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) RS Ltd. has acquired a heavy plant at a cost of ₹ 2,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the 2nd year, one of the major components i.e. the Boiler has become obsolete and requires replacement, as further maintenance is uneconomical. The remainder of the plant is perfect and is expected to last for next 8 years. The cost of a new boiler is ₹ 60,00,000. The discount rate assumed is 5%.

Can the cost of the new boiler be recognised as an asset, and, if so, what should be the carrying value of the plant at the end of second year? ***(5 Marks)***

(b) A contractor firm obtained a contract for construction of bridge. The following details are available in the records kept for the year ended 31st March, 2019:

		(₹ in crore)
Total contract price		500
Work certified		250
Work not certified		80
Estimated further cost to completion		220
Progress payment	- Received	200
	- To be received	70

You are required to calculate:

(i) The amount of revenue to be recognized.

(ii) The amount of profit or loss to be recognized.

(iii) The amount due from/ to customers.

Also present relevant disclosures as per AS 7 (Revised). ***(5 Marks)***

(c) How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2. Compute the amount *of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.* ***(5 Marks)***

(d) *P Ltd. leased a machinery to Q Ltd. on the following terms:*

	(₹ in lakh)
Fair value of the machinery (₹)	*24*
Lease term	*5 years*
Lease Rental per annum (₹)	*6*
Guaranteed Residual value (₹)	*1*
Expected Residual value (₹)	*3*
Internal Rate of Return	*15%*

You are required to ascertain the amount of unearned finance income.

Present value of ₹ 1 for year 1 to 5 are 0.8696, 0.7561, 0.6575, 0.5718, 0.4972. ***(5 Marks)***

Answer

(a) Recognition of Asset: The new boiler will produce economic benefits to RS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. Since the new boiler has been purchased, it is assumed that the old boiler has been disposed off. Hence, it has been derecognized.

The original invoice for the machine did not specify the cost of the boiler; however, the cost of the replacement ₹ 60,00,000 can be used as an indication for determining its likely cost (by discounting factor method) at the time of purchase ie. two years back.

Statement showing cost of new boiler and machine after year 2

Original cost of plant		2,00,00,000
Less: Accumulated depreciation [(2,00,00,000 /10) x 2]		(40,00,000)
Carrying value of the plant after two years		1,60,00,000
Less: Current Cost of Old Boiler to be derecognized		
Cost of Boiler before 2 years (discounted cost @ 5%)		
(60,00,000/(1.05)(1.05))	54,42,177	
Less: Depreciation for 2 years		
[(54,42,177/10) x 2]	(10,88,435)	(43,53,742)
		1,16,46,258
Add: Cost of new Boiler to be recognized		60,00,000
Revised carrying amount of Plant		1,76,46,258

(b) (i) **Proportion of total contract value recognised as revenue**

Cost of construction till date = Work certified x work uncertified

= ₹ 250 crore + ₹ 80 crore = ₹ 330 crore

Total estimated cost of production = Cost of construction till date + Estimated further cost to completion

= ₹ 330 crore + ₹ 220 crore = ₹ 550 crore

Percentage of completion of contract to total estimated cost of construction

= (330 crore / (550 crore) $\times$ 100 = 60%

Revenue to be recognized till date = 60% of total contract price

= 60% of ₹ 500 crore = ₹ 300 crore.

(ii)

Calculation of profit/ loss for the year ended 31st March, 2019		***(₹ in crore)***
Total estimated cost of construction		
Work certified	250	
Work not certified	80	
Estimated further cost to completion	220	550
Less: Total contract price		(500)
Total foreseeable loss to be recognized as expense		50
Loss for the year (330 crore – 300 crore)		30
Provision for future foreseeable loss		20

According to AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(iii) **Amount due from / to customers** = Contract costs incurred till date + Recognised profits Recognised losses (Progress payments received + Progress payments to be received)

= ₹ [(250 + 80) + Nil – 50 – (200 + 70)] crore

= ₹ [330 – 50 – 270] crore

Amount due from customers (shown as an asset) = ₹ 10 crore.

The relevant disclosures under AS 7 (Revised) are given below:

	₹ in crore
Contract revenue till 31st March, 2019	300

Contract expenses till 31st March, 2019	330
Recognized losses for the year 31st March, 2019	50
Progress billings ₹ (200+ 70)	270
Progress payments to be received (billed but not received from contractee)	70
Gross amount due from customers	10

(c) Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie Rs. 1,80,000 (2,00,000 – 20,000)

Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	*Opening Borrowing*	*Interest expense @ 13.39% to be capitalised*	*Total*	*Interest paid*	*Closing Borrowing*
	(1)	*(2)*	*(3)*	*(4)*	*(5) = (3) – (4)*
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of Rs. 48,753 will be capitalized to the cost of qualifying asset.

(d) As per AS 19 on Leases, ***unearned finance income*** is the difference between (a) the ***gross investment*** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; Where:

(i) ***Gross investment*** = Minimum lease payments from the standpoint of the lessor + Unguaranteed residual value

or

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹ 6 lakh × 5 years) + ₹ 1 lakh] + ₹ 2 lakh (Refer W.N.) = ₹ 33 lakh (A)

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

Year	***M.L.P. inclusive of URV ₹ in lakh***	***Internal rate of return (Discount factor @ 15%)***	***Present Value ₹ in lakh***
1	6	0.8696	5.2176
2	6	0.7561	4.5366
3	6	0.6575	3.945
4	6	0.5718	3.4308
5	6	0.4972	2.9832
	1 (GRV)	0.4972	0.4972
	31		20.6104 (i)
	2 (URV)	0.4972	0.9944 (ii)
	33	(i) + (ii)	21.6048 (B)

Unearned Finance Income = (A) – (B) = ₹ 33 lakh – ₹ 21.6048 lakh = ₹ 11.3952 lakh

Working Note:

Unguaranteed residual value = Expected residual value – Guaranteed residual value

= ₹ 3 lakh – ₹ 1 lakh

= ₹ 2 lakh

Question 2

The following are the Balance Sheets of Aakash Limited and Ganga Limited as at 31st March, 2019:

Particulars	*Note No.*	*Aakash Limited (₹)*	*Ganga Limited (₹)*
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	*1*	*80,00,000*	*20,00,000*
(b) Reserves and Surplus	*2*	*(3,24,00,000)*	*56,00,000*

(2) Non-current Liabilities:			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	-
(3) Current Liabilities:			
(a) Trade Payables		56,00,000	36,00,000
(b) Other Current Liabilities	5	2,04,00,000	56,00,000
Total		**5,08,00,000**	**3,28,00,000**
II. Assets:			
(1) Non-current Assets:			
Property, Plant & Equipment		68,00,000	1,36,00,000
(2) Current Assets:			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		**5,08,00,000**	**3,28,00,000**

Notes to Accounts:

Note No.		Aakash Limited (₹)	Ganga Limited (₹)
1.	Share Capital		
	Authorised, Issued, Subscribed & Paid up:		
	6,00,000 Equity Shares of ₹ 10 each	60,00,000	-
	20,000 Preference Shares of ₹ 100 each	20,00,000	-
	2,00,000 Equity Shares of ₹ 10 each	-	20,00,000
		80,00,000	**20,00,000**
2.	Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	**56,00,000**
3.	Secured Loans (Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
4.	Unsecured Loans	1,72,00,000	-
5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000

	(Statutory Liabilities including ₹ 44 Lakh in case of Aakash Limited of a claim not having been admitted shown as contingent liability)		
	Liability to Employees	*60,00,000*	*36,00,000*
		2,04,00,000	***56,00,000***

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is given:

(i) *All Current Assets of two companies, except pledged inventory are taken over by AakashGanga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.*

(ii) *Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.*

(iii) *Secured Loans include ₹ 32,00,000 accrued interest in case of Ganga Limited.*

(iv) *4,00,000 Equity Shares of ₹ 10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.*

(v) *Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth ₹ 4,00,000 in lieu of their present holdings.*

(vi) *Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.*

(vii) *Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.*

(viii) *Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.*

(ix) *Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the book value.*

You are required to prepare the opening Balance Sheet of AakashGanga Limited. ***(16 Marks)***

Answer

Balance Sheet of AakashGanga Ltd. as at 31st March, 2019

Particulars	*Note No.*	*(₹)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
Share Capital	1	1,40,00,000

(2) **Non-current Liabilities**		
(a) Long term borrowings	2	2,12,60,000
(3) **Current Liabilities**		
(a) Trade Payables	3	73,60,000
(b) Other current liabilities	4	1,64,00,000
Total		**5,90,20,000**
II. **Assets**		
(1) **Non-current assets**		
(a) Property, Plant & Equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000
(2) **Current assets**		
(a) Cash and cash equivalents		40,00,000
(b) Other current assets	7	1,92,00,000
Total		**5,90,20,000**

Notes to Accounts:

				(₹)
1.	**Share Capital**			
	Issued, subscribed & paid-up:			
	14,00,000 equity shares of ₹ 10 each, fully paid up (W.N.4)			1,40,00,000
	(Of the above, 10,00,000 shares have been issued for consideration other than cash)			
2.	**Long Term borrowings**			
	Secured Loans			
	Aakash Limited	25,60,000		
	Ganga Limited	1,44,00,000	1,69,60,000	
	Unsecured Loans		43,00,000	2,12,60,000
3.	**Trade Payables (W.N.1)**			
	Aakash Limited		44,80,000	
	Ganga Limited		28,80,000	73,60,000
4.	**Other current liabilities**			
	Statutory Liabilities			
	Aakash Limited		1,44,00,000	
	Ganga Limited		20,00,000	1,64,00,000

5.	**Property, Plant & Equipment**		
	Aakash Limited	68,00,000	
	Ganga Limited	1,36,00,000	2,04,00,000
6.	**Intangible assets**		
	Goodwill (W.N.3)		1,54,20,000
7.	**Other Current Assets**		
	Aakash Limited	57,60,000	
	Ganga Limited	1,34,40,000	1,92,00,000

Working Notes:

1. Value of total liabilities taken over by AakashGanga Ltd. *(₹)*

	Aakash Limited		**Ganga Limited**	
Current liabilities				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	44,80,000	2,48,80,000	28,80,000	84,80,000
Secured loans				
Given in the Balance Sheet	3,20,00,000		1,60,00,000	
Adjustment for				
Interest waived	-		16,00,000	1,44,00,000
Value of Inventory (80% of ₹ 3,68,00,000)	2,94,40,000	25,60,000		
Unsecured Loans (25% of ₹1,72,00,000)		43,00,000		-
		3,17,40,000		2,28,80,000

***Note :** Contingent liabilities have been taken over by AakashGanga Ltd. Hence, it has been considered as recognized liability in AakashGanga Limited.

2. Assets taken over by AakashGanga Ltd.

	Aakash Limited ₹	**Ganga Limited** ₹
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets 80% and 70% respectively of book value	57,60,000	1,34,40,000
	1,25,60,000	2,70,40,000

3. Goodwill / Capital Reserve on amalgamation *(₹)*

Liabilities taken over (W.N.1)	3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders	4,00,000	-
A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2) B	(1,25,60,000)	(2,70,40,000)
A-B	1,95,80,000	(41,60,000)
	Goodwill	Capital Reserve
Net Goodwill (1,95,80,000 - 41,60,000)	1,54,20,000	

4. Equity shares issued by AakashGanga Ltd.

	(₹)	(₹)
(i) For cash (4,00,000 shares @ Rs. 10 each)		40,00,000
For consideration other than cash		
(ii) In discharge of liabilities to employees	96,00,000	
(iii) To Preference shareholders	4,00,000	1,00,00,000
		1,40,00,000
Number of equity shares issued @ ₹ 10 each		14,00,000

Question 3

HE Limited is a company carrying on the business of beauty products and is having a subsidiary SHE Limited. Balance Sheets of both the companies as at 31st March, 2019 are as under:

Particulars	***Note No.***	***HE Limited (₹)***	***SHE Limited (₹)***
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	*1*	*1,25,00,000*	*29,00,000*
(b) Reserves and Surplus	*2*	*25,62,500*	*16,25,000*
(2) Current Liabilities			
(a) Trade Payables	*3*	*24,15,000*	*15,92,500*
Total		***1,74,77,500***	***61,17,500***
II. Assets:			
(1) Non-current Assets			

	(a) Property, Plant & Equipment		1,08,50,000	31,25,000
	(b) Investments	4	25,50,000	-
(2)	Current Assets:			
	(a) Inventories		24,00,000	15,96,000
	(b) Trade Receivables	5	12,40,000	13,20,000
	(c) Cash and Cash Equivalents		4,37,500	76,500
Total			1,74,77,500	61,17,500

Notes to Accounts:

Note No.		HE Limited (₹)	SHE Limited (₹)
1.	Share Capital		
	Authorised, issued, subscribed & paid up:		
	1,25,000 Equity Shares of ₹ 100 each	1,25,00,000	-
	29,000 Equity Shares of ₹ 100 each	-	29,00,000
2.	Reserves and Surplus		
	General Reserve	10,00,000	6,00,000
	Profit and Loss Account	15,62,500	10,25,000
		25,62,500	16,25,000
3.	Trade Payables		
	Trade Payables	22,75,000	11,77,500
	Bills Payable	1,40,000	4,15,000
		24,15,000	15,92,500
4.	Investments (20,300 Shares in SHE Limited)	25,50,000	-
5.	Trade Receivables		
	Trade Receivables	9,00,000	8,20,000
	Bills Receivables	3,40,000	5,00,000
		12,40,000	13,20,000

HE Limited has also given the following information:

(i) HE Limited has acquired the shares in SHE Limited in two lots on two different dates during the current financial year 2018-2019.

The relevant information at the time of acquisition of shares was as under:

No. of shares acquired	*Balance in General Reserve*	*Balance in Profit & Loss A/c*
1st acquisition - 17,400	*4,00,000*	*1,25,000*
2nd acquisition - 2,900	*4,25,000*	*5,10,000*

(ii) Bills Receivables of HE Limited· includes ₹ 75,000 being acceptance from SHE Limited.

(iii) Both the companies have proposed dividend of 10% for the year ended on 31st March, 2019, but it has not been provided in the books of accounts.

(iv) SHE Limited's inventory includes stock of ₹ 7,25,000 purchased from HE Limited. HE Limited sells goods at mark up of 25% on its costs.

You are required to prepare the Consolidated Balance Sheet of HE Limited along with 'Notes to Accounts'. ***(16 Marks)***

Answer

Consolidated Balance Sheet of HE Ltd. and its subsidiary SHE Ltd. as at 31st March, 2019

Particulars	*Note No.*	*₹*
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital	1	1,25,00,000
Reserves and Surplus	2	31,46,500
(2) Minority Interest (W.N.2)		13,57,500
(3) Current Liabilities		
Trade payables	3	39,32,500
Total		2,09,36,500
II. Assets		
(1) Non-current Assets		
Property, Plant and Equipment	4	1,39,75,000
Intangible assets	5	1,11,500
(2) Current assets		
Inventories	6	38,51,000

Trade Receivables	7	24,85,000
Cash and Cash equivalents	8	5,14,000
		2,09,36,500

Note: 'Trade payables' and 'Bills payable' may be shown separately under 'Current liabilities' in the balance sheet. Similarly, 'Trade receivables' and 'Bills receivables' may be shown separately under 'Current assets' in the balance sheet. Accordingly, separate Notes to accounts for them should be prepared.

Notes to Accounts:

				₹
1.	**Share Capital**			
	Authorised, issued, subscribed and paid up			
	1,25,000 Equity shares of ₹ 100 each			1,25,00,000
2.	**Reserves and Surplus**			
	General Reserve (W.N.4)		11,37,500	
	Profit & Loss Account (W.N.4)		20,09,000	31,46,500
3.	**Trade payables**			
	Trade Payables			
	HE Ltd.		22,75,000	
	SHE Ltd.		11,77,500	34,52,500
	Bills payable			
	HE Ltd.		1,40,000	
	SHE Ltd.	4,15,000		
	Less: Mutual owings	(75,000)	3,40,000	4,80,000
				39,32,500
4.	**Property, Plant and Equipment**			
	HE Ltd.		1,08,50,000	
	SHE Ltd.		31,25,000	1,39,75,000
5.	**Intangible assets**			
	Goodwill (W.N.3)			1,11,500
6.	**Inventories**			
	HE Ltd.		24,00,000	
	SHE Ltd.		15,96,000	
			39,96,000	
	Less: Unrealised profit		(1,45,000)	38,51,000

7.	**Trade Receivables**			
	Trade Receivables			
	HE Ltd.		9,00,000	
	SHE Ltd.		8,20,000	17,20,000
	Bills Receivable			
	HE Ltd.	3,40,000		
	Less: Mutual owings	(75,000)	2,65,000	
	SHE Ltd.		5,00,000	7,65,000
				24,85,000
8.	**Cash and Cash equivalents**			
	HE Ltd.		4,37,500	
	SHE Ltd.		76,500	5,14,000

Note: Since dividend has been proposed by both the companies, it has been considered as declared after the reporting date. As per the amendment in AS 4, no adjustment is required to be made in the financial statements if dividend is declared after the reporting date. However, disclosure of the same is required by the way of a Note.

Note not forming part of items of Balance Sheet

9. 10% dividend has been proposed by the group companies as follows:

HE Ltd.	₹ 12,50,000
Minority Interest of SHE Ltd. (29,00,000 x 10% x 30%)	₹ 87,000
	13,37,000

However, this being a non-adjusting event has **not** been recognized in the Consolidated Financial Statements ended on 31.3.2019.

Working Notes:

1. Analysis of Reserves and Surplus of SHE Limited

		Pre-acquisition Profits	*Post-acquisition*	
			General Reserve	*Profit & Loss Account*
		₹	₹	₹
General Reserve		4,00,000	2,00,000	
Profit & Loss Account		1,25,000		9,00,000
For Lot 1	(A)	5,25,000	2,00,000	9,00,000

Pre-acquisition for Lot 2			
General Reserve (4,25,000 – 4,00,000)		25,000	
Profit & Loss Account (5,10,000-1,25,000)			3,85,000
HE Ltd. (70%) of (A)	3,67,500	1,40,000	6,30,000
Adjustment of pre-acquisition General Reserve for Lot 2 (10%)	2,500	(2,500)	
Adjustment of pre-acquisition Profit & Loss Account for Lot 2 (10%)	38,500	____	(38,500)
HE Ltd.	4,08,500	1,37,500	5,91,500
Minority Interest (30%) of (A)	1,57,500	60,000	2,70,000

2. Minority Interest

	₹
Share Capital (30%)	8,70,000
Add: Share of pre-acquisition profit of SHE Ltd.	1,57,500
Share of post-acquisition General Reserve	60,000
Share of post-acquisition Profit & Loss Account	2,70,000
	13,57,500

3. Cost of Control/Goodwill

	₹
Cost of investments	25,50,000
Less: Share capital (70%)	(20,30,000)
Share of pre-acquisition profit	(4,08,500)
Goodwill	1,11,500

4. Consolidated General Reserve & Profit and Loss Account

	General Reserve	*Profit and Loss*
	₹	₹
HE Ltd.	10,00,000	15,62,500
Less: Unrealised profit		(1,45,000)
Add: Share in post-acquisition item of SHE Ltd.	1,37,500	5,91,500
	11,37,500	20,09,000

Question 4

(a) *Describe major changes in Ind AS 16 vis-a-vis IAS 16 not resulting in Carve Outs and major changes in Ind AS 16 vis-a-vis notified AS 10.* ***(5 Marks)***

(b) *What are the five steps of Revenue Recognition as per Ind AS 115?* ***(5 Marks)***

(c) *A Ltd. made a security deposit the details of which are given below:*

Particulars	***Details***
Date of Security Deposit (Starting Date)	*01-04-2019*
Date of Security Deposit (Finishing Date)	*31-03-2024*
Description	*Lease*
Total Lease Period	*5 years*
Discount Rate	*10.00%*
Security deposit	*₹ 15,00,000*
Present value factor for 5th year @ 10% p.a.	*0.6209*

You are required to pass necessary journal entries for accounting of the deposit in the first year and last year.

Assume market interest rate for a deposit for similar period to be 10% per annum.

(6 Marks)

Answer

(a) Major Changes in Ind AS 16 vis-à-vis IAS 16 Not Resulting in Carve Outs

1. ***Fair Value Model:*** Paragraph 5 of Ind AS 16 has been modified, since Ind AS 40, '*Investment Property'*, prohibits the use of fair value model.

2. ***Guidance for Allocation Basis:*** Paragraph 12 of Appendix B has been modified by giving example of types of costs that would be included as directly attributable overhead costs of the stripping activity asset. Paragraph 13A has been added in Appendix B to provide guidance on allocation basis.

Major Changes in Ind AS 16 vis-à-vis AS 10

(i) Fixed Assets retired from Active Use and Held for Sale: Ind AS 16 does not deal with the assets 'held for sale' because the treatment of such assets is covered in Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. AS 10 deals with accounting for items of fixed assets retired from active use and held for sale.

(ii) Stripping Costs in the Production Phase of a Surface Mine: Ind AS 16 provides guidance on measuring 'Stripping Costs in the Production Phase of a Surface Mine'. AS 10 does not contain this guidance.

(b) Revenue shall be recognised by an entity by applying the following five steps:

Step 1. Identify contract with a customer: This Standard defines a 'contract' and a 'customer' and specifies five mandatory criteria to be met for identification of a contract.

Step 2. Identify performance obligations in contract: At contract inception, assess the goods or services promised and identify as a performance obligation each promise to transfer to the customer either:

(a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Step 3. Determine transaction price: This Standard uses transaction price approach while determining amount of consideration. The consideration promised may include fixed amounts, variable amounts, or both. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component for any consideration payable to the customer.

Step 4. Allocate the transaction price to the performance obligations in the contract: An entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract.

Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract.

Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

Step 5. Recognise revenue when the entity satisfies a performance obligation: An entity recognises revenue when it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time or over time.

(c) The security deposit of ₹ 15,00,000 is an interest free deposit redeemable at the end of lease term. Since, this involves collection of contractual cash flows, it shall be accounted at amortised cost.

Upon initial measurement –

Particulars	Details
Security deposit (A)	15,00,000
Total Lease Period (Years)	5
Discount rate	10%

Present value annuity factor	0.6209
Present value of deposit at beginning (B)	9,31,350
Prepaid lease payment at beginning (A-B)	5,68,650

Journal Entries

At the beginning of year 1

Particulars		Amount	Amount
Security deposit a/c	Dr.	9,31,350	
Prepaid lease expenses	Dr.	5,68,650	
To Bank a/c			15,00,000

Subsequently, every annual reporting year, interest income shall be accrued @ 10% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

At the end of Year 1

Particulars		Amount	Amount
Security deposit a/c (Refer W.N.)	Dr.	93,135	
To Interest income			93,135
Lease expense (5,68,650 / 5 years)	Dr.	1,13,730	
To Prepaid lease expenses			1,13,730

At the end of 5th year, the security deposit shall accrue ₹ 15,00,000 and prepaid expenses shall be fully amortised. Journal entry for realisation of security deposit –

Particulars		Amount	Amount
Security deposit a/c (Refer W.N.)	Dr.	1,36,410	
To Interest income			1,36,410
Lease expense (5,68,650 / 5 years)	Dr.	1,13,730	
To Prepaid lease expenses			1,13,730
Bank a/c	Dr.	15,00,000	
To Security deposit a/c			15,00,000

Working Note:

Table showing accrual of interest over the lease term

Year end	Opening balance	Interest @ 10%	Closing balance
1	9,31,350	93,135	10,24,485

2	10,24,485	1,02,449	11,26,934
3	11,26,934	1,12,693	12,39,627
4	12,39,627	1,23,963	13,63,590
5	13,63,590	1,36,410*	15,00,000

*Difference is due to approximation.

Question 5

Following is the extract from the Balance Sheet of XYZ Limited:

		As at 31.3.2018 (₹)	*As at 31.3.2019 (₹)*
I.	***Equity and Liabilities:***		
	Share Capital	*2,50,00,000*	*2,50,00,000*
	General Reserve	*2,00,00,000*	*2,12,50,000*
	Profit and Loss Account	*80,00,000*	*1,07,50,000*
	12% Term loan	*90,00,000*	*82,50,000*
	Trade Payables	*17,50,000*	*22,50,000*
	Provision for Tax	*5,50,000*	*6,50,000*
		6,43,00,000	***6,81,50,000***
II.	***Assets:***		
	*Fixed Assets**	*2,75,00,000*	*3,25,00,000*
	9% Investment	*1,25,00,000*	*1,25,00,000*
	Inventory	*1,30,00,000*	*1,50,00,000*
	Trade Receivables	*85,00,000*	*55,00,000*
	Cash at Bank	*23,00,000*	*22,50,000*
	Fictitious Assets	*5,00,000*	*4,00,000*
		6,43,00,000	***6,81,50,000***

Additional Information:

(i) Replacement values of Fixed Assets were ₹ 5,50,00,000 on 31-03-2018 and ₹ 6,25,00,000 on 31.3.2019 respectively.*

(ii) Rate of depreciation adopted on Fixed Assets was 5% p.a.*

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* **PS:** Read 'Fixed Assets' as 'Property, Plant and Equipment'.

(iii) 50% of the inventory is to be valued at 120% of its book value.

(iv) 50% of Investments were trade investments.

(v) Trade Receivables on 31st March, 2019 included foreign trade receivables of \$ 17,500 recorded in the books at ₹ 65 per US Dollar. The closing exchange rate was \$ 1 = ₹ 69.

(vi) Trade Payables on 31st March, 2019 included foreign trade payables of \$ 30,000 recorded in the books at ₹ 63 per US Dollar. The closing exchange rate was \$ 1 = ₹ 69.

(vii) Profits for the year 2018-2019 included ₹ 30,00,000 of government subsidy which is not likely to recur.

(viii) ₹ 62,50,000 of Research and Development expenditure was written off to the Profit and Loss Account in the current year. This expenditure is not likely to recur.

(ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.

(x) Tax rate during 2018-2019 was 50%, effective future tax rate will be 40%.

(xi) Normal rate of return expected is 7%.

One of the directors of the company, feels that the company does not have goodwill in the prevalent market circumstances. Do you agree with the contention of the director? If yes, then why and if no, then calculate the value of goodwill along with its leverage effect on company's result. Industry average return is 6% on long-term funds and 8% on equity funds. (Use average capital employed for the purpose of calculations.) ***(16 Marks)***

Answer

1. ***Calculation of Capital employed (CE)***	₹	
	As on 31.3.18	***As on 31.3.19***
Replacement cost of Property, Plant and Equipment	5,50,00,000	6,25,00,000
9% Trade investment (50%)	62,50,000	62,50,000
Current cost of inventory		
$65,00,000 + 65,00,000 \times \frac{120}{100}$	1,43,00,000	
$75,00,000 + 75,00,000 \times \frac{120}{100}$		1,65,00,000
Trade receivables *[55,00,000 + {17,500 x (69-65)}]*	85,00,000	*55,70,000*
Cash at bank	23,00,000	22,50,000
Total (A)	8,63,50,000	9,30,70,000
Less: Outside liabilities		

	12% term loan	90,00,000	82,50,000
	Trade payables *[22,50,000+{30,000x(69-63)}]*	17,50,000	*24,30,000*
	Provision for tax	5,50,000	5,95,000
	Tax effect on increase in value of trade payables and trade receivables [(1,80,000-70,000) x 50%]		(55,000)
	Total (B)	1,13,00,000	1,12,20,000
Capital employed (A-B)		7,50,50,000	8,18,50,000

Average Capital employed at current value

$$= \frac{\text{Opening capital employed + closing capital employed}}{2}$$

2.	***Future Maintainable Profit***		₹	
	Increase in General Reserve		12,50,000	
	Increase in Profit and Loss Account		27,50,000	
	Profit After Tax		40,00,000	
	Pre-tax Profit = 40,00,000 / (1 – 0.5)			80,00,000
	Less:	Non-Trading investment income (9% of ₹ 62,50,000)	5,62,500	
		Subsidy	30,00,000	
		Exchange Loss on Trade Payables [30,000 × (69-63)]	1,80,000	
		Additional depreciation on increase in value of Property, Plant and Equipment (current year) i.e., 6,25,00,000 – 3,25,00,000 x 5%	15,00,000	(52,42,500)
				27,57,500
	Add:	Exchange Gain on trade receivables [17,500 × (69-65)]	70,000	
		Research and development expenses written off	62,50,000	
		Inventory Adjustment (15,00,000 – 13,00,000)	2,00,000	65,20,000
				92,77,500
	Add:	Expected increase of 10%		9,27,750

Future Maintainable Profit before Tax		1,02,05,250
Less: Tax @ 40% (40% of ₹ 1,02,05,250)		(40,82,100)
Future Maintainable Profit		61,23,150
3. *Valuation of Goodwill*		**₹**
According to Capitalization of Super Profit Method		
Future Maintainable Profit		61,23,150
Less: Normal Profit @ 7% on average capital employed (7,84,50,000 × 7%)		(54,91,500)
Super Profit		6,31,650
Capitalised value of super profit 6,31,650 / 7% i.e. Goodwill		90,23,571

Goodwill exists; hence director's fear is not valid.

Leverage Effect on Goodwill

		₹
Future Maintainable Profit on equity fund		61,23,150
Future Maintainable Profit on Long-term Trading Capital employed		
Future Maintainable Profit After Tax	61,23,150	
Add: Interest on Term Loan 82,50,000 × 12% = 9,90,000		
After reduction of 40% tax $9,90,000 \times \frac{(100-40)}{100}$	5,94,000	67,17,150

Average capital employed (Equity approach)	7,84,50,000
Add: 12% Term Loan (90,00,000 + 82,50,000)/2	86,25,000
Average capital employed (Long-term Fund approach)	8,70,75,000
Value of Goodwill	
(A) Equity Approach	
Capitalised value of Future Maintainable Profit = 61,23,150 / 8%	7,65,39,375
Less: Average capital employed	(7,84,50,000)
Value of Goodwill	NIL

(B)	Long-Term Fund Approach	
	Capitalized value of Future Maintainable Profit = (67,17,150 / 6%)	11,19,52,500
	Less: Average capital employed	(8,70,75,000)
	Value of Goodwill	2,48,77,500

Comments on Leverage effect of Goodwill: Adverse Leverage effect on goodwill is 2,48,77,500 (i.e., ₹ 2,48,77,500– NIL).

Question 6

(a) The following particulars in respect of stock options granted by a company are available:

Grant date	*1st April, 2016*
Number of employees covered	*800*
Number of options granted per employee	*120*
Nominal value per share (₹)	*100*
Exercise price per share (₹)	*120*

Shares offered were put in three groups. Group-I was for 20% of shares offered with vesting period one-year. Group-II was for 40% of shares offered with vesting period two-years. Group-III was for 40% of shares offered with vesting period three-years. Fair value of option per share on grant date was ₹ 10 for Group-I, ₹ 12 for Group-II and ₹ 14 for Group-III.

Position on 31-03-2017:

(i) Number of employees left = 80

(ii) Estimate of number of employees to leave in 2017-18 = 72

(iii) Estimate of number of employees to leave in 2018-19 = 68

(iv) Number of employees exercising options in Group-I = 700

Position on 31-03-2018:

(i) Number of employees left = 70

(ii) Estimate of number of employees to leave in 2018-19 = 60

(iii) Number of employees exercising options in Group-II= 638

Position on 31-03-2019:

(i) Number of employees left = 56

(ii) Number of employees at the end of last vesting period = 594

(iii) Number of employees exercising options in Group-III = 590

Options not exercised immediately on vesting, were forfeited.

You are required to calculate the expenses to be recognized in each year and also the number of options forfeited. ***(8 Marks)***

(b) *Vyom Gupta has invested in three mutual funds. From the details given below, you are required to find out effective yield on per annum basis in respect of each of the schemes to Vyom Gupta upto 31-03-2019.*

Particulars	***Mutual Fund***		
	X	***Y***	***Z***
Date of Investment	*1.11.2018*	*1.12.2018*	*1.3.2019*
Amount of investment (₹)	*1,50,000*	*2,50,000*	*1,25,000*
NAV at the date of investment (₹)	*10.60*	*10.50*	*10.00*
Dividend received upto 31.3.2019 (₹)	*2,100*	*3,200*	*Nil*
NAY as on 31.3.2019 (₹)	*10.70*	*10.40*	*10.20*

(8 Marks)

Answer

(a) Table showing number of options expected to vest / exercised

Year	*Group*	*Number of employees*	*Number of shares vested to each employee*	*Total number of shares expected to vest*	*Fair value of option per share*	*Fair value of option*
		a	*b*	*c= a x b*	*d*	*e = c x d*
2016-17	I	700	24	16,800	10.00	1,68,000
	II	648	48	31,104	12.00	3,73,248
	III	580	48	27,840	14.00	3,89,760
2017-18	II	638	48	30,624	12.00	3,67,488
	III	590	48	28,320	14.00	3,96,480
2018-19	III	590	48	28,320	14.00	3,96,480

Table showing expense recognised in the year 2016-2017

	₹	
Group I	1,68,000	
Group II	1,86,624	3,73,248/2

Group III	1,29,920	3,89,760/3
	4,84,544	

Table showing expense recognised in the year 2017-2018

	₹	
Group I	1,68,000	
Group II	3,67,488	
Group III	2,64,320	(3,96,480/3) x 2
Cumulative expense for 2016-2017 and 2017-2018	7,99,808	
Less: Expense recognised in 2016-2017	(4,84,544)	
Expense recognised in 2017-2018	3,15,264	

Table showing expense recognised in the year 2018-2019

	₹
Group I	1,68,000
Group II	3,67,488
Group III	3,96,480
Cumulative expense for 2016-2017 to 2018-2019	9,31,968
Less: Expense recognised in 2016-2017 and 2017-2018	(7,99,808)
Expense recognised in 2018-2019	1,32,160

Table showing number of options forfeited

		Group I *2016-2017*	*Group II* *2017-2018*	*Group III* *2018-2019*
Number of employees qualifying		720	650	594
Less: Number of employees exercising		(700)	(638)	(590)
Number of employees not exercising	a	20	12	4
Number of options per employee	b	24	48	48
Number of options forfeited	a x b	480	576	192

(b) Calculation of effective yield on per annum basis in respect of three mutual fund schemes of Vyom Gupta upto 31.03.2019

		Mutual Fund		
		X	Y	Z
1	Amount of Investment (₹)	1,50,000	2,50,000	1,25,000

2	Date of investment	1.11.2018	1.12.2018	1.3.2019
3	NAV at the date of investment (₹)	10.60	10.50	10.00
4	No. of units on date of investment [1/3]	14,150.94	23,809.52	12,500
5	NAV per unit on 31.03.2019 (₹)	10.70	10.40	10.20
6	Total NAV of mutual fund investments on 31.03.2019 [4 x 5]	1,51,415.06	2,47,619.00	1,27,500.00
7	Increase/ decrease of NAV [6-1]	1,415.06	(2,381.00)	2,500.00
8	Dividend received upto 31.3.2019	2,100	3,200	Nil
9	Total yield [7+8]	3,515.06	819.00	2,500
10	Yield % [9/1] x 100	**2.34%**	**0.33%**	**2%**
11	Number of days	151	121	31
12	Effective yield p.a. [10/11] x 365 days	**5.66%**	**1%**	**23.55%**

Note: The effective yield in the above solution is calculated on number of days basis. However, the same may be calculated on the basis of number of months. The yield based on the number of months the yield will be 5.62 %,0.983%, & 24 % respectively for X, Y & Z for Point No. 12.

Question 7

Attempt any four of the following:

(a) *R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 16% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd.*

You are required to assess the situation from the view point of AS 18 on Related Party Disclosures. ***(4 Marks)***

(b) *From the following information you are required to determine the possible value of brand as per Potential Earning Model:*

		₹ in lakh
(i)	*Profit After Tax (PAT)*	*3,500*
(ii)	*Tangible Fixed Assets**	*15,000*

* **PS:** Read 'Tangible fixed Assets' as 'Property, Plant and Equipment'.

(iii)	*Identifiable intangible assets other than brand*	*1,800*
(iv)	*Weighted average cost of capital (%)*	*15%*
(v)	*Expected normal return on tangible assets weighted average cost (15%) + normal spread (4%)*	*19%*
(vi)	*Appropriate capitalisation factor for intangibles*	*25%*

(4 Marks)

(c) Growing Bank has a criterion that it 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. The data relating to the company are as follows:

(i) Average operating income after tax equals ₹ 30,00,000 per year for the last three years.

(ii) Average total assets over the last three years equals ₹ 90,00,000.

(iii) Weighted average cost of capital appropriate for the company is 12% which is applicable for all three years.

(iv) The company's average current liabilities over the last three years are ₹ 20,00,000.

You are required to justify whether the company qualifies for bank loan? ***(4 Marks)***

(d) On 1st April, 2018, a mutual fund scheme had ₹ 45 lakh units of face value ₹ 10 each. The scheme earned ₹ 405 Lakh in 2018-2019, out of which ₹ 225 Lakh was earned in first half-year. ₹ 5 Lakh units were further issued by scheme on 30.9.2018 at NAV ₹ 60. You are required to show the allocation of earnings and distribution of earnings per unit. Also show important journal entries for sale of units and distribution of dividend at the end of 2018-2019. ***(4 Marks)***

(e) Z Limited issued 25,00,000, 9% Convertible Debentures of ₹ 10 each on April 01, 2018. The debentures are due for redemption on March 31, 2022 at a premium of 10% convertible into equity shares to the extent of 50% and the balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 12%. You are required to calculate the debt and equity components at the time of the issue and show the accounting entry in the company's books at initial recognition.

The following Present Values of ₹ 1 at 9% and at 12% are given to you:

Interest Rate	*Year 1*	*Year 2*	*Year 3*	*Year 4*
9%	*0.9174*	*0.8417*	*0.7722*	*0.7084*
12%	*0.8929*	*0.7972*	*0.7118*	*0.6355*

(4 Marks)

Answer

(a) Para 10 of AS 18 'Related Party Disclosures', defines *related party* as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Definition for Control

Here, control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and *Significant Influence* is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

Nature of Relationship

R Ltd. has direct economic interest in T Ltd. to the extent of 16%, and through S Ltd. in which it is the majority shareholders, it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%). These two taken together (16% + 9%) make the total control of 25%.

Conclusion

In the present case, control of R Ltd. in T Ltd. directly and through S Ltd., does not go beyond 25%. However, as per para 12 of AS 18, significant influence may be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of T Ltd. Accordingly, R Ltd. and T Ltd. are related parties. Since T Ltd. regularly supplies goods to R Ltd., related party disclosure, as per AS 18, is required.

(b) Calculation of possible value of brand as per Potential Earning Model

	₹ in lakh
Profit after Tax	3,500
Less: Profit allocated to tangible assets [19% of ₹15,000]	(2,850)
Profit allocated to intangible assets including brand	650
Capitalisation factor 25%	
Capitalised value of intangible assets including brand $\left[\frac{650}{25}\times 100\right]$	2,600
Less: Identifiable intangible assets other than brand	(1,800)
Brand value	800

(c) Calculation of Economic Value Added

	₹
Net Operating Profit After Tax	30,00,000
Less: Cost of capital employed (Refer W.N.)	(8,40,000)
Economic Value Added	21,60,000

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

Working Note:

Calculation of Cost of Capital employed	₹
Average total assets	90,00,000
Less: Average current liabilities	(20,00,000)
Capital employed	70,00,000

Cost of capital = Capital employed x Weighted average cost of capital
= ₹ 70,00,000 x 12/100 = ₹ 8,40,000

(d)

Allocation of Earnings	***Old Unit Holders***	***New Unit Holders***	***Total***
	[45 lakh units]	***[5 lakh units]***	***[50 lakh units]***
	₹ in lakh	***₹ in lakh***	***₹ in lakh***
First half year (₹ 5 per unit)	225.00	Nil	225.00
Second half year (₹ 3.60 per unit)	162.00	18.00	180.00
	387.00	18.00	405.00
Add: Equalization payment recovered	-	-	25.00*
Total available for distribution			430.00

*Equalization Payment = ₹ 225 lakh / 45 lakh = ₹ 5 per unit.
Recovered from unit holders of 5 lakh units = 5 lakh x ₹ 5 per unit = 25 lakh.

	Old Unit Holders ₹	**New Unit Holders** ₹
Dividend distributed	8.60	8.60
Less: Equalization payment	-	(5.00)
	8.60	3.60

Journal Entries

				(₹ in lakh)
30.9.2018	Bank A/c [5 lakh units x (₹ 60 + ₹ 5)]	Dr.	325.00	
	To Unit Capital [5 lakh units x ₹ 10]			50.00
	To Reserve [₹ 300 lakh - ₹ 50 lakh]			250.00
	To Dividend Equalization [5 lakh units x ₹ 5]			25.00
	(Being the amount received on sale of 5 lakh unit at NAV of ₹ 60 per unit)			
31.3.2019	Dividend Equalization	Dr.	25.00	
	To Revenue A/c			25.00
	(Being the amount transferred to Revenue Account)			
30.9.2019	Revenue A/c	Dr.	430.00	
	To Bank			430.00
	(Being the amount distributed among 50 lakh unit holders @ ₹ 8.60 per unit)			

(e) Computation of debt component of convertible debentures on 1st April, 2018

Particulars	*(₹)*
Present value of principal amount repayable after 4 years	
(A) 2,50,00,000 x 50% x 1.10 x 0.6355 (12% discount factor)	87,38,125
(B) Present value of interest [2,50,00,000 x 9% x 3.0374] (4 years cumulative 12% discount factor)	68,34,150
Total present value of debt component (A) + (B)	1,55,72,275
Issue proceeds from convertible debentures	(2,50,00,000)
Value of equity component	94,27,725

Journal entry at initial recognition

Particulars		*(₹)*	*(₹)*
Bank A/c	Dr.	2,50,00,000	
To 9% Debentures A/c (liability component)			1,55,72,275
To 9% Debentures A/c (equity component)			94,27,725
(Being Debentures recorded at fair value)			