Test Series : April, 2021

MOCK TEST PAPER 2

FINAL (OLD) COURSE

PAPER 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/ HINTS

1. (a) The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes In Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. As per paragraph 8 of AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements.

However, it can be considered as extra-ordinary items. Hence, the amount so written-back (If material) should be disclosed as an extraordinary item as per AS 5.

(b) As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Polices". The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year 2020-2021.

(c) (1) Computation of actual borrowing costs incurred during the year

Sources	*Loan amount (Rs. in lakh)*	*Interest rate*	*Interest amount (Rs. in lakh)*
Bank Loan	65.00	10%	6.50
9% Debentures	125.00	9%	11.25
Term Loan from Corporation Bank	100.00	10%	10.00
Term Loan from State Bank of India	110.00	11.5%	12.65
Total	400.00		40.40
Specific Borrowings included in above	190.00		17.75

(2) Weighted Average Capitalization Rate for General Borrowings

Weighted Average Capitalization Rate for General Borrowings =

$$\frac{\text{Total Interest} - \text{Interest on Specific borrowings}}{\text{Total Borrowings} - \text{Specific borrowings}}$$

=

$\frac{(40.40 - 17.75)}{(400 - 190)} = 22.65/210 = 10.79\%$ (approx.)

(3) Capitalization of Borrowing Costs under AS 16 will be as under:

Plant	*Borrowing*	*Loan Amount*	*Interest Rate*	*Interest Amount*	*Cost of Asset*	
P	General	100	10.79%	10.79		110.79
Q	Specific	65	10.00%	6.50	71.50	
	General	60	10.79%	6.47	66.47	137.97
R	Specific	125	9.00%	11.25	136.25	
	General	50	10.79	5.39	55.39	191.64
	Total	400		40.40		440.40

Note: The amount of borrowing costs capitalized should not exceed the actual interest cost.

(d) Calculation of theoretical ex-rights fair value per share

$$= \frac{(12,00,000 \text{ shares} \times \text{Rs. } 24) + (6,00,000 \text{ shares} \times \text{Rs. } 18)}{12,00,000 \text{ shares} + 6,00,000 \text{ shares}}$$

$$= \frac{\text{Rs. } 2,88,00,000 + \text{Rs. } 1,08,00,000}{18,00,000 \text{ shares}} = 22$$

Calculation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{\text{Rs. } 24}{\text{Rs. } 22} = 1.091$$

Calculation of EPS for the year ended 31.3.2020

EPS originally reported $= \frac{\text{Rs. } 40,00,000}{12,00,000 \text{ shares}} = \text{Rs. } 3.33$

EPS restated for rights issue $= \frac{\text{Rs. } 40,00,000}{12,00,000 \text{ shares} \times 1.091} = \frac{40,00,000}{13,09,200} = \text{Rs. } 3.06$

Calculation of EPS for the year ended 31.3.2021

$$= \frac{\text{Rs. } 54,00,000}{(12,00,000 \times 1.091 \times 9/12) + (18,00,000 \times 3/12)} = \frac{54,00,000}{9,81,900 + 4,50,000} = 3.77$$

2. (i) Computation of Purchase Consideration

	Rs.
For Preference Shareholders	
Present Income of Preference Shareholders of B Ltd.	72,000
Add : Required 20% increase	14,400
	86,400
10% Preference Shares to be issued of Rs. 8,64,000 (86,400/10x 100)	
For Equity Shareholders	

Valuation of Equity Shares of B Ltd. = Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of A Ltd. x 60/100) = 1,80,000 x (Rs.2 x 20x $\frac{60}{100}$) =1,80,000 x 24 = Rs. 43,20,000 *Issue of Equity Shares* No. of Equity Shares to be issued at 80% of Market Price i.e. 80% of Rs. 40 = Rs. 32 $\frac{43,20,000}{32}$ = 1,35,000 shares	
Equity Share Capital = 1,35,000 x Rs.10 = Rs.13,50,000 Securities Premium = 1,35,000 x Rs. 22 = Rs.29,70,000 Rs.43,20,000	
Issue of Preference Shares	*Rs.*
Present Equity Dividend	2,70,000
Less: Expected Equity Dividend from A Ltd.	
(13,50,000 x $\frac{10}{100}$)	1,35,000
	1,35,000
10% Preference Shares to be issued of Rs. 13,50,000 (1,35,000/10 x 100)	
Purchase Consideration	
Preference Shares Capital [Rs.8,64,000 + Rs.13,50,000]	22,14,000
Equity Share Capital (1,35,000 shares of Rs. 10 each at Rs. 32 per share)	43,20,000
	65,34,000

(ii) Balance Sheet of A Ltd (after absorption of B Ltd.) as at 31.3.2021

	Note No.	Amount
		Rs.
Equity and Liabilities		
Share Capital:	1	83,64,000
Reserve & Surplus:	2	64,94,000
Non-current liabilities		
15% Debentures (5,00,000 + 6,00,000)		11,00,000
Current Liabilities		
Trade payables (10,80,000+12,80,000-20,000)		23,40,000
Bills Payable (20,000 + 20,000)		40,000
		1,83,38,000
Assets		
Non-current assets:		
Property, plant and equipment (60,00,000+36,00,000)		96,00,000
Intangible assets		18,94,000

Investment (5,00,000+5,00,000)		10,00,000
Current Assets		
Inventories (18,00,000+10,80,000)		28,80,000
Trade Receivables (15,00,000 + 12,00,000 -20,000)		26,80,000
Bills Receivable (50,000+10,000)		60,000
Cash at Bank (1,50,000 + 90,000-16,000)		2,24,000
		1,83,38,000

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

Notes to Accounts

1.	*Share Capital:*		*Rs.*
	4,95,000 Equity Shares of Rs. 10 each fully paid	49,50,000	
	(1,35,000 shares have been allotted as fully paid up for consideration other than cash)		
	10% Preference Shares of Rs. 100 each fully paid	34,14,000	83,64,000
2.	**Reserves and surplus**		
	Statutory Reserve	2,00,000	
	Revaluation Reserve	10,00,000	
	General Reserve (25,00,000 – 16,000)	24,84,000	
	Securities Premium	29,10,000	
	Amalgamation Adjustment Reserve	(1,00,000)	64,94,000

Working Notes:

1. **Calculation of EPS & P/E ratio**

	A Ltd. *Rs.*	*B Ltd.* *Rs.*
Profit before Interest and Tax	14,75,000	7,80,000
Less: Interest on debentures	75,000	60,000
Profit before tax	14,00,000	7,20,000
Less: Tax @ 40%	5,60,000	2,88,000
	8,40,000	4,32,000
Less: Preference Dividend	1,20,000	72,000
Earnings available for equity shareholders	7,20,000	3,60,000
Number of shares	3,60,000 shares	1,80,000 shares
EPS (Earnings/ No. of shares)	2	2
Market Price	Rs.40	Not given
P/E ratio	40/2 = 20	N.A.

2. **Computation of Goodwill/Capital Reserve on absorption**

				Rs.
Purchase Consideration				65,34,000
Property, plant and equipment taken over		30,00,000		
Add:	Increase by 20%	6,00,000	36,00,000	
Investments			5,00,000	
Current Assets:				
Inventories		12,00,000		
Less:	Reduction in value by 10%	1,20,000		
		10,80,000		
Trade Receivables		12,00,000		
Bills receivables		10,000		
Cash at Bank		90,000	23,80,000	
			64,80,000	
Less:	Outside Liabilities:			
	12% Debentures at premium	5,40,000		
	Trade Payable	12,80,000		
	Bills Payable	20,000	18,40,000	46,40,000
Goodwill				18,94,000

3. **Consolidated Balance Sheet of Arun Ltd. and its subsidiaries as on 31.3.2021**

Liabilities	*Rs.*
Share Capital (Shares of Rs. 100 each)	6,00,000
Minority Interest (W. N. 4)	2,33,729
Reserves and surplus	
General reserve (W. N. 8)	83,021
Profit & Loss A/c (W. N. 8)	2,54,250
Current liabilities	
Trade payables	2,40,000
	14,11,000
Assets	
Non-current assets	
Property, plant and equipment	7,08,000
Intangible assets	1,81,000
Current Assets	
Other Current Assets	5,14,000
Cash and cash equivalent (W. N. 7)	8,000
	14,11,000

Working Notes:

1. Shareholding Pattern

	Number of Shares	*%age of Holding*
In Brown Ltd.:		
Arun Ltd.	3,000	75%
Minority Interest	1,000	25%
In Crown Ltd.:		
Arun Ltd.	400	16.667%
Brown Ltd.	1,400	58.333%
Minority Interest	600	25%

2. Analysis of apportionment of profit in Crown Ltd.

(a) Calculation of Unrealized Profit in Equipment

Crown Ltd sold equipment to Brown Ltd. at a profit of Rs. 8,000 and this would be apportioned to

	Rs.
Arun Ltd.	1,333
Brown Ltd.	4,667
Minority Interest	2,000
	8,000

Brown Ltd sold the equipment to Arun Ltd. at a profit of Rs. 4,000. This would be apportioned to:

	Rs.
Arun Ltd.	3,000
Minority Interest	1,000
	4,000

The above amounts are to be deducted from the respective share of profits.

(b) Reserves

	Rs.	
Closing balance	30,000	
Opening balance	20,000	Capital Profit
Current year Appropriation	10,000	
Apportionment of Profit from 1.4.2020 to 30.9.2020	5,000	Capital Profit
Apportionment of Profit from 1.10.2020 to 31.3.2021	5,000	Revenue Reserve

(c) Profit and Loss Account

Closing balance	1,00,000	
Opening balance	12,000	Capital Profit
Current year profits before interim dividend	1,12,000	
Apportionment of Profit from 1.4.2020 to 30.9.2020	56,000	
Less: Interim Dividend	(24,000)	
	32,000	Capital Profit
From 1.10.2020 to 31.3.2021	56,000	Revenue Profit

(d) Apportionment of profits of Crown Ltd.

	Pre-Acquisition	Post Acquisition	
	Capital Profit	*Revenue Reserve*	*Revenue Profit*
	Rs.	*Rs.*	*Rs.*
General Reserves	25,000	5,000	--
Profit & Loss Account	44,000	--	56,000
	69,000	5,000	56,000
Arun Ltd [16.667%]	11,500	833	9,333
Brown Ltd. [58.333%]	40,250	2,917	32,667
Minority Interest [25%]	17,250	1,250	14,000

3. Analysis of Profit of Brown Ltd

(a) Reserves

	Rs.	
Closing balance	40,000	
Opening balance	40,000	(Capital Profit)
Current year Appropriation	Nil	

(b) Profit and Loss Account

	Rs.
Closing balance	1,20,000
Opening balance (Dr.)	20,000
Current year Appropriation after interim dividend	1,40,000
Interim Dividend	40,000
Profit before Interim Dividend	1,80,000
Less: Dividend from Crown Ltd.	14,000
	1,66,000
Apportionment of Profit from 1.4.2020 to 30.9.2020	83,000
Less: Interim Dividend	40,000
Capital profit	43,000
Apportionment of Profit from 1.10.2020 to 31.3.2021 (Revenue profit)	83,000

(c) Apportionment of Profit of Brown Ltd.

	Pre-Acquisition	Post-Acquisition	
	Capital Profit Rs.	*Revenue Reserve Rs.*	*Revenue Profit Rs.*
General Reserves	40,000	--	--
Profit & Loss Account (Opening balance (-) 20,000+43,000)	23,000		83,000
Less: Unrealised Profit of Equipment from Crown Ltd.			(4,667)
Share of Post-Acquisition Profit of Crown Ltd.	--	2,917	32,667
	63,000	2,917	1,11,000
Arun Ltd. 75%	47,250	2,188	83,250
Minority Interest 25%	15,750	729	27,750

4. Minority Interest

	Brown Ltd. Rs.	*Crown Ltd. Rs.*
Share Capital	1,00,000	60,000
Capital Profit	15,750	17,250
Revenue: General Reserve	729	1,250
Profit & Loss Account	27,750	14,000
Unrealised Profit on Equipment	(1,000)	(2,000)
	1,43,229	90,500
Total Minority Interest: Rs. 1,43,229+ Rs. 90,500 = Rs. 2,33,729		

5. Cost of Control

	Arun Ltd. in Brown Ltd. Rs.	*Arun Ltd. in Crown Ltd. Rs.*	*Brown Ltd in Crown Ltd. Rs.*
Amount Invested	3,60,000	60,000	2,08,000
Less: Pre-acquisition dividend*	30,000	4,000	14,000
Adjusted Cost of Investment (A)	3,30,000	56,000	1,94,000
Share capital	3,00,000	40,000	1,40,000
Capital Profit	47,250	11,500	40,250
(B)	3,47,250	51,500	1,80,250
Capital Reserve/Goodwill (A)-(B)	(17,250)	4,500	13,750
Net Goodwill	Rs.1,000		

* The entire amount of interim dividend of 10 % has been treated as pre-acquisition dividend.

6. Dividend declared

	Brown Ltd. *Rs.*	*Crown Ltd.* *Rs.*
Dividend declared	40,000	24,000
Share of: Arun Ltd.	30,000	4,000
Brown Ltd.		14,000
Minority	10,000	6,000

7. Inter-Company Transactions

(a) Owings

	Dr. *Arun Ltd.* *Rs.*	*Cr.* *Brown Ltd.* *Rs.*	*Cr.* *Crown Ltd.* *Rs.*
Balance in books	80,000	40,000	32,000
Less: Inter- co. owings	72,000	40,000	32,000
Cash-in-transit	8,000	NIL	NIL

(b) Property, plant and equipment

	Rs.
Total Property, plant and equipment	7,20,000
Less: Unrealised Profit on sale of equipment	12,000
Amount to be taken to consolidated Balance Sheet	7,08,000

8. General Reserves and Profit and Loss Account in the Consolidated Balance Sheet

	General Reserve *Rs.*	*Profit and Loss A/c* *Rs.*
Balance in Books	80,000	2,00,000
Add: Shares of Post-acquisition Profits:		
From Brown Ltd.	2,188	83,250
From Crown Ltd	833	9,333
Less: Pre-Acquisition dividend: (W.N.6)		
From Brown Ltd.		(30,000)
From Crown Ltd		(4,000)
Less: Unrealised Profit on Equipment:		
From Brown Ltd.		(3,000)
From Crown Ltd.		(1,333)
	83,021	2,54,250

4 (a) Journal Entries in the Books of ABC Ltd.

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.3.2019	Employees compensation expenses account	Dr.	48,000	
	To Employees stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2020	Employees compensation expenses account	Dr.	48,000	
	To Employees stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2021	Employees stock option outstanding account (W.N.1)	Dr.	12,000	
	To General Reserve account (W.N.1)			12,000
	(Being excess of employees compensation expenses transferred to general reserve account)			
30.6.2021	Bank A/c (600 x Rs.40)	Dr.	24,000	
	Employee stock option outstanding account (600 x Rs.120)	Dr.	72,000	
	To Equity share capital account (600 x Rs. 10)			6,000
	To Securities premium account (600 x Rs.150)			90,000
	(Being 600 employees stock option exercised at an exercise price of Rs. 40 each)			
01.10.2021	Employee stock option outstanding account	Dr.	12,000	
	To General reserve account			12,000
	(Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)			

Working Note:

On 31.3.2021, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e. Rs.

No. of options actually vested (700 x Rs.120)	84,000
Less: Expenses recognized Rs.(48,000 + 48,000)	(96,000)
Excess expenses transferred to general reserve	12,000

(b) As per the revised definition of 'Materiality' as amended in Ind AS-

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:

(a) information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;

(b) information regarding a material item, transaction or other event is scattered throughout the financial statements;

(c) dissimilar items, transactions or other events are inappropriately aggregated;

(d) similar items, transactions or other events are inappropriately disaggregated; and

(e) the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances.

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

(c) 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: **Rs.**

Transaction value of the Redeemable preference shares	5,00,00,000
Less: Present value of loan component @ 12% (5,00,00,000 x 0.7118)	(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
0	1st April, 2018	3,55,90,000	-	3,55,90,000
1	31st March, 2019	3,55,90,000	42,70,800	3,98,60,800
2	31st March, 2020	3,98,60,800	47,83,296	4,46,44,096
3	31st March, 2021	4,46,44,096	53,55,904*	5,00,00,000

* Rs. 4,46,44,096 x 12% = Rs. 53,57,292. The difference of Rs. 1,388 (Rs. 53,57,292 – Rs. 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, 2018	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, 2019	Redeemable Preference Shares	Dr.	42,70,800	
	To Interest income			42,70,800
	(Interest income on loan component recognized)			
31st March, 2020	Redeemable Preference Shares	Dr.	47,83,296	
	To Interest income			47,83,296
	(Interest income on loan component recognized)			

31st March, 2021	Redeemable Preference Shares	Dr.	53,55,904	
	To Interest income			53,55,904
	(Interest income on loan component recognized)			
31st March, 2021	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)			

5. (a) Statement showing the Movement of Unit Holders' Funds for the year ended 31st March, 2021

	(Rs.'000)
Opening balance of net assets	12,00,000
Add: Par value of units issued (8,50,200 × Rs.100)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working Note)	15,390
	13,85,410
Less: Par value of units redeemed (7,52,300 × Rs.100)	(75,230)
Closing balance of net assets (as on 31st March, 2021)	13,10,180

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
	Rs.'000	Rs.'000
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve /Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund		15,390

(b) Value added Statement of C Ltd for the year ended 31st March, 2021

Particulars	Rs. 000	Rs. 000	
VALUE ADDED			
Sales		1,454	
Less: Cost of bought in materials and services Materials	1,060		
Other Expenses [94 – (18 + 6)]	70		
Short-term Interest (14 – 8)	6	1,136	
Value Added by manufacturing and trading activities		318	
Add: Other Income		26	
Total Value Added		344	
APPLICATION OF VALUE ADDED			%
To Employees:			
Salaries, Wages and Benefits (38+18)		56	16.3

To Government:			
GST		124	
Income Tax		62	
		186	54.1
To Finance Providers:			
Interest on Long Term Loans		8	
Dividend on Equity shares		10	
		18	5.2
To Entity's needs -			
Meeting Loss on Sale of Property, plant and equipment		6	
Preliminary Expenses		10	
Depreciation		10	
Transfer to Reserves (Debenture Redemption & General Reserve)		58	
		84	24.4
Total application		344	100.0

6. Calculation of Maximum Price that can be quoted for take over of Fine Toys Ltd.

	Rs. in lakh	*Rs. in lakh*
Present (Discounted) value of incremental cash flows (Refer Working Note)		7,845.02
Add: Proceeds from disposal of Property, plant and equipment	50.00	
Proceeds from disposal of inventories	100.00	
Receipts from trade receivables	50.00	200.00
		8,045.02
Less: Settlement of trade payables	165.00	
Bank Loans	250.00	
Employee settlement	90.00	
Renovation of Plant	150.00	
Revamp of machine shop floor (Rs. 50 lakh× 0.6944)*	34.72	689.72
Maximum value that can be offered		7,355.30
Maximum price per share of Fine Toys Ltd. (Rs.7,355.30 lakh / 55,500 shares) = Rs. 13,252.79		

* Discount factor of year 2 @20%.

Working Note:

Present Value of Incremental Cash Flows

(Rs. in lakh)

Year	Cash flow after takeover	Cash flows before takeover	Incremental Cash flows	Discount factor@20%	Discounted Cash flows
1	1,800	1600	200	0.8333	166.66
2	2,400	2000	400	0.6944	277.76
3	3,600	3000	600	0.5787	347.22
4	4,400	3200	1200	0.4823	578.76
5	6,000	4400	1600	0.4019	643.04
6	8,000	5200	2800	0.3349	937.72
7	9,600	6000	3600	0.2791	1,004.76
8	10,000	5500	4500	0.2326	1,046.70
9	14,000	7000	7000	0.1938	1,356.60
10	20,000	10800	9200	0.1615	1,485.80
					7,845.02

7. **(a)** As per para 9.2 of AS 9 'Revenue Recognition', where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, SCL Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstandings is also an estimate and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

(b) The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from Rs. 3.5 lakh to Rs. 2.5 lakh is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2020-2021:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by Rs. 1 lakh."

(c) Calculation of Economic Value Added

	Rs.
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	Rs.
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

$$= \text{Rs. } 60,00,000 \times \frac{10}{100} = \text{Rs. } 6,00,000$$

(d) AS 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

(e) Valuation of liabilities is the measurement of liability in monetary term. It may be measured at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business or required to settle the obligation currently in the normal course of business. It may also be carried at the present value of the future net cash flows that are expected to be required to settle the liabilities in the normal course of business. Correct valuation of liabilities is required to ensure true and fair financial position of the business entity. In other words, all matters which affect the financial position of the business have to be disclosed. Under or over valuation of liabilities may not only affect the operating results and financial position of the current period but will also affect these for the next accounting periods.