
To Bank A/c			5,89,290
(Being the repurchase of the liability component recognised)			

9% Debentures (Equity component)	Dr.	84,282	
To Bank A/c			40,710
To Reserves and Surplus A/c			43,572
(Being the cash paid for the equity component recognised)			

Question 5

The summarized Balance Sheet of CBA Limited as on 31st March, 2018, 2019 and 2020 are as follows:

			₹ in '000
	31st March, 2018	31st March, 2019	31st March, 2020
Equity and Liabilities			
Equity share capital of ₹ 10 each fully paid-up	4,000	4,000	4,000
General Reserve	2,200	2,700	3,200
Profit and Loss A/c	620	750	1,000
Trade Payables	1,800	2,300	2,700
Total	8,620	9,750	10,900
Assets			
Goodwill	800	600	400
Tangible Assets (Net)	3,400	3,950	4,600
Investments	1,600	1,600	1,600
Inventories	1,850	2,100	2,300
Trade Receivables	750	1,250	1,450
Cash and Cash equivalents	220	250	550
Total	8,620	9,750	10,900

Additional information:

(1) *The tangible assets and inventories were revalued as under:* ₹ In '000

	2017-2018	2018-2019	2019-2020
Tangible assets	3,600	4,350	5,200
Inventories	2,050	2,300	2,500

(2) *The company charges depreciation @ 10% p.a.*

(3) *The balance in General Reserve and Profit and Loss A/c as on 1.4.2017 were ₹ 1,800 ('000) and ₹ 520 ('000) respectively.*

(4) *The capital employed at the beginning of the year at market value was ₹ 5,400 ('000) which included cost of goodwill which is purchased.*

(5) The normal annual return on average capital employed in the line of business of CBA Limited is 10%.

(6) 50% of the total investment is non-trade investment on which income is earned @ 5% per annum.

(7) Goodwill shown on 31st March, 2018 was purchased on 1st April, 2017 for ₹ 800 ('000). It is to be revalued at 5 years purchase of average super profits of last three years.

(8) Tax rate may be considered at 50% in all the years.

Find out average capital employed at the end of each year and total value of business as on 31st March, 2020. ***(16 Marks)***

Answer

1. Calculation of Capital Employed *₹ in '000*

	2017-2018	*2018-2019*	*2019-2020*
Tangible assets (Refer W.N.)	3,580	4,310	5,140
Inventories	2,050	2,300	2,500
Trade Investment (50%)	800	800	800
Trade Receivables	750	1,250	1,450
Cash and cash equivalents	220	250	550
	7,400	8,910	10,440
Less: Current Liabilities (Trade Payable)	(1,800)	(2,300)	(2,700)
Net assets / Closing capital employed	5,600	6,610	7,740
Opening capital employed	4,600	5,600	6,610
Average capital employed [(Opening capital employed + closing capital employed) / 2]	5,100*	6,105	7,175

* Opening capital employed (assumed to be of 1st April, 2017) – Purchase goodwill.

= 5,400 – 800 = 4,600

2. Calculation of Future Maintainable Profit *₹ in '000*

	2017-2018	*2018-2019*	*2019-2020*
Closing balance of Profit and Loss Account as on 31st March	620	750	1,000
Add back: Transfer to General reserve (in 2017-2018 = 2,200-1,800)	400	500	500
	1,020	1,250	1,500

Less: Opening Balance	(520)	(620)	(750)
Profit after tax earned during the year	500	630	750
Add back: Tax @ 50%	500	630	750
Profit before tax	1,000	1,260	1,500
Less: Interest on non-trade investment	(40)	(40)	(40)
Add back: Amortisation of goodwill	0	200	200
Less: Extra depreciation on upward revaluation	(20)	(40)	(60)
	940	1,380	1,600
Add: Upward valuation of closing inventories	200	200	200
Less: Upward valuation of opening inventories	0	(200)	(200)
	1,140	1,380	1,600
Less: Tax @ 50%	(570)	(690)	(800)
Future Maintainable Profit	570	690	800

3. Calculation of Goodwill ₹ in '000

	2017-2018	2018-2019	2019-2020
Future Maintainable Profit	570	690	800
Less: Normal profit @ 10% of Average capital employed	(510)	(610.50)	(717.50)
Super Profit	60	79.50	82.50
Average super profit [(60 + 79.50 + 82.50)/3]			74
Goodwill (74 x5)			370

4. For valuation of business

Value of an Equity Share on net assets basis ₹ *in '000*

Net assets as on 2019-2020 excluding goodwill	7,740
Add: Non- trade investment	800
Add: Goodwill	370
Total net assets / Value of business	8,910

Working Note:

Value of Tangible Assets for the purpose of calculation of Capital Employed ₹ *in '000*

	2017-2018	*2018-2019*	*2019-2020*
Tangible asset as per the Balance Sheet	3,400	3,950	4,600
Add: Upward increase in the value of the asset	200	400	600
	3,600	4,350	5,200
Less: Additional depreciation on the increased value of the asset	(20.00)	(40.00)	(60.00)
	3,580	4,310	5,140

Assumption:

1. Goodwill has no relevance in future. It is a non-recurring item. Hence, while computing future maintainable profit, the amortisation of goodwill has been reverted back.
2. Since every year transfer to general reserve was made, so we have also made the necessary adjustment while calculating the profit available to equity shareholders.

Question 6

(a) A company has decided to introduce a value added incentive scheme based on the best index performance i.e. Employee Costs to Total Value Added for the last four years (favourable to employees) will be considered as the target index. Incentive will be determined on actual improvement over the target index and will be shared by the Company and the employees in the ratio of 3: 2. The incentive will be payable at the end of the year after the determination of the profit.

The following information for the last four years is given:

				(₹ in lacs)
Particulars	*2014-2015*	*2015-2016*	*2016-2017*	*2017-2018*
Total Added Value	*420*	*470*	*530*	*580*
Employee Cost	*175*	*190*	*205*	*225*

Summarised Statement of Profit and Loss for the year ended on 31st March, 2019

Particulars		***₹ in Lacs Amount***
Income:		
Sales less returns	*1,450*	
Dividend and Interest	*75*	
Other Income	*75*	*1,600*

Expenditure:		
Production and Operational Expenses:		
Cost of Material		
Wages and Salaries	*650*	
Other Manufacturing Expenses	*175*	
Administrative Expenses:	*155*	*980*
Salaries	*75*	
Expenses	*65*	*140*
Selling and Distribution Expenses:		
Salaries	*15*	
Expenses	*45*	*60*
Financial Expenses:		
Debenture Interest		*12*
Depreciation		*165*
Total Expenditure		*1,357*
Profit before tax		*243*
Provision for taxation		*61*
Profit after tax		*182*

From the above information, prepare Value Added Statement for the year 2018-2019 and determine the amount of incentive payable to employees, if eligible. ***(8 Marks)***

(b) S Limited grants 120 stock options to each of its 750 employees on 1st April, 2016. The grant is conditional upon the employee remaining in service over the next 3 years. The exercise date is 31st March, 2020 and the vesting date is 31st March, 2019. The company estimates that fair value of each option on the grant date is ₹ 20. The nominal value and exercise price per share is ₹ 100 and ₹ 130 respectively.

On 31st March, 2017 the exercise price of the company has dropped to ₹ 125 and the company has repriced its stock option which will vest at the end of 3rd year i.e. 31st March, 2019. The company estimates that at the date of repricing, the fair value of each of the original options granted (i.e. before taking into account the repricing) is ₹ 14 and that the fair value of each repriced stock option is ₹ 17.

The following information is given:

	31st March,2017	*31st March,2018*	*31st March, 2019*
Number of employees left	*55*	*45*	*40*

Estimated no. of employees to leave in next year/s	*95*	*45*	*0*

On 31st March, 2020, 600 employees exercised the option. You are required to compute the amount of expense the company should recognize in each of the years 2016-2017, 2017-2018 and 2018-2019. Also give an extract of ESOP Outstanding A/c as will appear in the books of the company in the year 2019-2020.

Answer

(a) 1. Calculation of Target index

				(₹ in Lacs)
Year	*2014-2015*	*2015-2016*	*2016-2017*	*2017-2018*
Employees cost	175	190	205	225
Total value added	420	470	530	580
Percentage of 'Employee cost' to 'Value added'	41.67%	40.43%	38.68%	38.79%

Target index percentage is taken as highest of the above from the employee's viewpoint i.e. 41.67%.

2. Value Added Statement for the year 2018-2019

	(₹ in Lacs)	*(₹ in Lacs)*
Sales		1,450
Less: Cost of bought in goods & services		
Materials consumed	650	
Other manufacturing expenses	155	
Administrative expenses	65	
Selling expenses	45	(915)
		535
Add: Other income		75
Dividend and interest		75
Total Value Added		685

3. Employee cost for 2018-2019

	(₹ in lacs)
Wages and salaries	175
Administrative salaries	75

Selling and distribution salaries	15
	265

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

= 41.67% x ₹ 685 Lacs = ₹ 285.44 Lacs

5. **Calculation of savings**

Target employee cost	=	₹ 285.44 Lacs
Less: Actual Cost	=	(₹ 265.00 Lacs)
Saving	=	₹ 20.44 Lacs

6. **Calculation of Bonus payable for the year 2018-2019:**

2/5 of savings is Bonus Payable = ₹ 20.44 Lacs x 2/5 = ₹ 8.18 Lacs.

(b) The re-pricing has been done at the end of year 1, and hence the increased expense would be spread over next 2 years equally.

Total increased value due to modification is	₹ 3	(1/2 weight each years)

	Year 1 (2016-2017)	Year 2 (2017-2018)	Year 3 (2018-2019)
Number of employees Employee left Expected to leave Net employees Options per employee Fair value of the option Period weight Modification Expense (original) [A]	750 (55) (95) 600 120 20 1/3 4,80,000 (600x120x20x1/3)	750 (100) (45) 605 120 20 2/3 3 4,88,000 [(605 x120 x 20 x 2/3) - 4,80,000]	750 (140) - 610 120 20 3/3 3 4,96,000 [(610 x120 x 20) - 4,80,000 - 4,88,000]
Modification [B]	Nil	1,08,900	1,10,700
		(605 x 120 x 3 x 1/2)	(610 x 120 x 3) - 1,08,900
Total expenses for the year [A] + [B]	4,80,000	5,96,900	6,06,700

ESOP Outstanding A/c

Year		₹	*Year*		₹
31st March, 2020	To General Reserve	27,600*	1st April, 2019	By Balance b/d (4,80,000 + 5,96,900 + 6,06,700)	16,83,600
	To Share Capital (600 x 120 x 100)	72,00,000	31st March, 2020	By Bank (600 x 120 x 125)	90,00,000
	To Securities Premium (600 x 120 x 48**)	34,56,000			
		1,06,83,600			1,06,83,600

*[₹ 16,83,600 x (10 employees / 610 employees)] = ₹ 27,600

**[(125-100) + (20 + 3)] = ₹ 48.

Question 7

Answer any four of the following:

(a) *Suvidha Limited is a non-banking financial Company. You are provided with the following information of outstanding of ₹ 400 lacs in its books of accounts as on 31st March, 2020. There were overdue accounts for ---*

(i) *Last two months in 250 accounts of ₹ 100 lacs.*

(ii) *Last three months in 30 accounts of ₹ 60 lacs.*

(iii) *For more than 24 months in 15 accounts of ₹ 36 lacs.*

(iv) *For more than 3 years in 8 accounts of ₹ 30 lacs which has been identified as sub-standard by the management.*

(v) *2 accounts having outstanding amount ₹ 20 lacs has already been identified by the management as non-recoverable.*

Out of 15 accounts overdue for more than 24 moths, 8 accounts having outstanding amounts of ₹ 8 lacs for more than 12 months has been identified by the management as sub-standard and balance accounts are identified as substandard for less than 12 months.

You are required to classify the assets of the company in line with Non-Banking Financial Company –Systemically Important Non—Deposit taking company and Deposit taking company (Reserve Bank) Directions, 2016. ***(4 Marks)***

(b) *On 1st October, 2018, A Limited granted 25,000 Employees' Stock Option at ₹ 70 per share. The market price of share was ₹ 130 per share. The options were to be exercised between 1st December, 2018 and 31st March, 2019. The face value of shares is ₹ 10 each. The employees exercised option for 18,000 shares only and the balance options lapsed. The company closes its books of accounts on 31st March every year.*

Pass necessary journal entries with narration to record the transaction in the books of the company. ***(4 Marks)***

(c) *Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of the magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15 of the month. The amount of ₹ 2,70,000 has been received upto 31st March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.*

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020.

If the publication of March issue gets delayed and is published on 5th May, 2020, will your answer be different? ***(4 Marks)***

(d) *Explain Net Asset Value (NAV) in case of Mutual Fund.* ***(4 Marks)***

(e) *Write short note on concept of Materiality.* ***(4 Marks)***

Answer

(a) Statement showing classification as per Non-Banking Financial Company – Systemically Important Non-Deposit taking company and Deposit taking Company (Reserve Bank) Directions, 2016

		(₹ in lakhs)
<u>Standard Assets</u>		
…… accounts (Balancing figure)	154.00	
250 accounts overdue for a period of 2 months	<u>100.00</u>	254.00
<u>Sub-Standard Assets</u>		
30 accounts overdue for a period of 3 months	60.00	
7 accounts identified as sub-standard asset for a period less than 12 months	<u>28.00</u>	88.00
<u>Doubtful Debts</u>		
8 accounts identified as sub-standard for a period more than 12 months		8.00
8 accounts identified as sub-standard for a period more than 3 years		30.00
<u>Loss Assets</u>		
2 accounts identified by management as loss asset		<u>20.00</u>
Total outstanding of Advances		<u>400.00</u>

(b) Journal Entries in the books of A Ltd.

Date	Particulars		*Dr. (₹)*	*Cr. (₹)*
01.12.2018 to	Bank A/c (18,000 x ₹ 70)	Dr.	12,60,000	
31.03.2019	Employee compensation expenses account [18,000 x (₹ 130- ₹ 70)]	Dr.	10,80,000	
	To Equity share capital account (18,000 x ₹ 10)			1,80,000
	To Securities premium account (18,000 x ₹120)			21,60,000
	(Being 18,000 employees stock option exercised at an exercise price of ₹ 70 each)			
31.3.2019	Profit and Loss account	Dr.	10,80,000	
	To Employee compensation expenses account			10,80,000
	(Being transfer of employee compensation expenses account to profit and loss account)			

Working Note:

Fair value of an option = Market price of a share – Exercise price of a share

= ₹ 130 – ₹ 70

= ₹ 60 per share

(c) **Definition:** As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Analysis of given case: In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

Accounting treatment for given situation: Hence, ₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

Accounting treatment if the publication is getting delayed: However, if the publication is delayed till 5.5.2020, revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.3.2021 after the magazine is published on 5.5.2020. The amount received from sale of advertising space on 31.3.2020 of ₹ 2,70,000 will be considered as an advance from advertisers for the year ended 31st March, 2020.

(d) 1. Mutual funds sell their shares to public and redeem them at current **Net Asset Value (NAV)** which is calculated as under:

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

2. The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme.

3. Thus, if the NAV is more than the face value (₹ 10), it means your money has appreciated and vice versa.

4. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme**.**

(e) Concept of materiality:

(i) Disclosure of all material items: AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality is a relative term and depends on the size of item or error judged in the particular circumstances of its omission or misstatement.

(ii) Aspect of materiality: From a positive perspective, materiality has to do with the significance of an item or event to warrant attention in the accounting process. From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process.

(iii) Assessment of materiality: Individual judgments are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organization, may not be material for another organization.

(iv) Materiality and relevance of information: The relevance of information is affected by its materiality. Information is material if its misstatements (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.