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) *On 1st April, 2018, Mansi Ltd. sold a plant for ₹ 8,52,800. The carrying amount of the plant on that date was ₹ 1,80,000. The sale was a part of the package under which Akash Ltd. leased the asset to Mansi Ltd. for eight years term.*

The economic life of the asset is estimated as 8 years. The minimum lease rents payable by the lessee has fixed at ₹ 1,60,000 payable annually beginning from 31st March, 2019.

The incremental borrowing interest rate of Mansi Ltd. is estimated at 10% p.a.

Calculate the net effect on the Statement of profit and loss in the books of Mansi Ltd.

(5 Marks)

(b) *C Ltd. acquired S Ltd. business (a cash generating unit) on 31-3-2016 for ₹ 8,000 Lakhs. The details of acquisition are us under: -*

Fair value of identifiable asset	*6000 Lakhs*
Goodwill	*2000 Lakhs*

The anticipated useful life of acquired assets is 5 years. Goodwill is to be amortised in 4 years. C Ltd. uses straight-line method of depreciation with no residual values anticipated. On 31-3-2018, C Ltd. estimated the significant decline in production due to change in Government policies. The net selling price of identifiable asset is not determinable. The cash flow forecast based on recent financial budget for next 7 years after considering change in Govt. policies are as follows. Incremental financing cost is 8% which represent current market assessment of the time value of money.

			₹ in Crore*
Year	***Cash flow***	***Year***	***Cash flow***
2019	*800*	*2022*	*600*
2020	*800*	*2023*	*600*
2021	*800*	*2024*	*500*
		2025	*400*

* PS: Read '₹ in crore' as '₹ in lakh'.

You are required to calculate:

(i) Value in use

(ii) Impairment loss

(iii) Revised carrying amount on 31-3-2018 **(5 Marks)**

(c) A Company has undertaken a contract to construct Railway Over Bridge (ROB), which is expected to be completed in three years. A summary of the financial data during construction period is as follows:

(₹ in lakhs)

	Year -I	Year -II	Year-III
Initial amount of revenue agreed in contract	750	750	750
Variation	-	50	50
Contract cost incurred upto the reporting date	240	520	700
Contract cost to complete	460	180	-
Material at site to be used in subsequent year included in contract cost above	65	100	-

Ascertain the amount of revenue, expenses and profit recognised in the Statement of Profit and Loss in each of the three years. **(5 Marks)**

(d) X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before the company knows through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya"'.

X Ltd. incurred additional legal fees to stop infringement on both trademarks.

Both trademarks have a remaining legal life of 10 years.

How should X Ltd. account for these legal costs incurred relating to the two trademarks?

(5 Marks)

Answer

(a) Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Mansi Ltd.)

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

The lease term is for 8 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is

₹ 8,53,600 [₹ 1,60,000 x 5.335 (Annuity factor of ₹ 1 @10% for 8 years)] and amounts to at least substantially all of the fair value (sale price i.e. ₹ 8,52,800) of the leased equipment. Thus, lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 6,72,800 (Sale value ₹ 8,52,800 less carrying amount ₹ 1,80,000) will not be recognized as income in the year of sale in the books of lessee i.e. Mansi Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that depreciation is charged on straight line basis, Mansi Ltd. will recognize depreciation of ₹ 1,06,600 per annum for 8 years (₹ 8,52,800/8) and amortise profit of ₹ 6,72,800 over the lease term of 8 years, i.e. ₹ 84,100 p.a.

The net effect is a debit of (₹ 1,06,600-84,100) ₹ 22,500 p.a. to the Statement of Profit and Loss, for 8 years as covered under the lease term.

(b) (i) Value in Use

Year ended on 31st March	Cash flow (₹ in lakh)	Discounting factor @ 8%	Present Value (₹ in lakh)
2019	800	0.926	740.80
2020	800	0.857	685.60
2021	800	0.794	635.20
2022	600	0.735	441.00
2023	600	0.681	408.60
2024	500	0.630	315.00
2025	400	0.583	233.20
			3459.40

(ii) Impairment loss

Impairment loss = Carrying amount of the asset - Recoverable Amount

= ₹ 4,600 lakhs - ₹ 3,459.40 lakhs (Refer W.N.)

= ₹ 1,140.60 lakhs

(iii) Revised Carrying Amount on 31.3.2018

As per para 87 of AS 28 'Impairment of Assets', an impairment loss should be allocated to reduce the carrying amount of the assets of CGU in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.

(₹ in lakh)

	Goodwill	***Identifiable assets***	***Total***
Useful life	4 years	5 years	
Historical cost	2,000	6,000	8,000
Accumulated depreciation/amortization (for 2 years)	(1,000)	(2,400)	(3,400)
Carrying amount before impairment	1,000	3,600	4,600
Impairment loss	(1,000)	(140.60)	(1,140.60)
Revised carrying amount after impairment loss	0	3,459.40	3,459.40

Working Note:

Calculation of Recoverable Amount

Recoverable amount = Higher of Asset's Net Selling Price or Value in Use

Where, Asset's net selling price is not determinable

Recoverable Amount of the asset will be equal to the Value in use ie. ₹ 3,459.40 lakh.

(c) Calculation of the amount of Revenue, Expenses and Profit recognized in the Statement of Profit and Loss in each of the three years:

(₹ in lakh)

	Up to the reporting date	***Recognized in previous years***	***Recognized in current year***
Year 1			
Revenue (750 x 25%)	187.50	-	187.50
Expenses (700 x 25%)	(175)	-	(175)
Profit	12.50	-	12.50
Year 2			
Revenue (800 x 60%)	480	187.50	292.50
Expenses (700 x 60%)	(420)	(175)	(245)
Profit	60	12.50	47.50
Year 3			
Revenue (800 x 100%)	800	480	320
Expenses (700 x 100%)	(700)	(420)	(280)
Profit	100	60	40

Working Note:

Computation of percentage of completion

	Year 1	Year 2	Year 3
Revenue before variations	750	750	750
Add: Variations Cost incurred till date	-	50	50
	750	800	800
Total Estimated cost :			
Actual cost incurred upto the reporting date	240	520	700
Further cost to be incurred	460	180	-
	700	700	700
Actual cost incurred up to the reporting date (excluding material to be used later year)	175 (240-65)	420 (520-100)	700
Percentage of completion	$\frac{175}{700}\times 100$	$\frac{420}{700}\times 100$	$\frac{700}{700}\times 100$
	25%	60%	100%

(d) As per para 59 of AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs must be recognised as an expense.

Question 2

The summarised Balance Sheet of Ujju Ltd. as at 31st March, 2017 is given below. In it, the respective shares of the company's two divisions namely A Division and B Division in the various assets and liabilities have also been shown.

(₹ in lakhs)

	A Division	B Division	Total
Fixed Assets (Net)	*490*	*210*	*700*
Investments			*105*
Net Current Assets:			

Current Assets	*387*	*505*	
Less: Current Liabilities	*(157)*	*(215)*	
	230	*290*	*520*
			1325
Financed by:			
Loan Funds		*25*	*385*
Own Funds			*300*
Equity Share Capital: (Shares of ₹ 10 each)			*640*
			1,325

Loan funds included, inter alia, Bank loans of ₹ 25 lakh specifically taken for Division B and Debentures of the paid up value of ₹ 100 lakhs redeemable at any time between 1st April, 2017 to 30th September, 2017.

On 1st April, 2017, the company sold all of its investments for ₹ 115 lakh and redeemed all the debentures at ₹ 115 lakh, the cash / bank transactions being recorded in the Bank Account pertaining to Division A.

Later a new company namely Jujju Ltd. was incorporated with an authorised capital of ₹ 900 lakh divided into equity shares of ₹ 10 each. All the assets and liabilities of Division B were transferred to the new company. Jujju Ltd. to allot to Ujju Ltd.'s shareholders its two fully paid equity shares of ₹ 10 each at par for every fully paid equity share of ₹ 10 each hold in Ujju Ltd. as discharge of consideration for the division taken over.

Jujju Ltd. recorded in its books the fixed assets at ₹ 357 lakh and all other assets and liabilities at the same values at which these appeared in the books of Ujju Ltd.

You are required to:

(a) Show the journal entries in the books of Ujju Ltd.

(b) Prepare Ujju Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Jujju Ltd.

(c) Calculate the intrinsic value of one share of Ujju Ltd. immediately before the demerger and immediately after the demerger. ***(16 Marks)***

Answer

(a) Journal Entries in the books of Ujju Ltd. *(₹ in lakh)*

		Dr. Amount	Cr. Amount
Bank Account (Current Assets)	Dr.	115	
To Investments			105

To Profit and Loss Account (Reserves and Surplus) (Sale of investments at a profit of ₹ 10 lakhs)			10
Debentures (Loan Funds)	Dr.	100	
Profits & Loss A/c	Dr.	15	
To Bank Account (Current Assets) (Redemption of debentures at premium)			115
Current Liabilities	Dr.	215	
Bank Loan (Loan Funds)	Dr.	25	
Loss on Demerger (Bal. fig.)	Dr.	475	
To Fixed Assets			210
To Current Assets			505
(Assets and liabilities pertaining to B Division transferred to Jujju Ltd.)			

(b) (i) Ujju Ltd.'s Balance Sheet after demerger

Particulars	***Note No.***	***(₹ in lakh)***
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		640
(b) Reserve and Surplus	1	(180)
(2) Non-current Liabilities		
Long-term borrowings	2	260
(3) Current Liabilities		157
Total		877
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets		490
(2) Current assets	3	387
Total		877

Notes to Accounts:

		(₹ in lakh)
1. Reserves and Surplus		
Own fund- Balance as on 31st March, 2017		300
Add: Profit on sale of investments		10
Less: Loss on redemption of debentures		(15)
Less: Loss on demerger		(475)
Balance shown in balance sheet after demerger		(180)
2. Loan Funds		
Balance as on 31st March, 2017		385
Less: Bank Loan transferred to Jujju Ltd.	25	
Debentures redeemed	100	(125)
Balance shown in balance sheet after demerger		260
3. Current Assets		
Balance as on 31st March, 2017		387
Add: Cash received from sale of investments		115
		502
Less: Cash paid to redeem debentures		(115)
Balance in balance sheet after demerger		387

(ii) Initial Balance Sheet of Jujju Ltd.

Particulars	**Note No.**	**(₹ in lakh)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,280
(2) Non-current Liabilities		
Long-term borrowings	2	25
(3) Current Liabilities		215
Total		1,520
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets (Revalued)		357

Intangible assets	3	658
(2) Current assets		505
Total		1,520

Notes to Accounts:

1. Share Capital

	(₹ in lakh)
Authorised capital	
128 lakh* Equity shares of ₹ 10 each	1,280
Issued and subscribed capital	
128 lakh Equity shares of ₹ 10 each	1280
(Issued for consideration other than cash)	

Note: * Authorised shares of Jujju Ltd. is 90 lakh, as given in the question. However, the shares issued by Jujju Ltd to shareholders of Ujju Ltd. is 128 lakh. Therefore, it is assumed that Jujju Ltd. have taken requisite approval from the shareholders for increasing the authorized shares /share capital and paid required fees to the Registrar of Companies.

2. Long-term borrowing

Loan Funds	25

3. Intangible Asset

	(₹ in lakh)
Goodwill (W.N.2)	658

(c) Calculation of intrinsic value of one share of Ujju Ltd.

Particulars	*Before demerger (Division A and B)*	*After demerger (Division A)*
Fixed Assets	700	490
Net Current Assets	(520-115+115) 520	(387-157) 230
Total Assets	1220	720
Less: Loan Funds (385-100)	(285)	(260)
Net Asset Value	₹ 935 lakh	₹ 460 lakh
Number of shares	64 lakh	64 lakh
Intrinsic value per share	₹ 14.61 per share.	₹ 7.19 per share

Working Notes:

1. **Calculation of Net Assets transferred to Jujju Ltd.**

		(₹ in lakhs)
Fixed Assets		357
Current Assets		505
		862
Less: Current Liabilities	215	
Loan funds	25	(240)
Net Assets		622

2. **Computation of Goodwill**

	(₹ in lakh)
Purchase consideration (2 shares against each 640 shares of Ujju Ltd.	1,280
Less: Net Assets transferred (W.N.1)	(622)
Goodwill	658

Question 3

Raja Ltd. is a holding company and Praja Ltd. and Sevak Ltd. are its subsidiaries. The summarised Balance Sheets of all the companies as on 31.03.2018 are as under:

Particulars	***Raja Ltd.*** ***₹***	***Praja Ltd.*** ***₹***	***Sevak Ltd.*** ***₹***
Share Capital	*3,00,000*	*2,50,000*	*1,50,000*
Reserves	*1,08,000*	*36,000*	*24,000*
Surplus in Statement	*40,000*	*30,000*	*22,000*
Trade Payables	*24,000*	*18,000*	*15,000*
Raja Ltd. Balance		*4,000*	
Sevak Ltd. Balance	*8,000*	*-*	*-*
	4,80,000	*3,38,000*	*2,11,000*

Particulars	***Raja Ltd.*** ***₹***	***Praja Ltd.*** ***₹***	***Sevak Ltd.*** ***₹***
Fixed Assets	*66,000*	*1,36,000*	*1,18,000*
Investments:			
Shares in Praja Ltd.	*2,20,000*		

Shares in Sevak Ltd.	*40,000*	*1,04,000*	
Inventory	*48,000*	*20,000*	*20,000*
Praja Ltd. Balance	*4,000*		
Raja Ltd. Balance			*8,000*
Trade Receivables	*90,000*	*70,000*	*50,000*
Cash & Cash equivalents	*12,000*	*8,000*	*15,000*
	4,80,000	*3,38,000*	*2,11,000*

Additional Information:

(1) The share capital of all the companies is divided into equity shares of ₹ 10 each.

(2) Raja Ltd. holds 20,000 shares of Praja Ltd. and 3000 shares of Sevak Ltd.

(3) Praja Ltd. holds 9000 shares of Sevak Ltd.

(4) All the investments were made on 30.09.2017.

(5) The position on 31.03.2017 was as under:

	Praja Ltd. (₹)	*Sevak Ltd. (₹)*
Reserves	*20,000*	*18,000*
Surplus in Statement of P & L	*16,000*	*10,000*

(6) The whole of inventory of Praja Ltd. as on 30.09.2017 (₹ 14,000) was later sold to Raja Ltd. for ₹ 16,000 and half of it remained unsold at Raja Ltd. as on 31.03.2018.

(7) Trade Receivables of Praja Ltd. includes ₹ 15,000 receivables from Sevak Ltd.

(8) All the companies proposed dividend of 12%.

Prepare the Consolidated Balance Sheet of the group as on 31.03.2018 using direct method. Notes to Accounts and working notes should form part of your solution. ***(16 Marks)***

Answer

Consolidated Balance Sheet of Raja Ltd. and its subsidiaries Praja Ltd. and Sevak Ltd. as on 31st March, 2018

Particulars	**Note No.**	**(₹)**
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		3,00,000
(b) Reserves and Surplus	1	1,91,720

	(2)	Minority Interest (W.N 5)		1,03,280
	(3)	Current Liabilities		
		(a) Trade payables	2	42,000
		Total		6,37,000
II.		Assets		
	(1)	Non-current assets		
		Fixed assets	3	3,20,000
	(2)	Current assets		
		(a) Inventories	4	87,000
		(b) Trade receivables	5	1,95,000
		(c) Cash and cash equivalents	6	35,000
		Total		6,37,000

Notes to Accounts

		(₹)	(₹)
1.	**Reserves and surplus**		
	(A) Reserves -		
	Balance as on 31.3.2018 (given)	1,08,000	
	Share in		
	Praja Ltd. [WN 3]	7,840	
	Sevak Ltd. [WN 2]	600	1,16,440
	(B) Profit & Loss Account		
	Balance as on 31.3.2018 (given)	40,000	
	Share in		
	Praja Ltd. [WN 3]	8,480	
	Sevak Ltd. [WN 2]	1,200	
		49,680	
	Less : Provision for unrealised profit on inventory [(16,000 -14,000) x½]x80%	(800)	48,880
	(C) Capital Reserve (W.N.4)		26,400
			1,91,720
2.	**Trade Payables**		
	Raja Ltd.	24,000	

	Praja Ltd.		18,000	
	Sevak Ltd. (15,000 -15,000)		Nil	42,000
3.	**Fixed Assets**			
	Raja Ltd.		66,000	
	Praja Ltd.		1,36,000	
	Sevak Ltd.		1,18,000	3,20,000
4.	**Inventories**			
	Raja	48,000		
	*Less:*Unrealised gain	(1,000)	47,000	
	Praja Ltd.		20,000	
	Sevak Ltd.		20,000	87,000
5.	**Trade Receivables**			
	Raja Ltd.		90,000	
	Praja Ltd. (70,000 – 15,000)		55,000	
	Sevak Ltd.		50,000	1,95,000
6.	**Cash and cash equivalents**			
	Raja Ltd.		12,000	
	Praja Ltd.		8,000	
	Sevak Ltd.		15,000	35,000

7. 12% dividend has been proposed by the group companies as follows:

Raja Ltd.	₹ 36,000	
Minority Interest		
Of Praja Ltd. (2,50,000 x 12% x 20%)	₹ 6,000	
Of Sevak Ltd. (1,50,000 x 12% x 20%)	₹ 3,600	45,600

However, this being a non-adjusting event has not been recognized in the Consolidated Financial Statements ended on 31.3.2018

Note: Since dividend has been proposed by all 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 Notes.

Working Notes:

Shareholding Pattern

	Praja Ltd.	Sevak Ltd.
Total Shares	25,000	15,000
Held by Raja Ltd.	20,000 [80%]	3,000 [20%]
Held by Praja Ltd.	NA	9,000 [60%]
Minority Holding	20%	20%

(1) Position on 30.09.2017 i.e. date of investment

	Reserves	*Profit and Loss Account*
	₹	₹
Praja Ltd.		
Balance as on 31.3.2018	36,000	30,000
Less: Balance as on 31.3.2017 (A)	(20,000)	(16,000)
Increase during the year	16,000	14,000
Estimated increase for half year (B)	8,000	7,000
Balance as on 30.9.2017 (A + B)	(20,000 +8,000) **28,000**	(16,000 + 7,000) **23,000**
Sevak Ltd.		
Balance as on 31.3.2018	24,000	22,000
Less: Balance as on 31.3.2017 (C)	(18,000)	(10,000)
Increase during the year	6,000	12,000
Estimated increase for half year (D)	3,000	6,000
Balance as on 30.9.2017 (C + D)	(18,000 + 3,000) **21,000**	(10,000 + 6,000) **16,000**

(2) Analysis of Profits of Sevak Ltd.

	Capital Profit ₹	*Revenue Reserve* ₹	*Revenue profit* ₹
Reserves as on 30.9.2017 [WN 1]	21,000		
Profit and Loss A/c as on 30.9.2017	16,000		
Increase in reserves after 30.9.2017		3,000	
Increase in profit after 30.9.2017			6,000
	37,000	3,000	6,000

Share of Raja Ltd. (20%)	7,400	600	1,200
Share of Praja Ltd. (60%)	22,200	1,800	3,600
Minority interest (20%)	7,400	600	1,200

(3) Analysis of Profits of Praja Ltd. (By direct method)

	Capital Profit ₹	***Revenue Reserve*** ₹	***Revenue profit*** ₹
Reserves as on 30.9.2017	28,000		
Profit and Loss A/c on 30.9.2017	23,000		
Increase in reserves after 30.9.2017		8,000	
Increase in profit after 30.9.2017			7,000
Share in Sevak Ltd. [WN 2]	-	1,800	3,600
	51,000	9,800	10,600
Share of Raja Ltd. (80%)	40,800	7,840	8,480
Minority interest (20%)	10,200	1,960	2,120

(4) Cost of control / Capital Reserve (by direct method)

	₹	₹
Investments in		
Praja Ltd.	2,20,000	
Sevak Ltd. [40,000 + 1,04,000]	1,44,000	3,64,000
Less : Paid up value of investments in		
Praja Ltd.	2,00,000	
Sevak Ltd. (30,000+90,000)	1,20,000	(3,20,000)
Capital profits in		
Praja Ltd. [WN 3]	40,800	
Sevak Ltd. [WN 2] (22,200 +7,400)	29,600	(70,400)
Capital Reserve		26,400

(5) Minority Interest

	₹	₹
Share Capital:		
Praja Ltd. [20%]	50,000	
Sevak Ltd. [20%]	30,000	80,000

Add: Share in profits and reserves (Pre and Post-acquisitions)		
Praja Ltd. [WN 3] (10,200 +1960+2120)	14,280	
Sevak Ltd. [WN 2] (7,400 +600+1,200)	9,200	23,480
		1,03,480
Less: Provision for unrealized profit [(16,000-14,000) x ½] x 20%		(200)
		1,03,280

Question 4

(a) *The capital structure of Manu Ltd. on 31st March, 2018 was as follows:*

	₹
Equity Share Capital (200000 shares of ₹ 10 each)	*20,00,000*
12% Preference Share Capital (10,000 shares of ₹ 100 each)	*10,00,000*
10% Secured Debentures	*12,00,000*
Reserves & Surplus	*4,50,000*
Profit earned before interest and taxes during the year	*11,80,000*
Tax rate was 30%	

Additional information:

(1) *The company has been paying regularly equity dividend @ 20%.*

(2) *The rate of return on equity shares of similar industry is 18%.*

(3) *The profit after tax covers fixed interest and fixed dividend at least 4 times.*

(4) *The Debt Equity ratio is at least 2.*

(5) *Yield on shares is calculated at 50% of distributed profit and 20% of undistributed profit.*

(6) *The risk premium for dividend is generally assumed at 2%.*

You are required to find out value of an equity share of the company. **(8 Marks)**

(b) *Naresh Ltd. had the following transactions during the financial year 2017-2018:*

(i) *Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2017. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, the life of resulting goodwill is unlimited.*

(ii) *Naresh Ltd. had taken a franchise on July 2017 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during* *the financial year 2017-2018. Naresh Ltd. projects future revenue of ₹ 1,00,000 in 2018-2019, ₹ 1,20,000 in 2019-2020 and ₹ 1,50,000 per annum for next 3 years thereafter.*

(iii) On 20th August, 2017, Naresh Ltd. was granted a patent that had been applied for by Sunil Ltd. During 2017-2018, Naresh Ltd, incurred legal costs of ₹ 2,40,000 to register the patent and an additional ₹ 3,20,000 to successfully prosecute a patent infringement suit against a competitor. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standard taking a full year amortization in the year of acquisition.

Prepare:

(1) A schedule showing the intangible section in Naresh Ltd. Balance Sheet at 31st March, 2018.

(2) A schedule showing the related expenses that would appear in Statement of Profit and Loss of Naresh Ltd. for 2017- 2018. ***(8 Marks)***

Answer

(a) Calculation of profit after tax (PAT)

	₹	₹
Profit before interest & tax (PBIT)		11,80,000
Less: Debenture interest (₹ 12,00,000 × 10/100)		(1,20,000)
Profit before tax (PBT)		10,60,000
Less: Tax@ 30%		(3,18,000)
Profit after tax (PAT)		7,42,000
Less: Preference dividend (₹ 10,00,000 x 12/100)	1,20,000	
Equity dividend (₹ 20,00,000 x 20/100)	4,00,000	(5,20,000)
Retained earnings (undistributed profit)		2,22,000

Calculation of Interest and Fixed Dividend Coverage

$$= \frac{\text{PAT + Debenture interest}}{\text{Debenture interest + Preference dividend}}$$

= (7,42,000 +1,20,000)/(1,20,000+1,20,000)

= 8,62,000 /2,40,000

= 3.59

Calculation of Debt Equity Ratio

$$\text{Debt Equity Ratio} = \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}}$$

$$= \frac{\text{Debentures}}{\text{Preference share capital} + \text{Equity share capital} + \text{Reserves}}$$

= ₹ 12,00,000/ (₹ 10,00,000 +₹ 20,00,000 + ₹ 4,50,000)

Debt Equity Ratio = ₹ 12,00,000 /₹ 34,50,000= 0.348

The ratio is less than the prescribed ratio.

Calculation of Yield on Equity Shares

Yield on equity shares is calculated at 50% of distributed profits and 20% of undistributed profits:

50% of distributed profits (50% of ₹ 4,00,000)	2,00,000
20% of undistributed profits (20% of ₹ 2,22,000)	44,400
	2,44,400

Yields on equity shares = $\frac{\text{Yield on shares}}{\text{Equity share capital}} \times 100$ = 2,44,400 / ₹ 20,00,000 = 12.22%

Calculation of Expected Yield on Equity Shares	
Normal return expected	18%
Add: Risk premium for low interest and fixed dividend coverage (3.59 < 4)	2%*
Risk for debt equity ratio not required	Nil**
	20%
Value of an Equity Share	
= $\frac{\text{Actual yield}}{\text{Expected yield}} \times$ Paid up value of a share = 12.22 / 20 x 10 = ₹ 6.11	

* When interest and fixed dividend coverage is lower than the prescribed norm, the riskiness of equity investors is high. They should claim additional risk premium over and above the normal rate of return.

** The debt equity ratio is lower than the prescribed ratio that means outside funds (Debts) are lower as compared to shareholders' funds. Hence, the risk is less for equity shareholders. Therefore, no risk premium is required to be added in this case.

(b) (a) **Naresh Ltd.**

Balance Sheet (Extract relating to intangible asset) as on 31st March 2018

	Note No.	₹
Assets		
(1) Non- current asset		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	**Intangible assets**		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

(b) **Statement of Profit and Loss (Extract)**

for the year ended 31st March 2018

	Note No.	₹
Revenue from Operations		60,000
Total Revenue		?
Expenses:		
Legal cost on patent		3,20,000
Amortization	2	1,72,800
Fee for Franchise (60,000 x 10%)	3	6,000
Total Expenses		?

Notes to Accounts (Extract)

2.	**Amortization expenses on**		
	Goodwill	1,12,800	
	Franchise	30,000	
	Patent	30,000	1,72,800
3.	**Fee for Franchise** (60,000 x 10%)		6,000

Working Notes:

		₹
(1)	**Goodwill on acquisition of business**	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 ie. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	**Franchise**	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	**Patent**	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

Question 5

(a) *Tanish Ltd. announce an ESOP scheme for each of its 400 employees on 1st April, 2016. The scheme grants 200 stock options to each employee at an exercise price of ₹ 30 per share subject to the condition of continuous employment in the company for 2 years.*

The fair value of the option is ₹ 12 on the grant date.

The other information is given as under:

(i) *The number of employees expected to satisfy service condition are 360 in the 1st year and 320 in the 2nd year.*

(ii) *30 employees left the company in the 1st year of service and 340 employees have actually completed 2-year vesting period.*

(iii) *The profit of the enterprise before amortization of the compensation cost on account of ESOPs is as follows:*

	PROFIT	*YEAR*
(A)	*₹ 11,20,000*	*2016-2017*
(B)	*₹ 13,40,000*	*2017-2018*

(iv) *The fair value of share for these years was ₹ 45 and ₹ 50 respectively.*

(v) The company has 3 lakh shares of ₹ 10 each outstanding at the end of both years. Calculate basic and diluted EPS for both the years. (Ignore the tax impacts)

(8 Marks)

(b) Anjali Ltd. has given a sum of ₹ 25 lakhs as a loan to Vidhya Ltd. at 12% rate of interest per annum, for 6 years. The loan had a Fair Value of ₹ 30,42,000 at the effective interest rate of 10%.

To mitigate prepayment risks but at the same time retaining control over the loan, Anjali Ltd. transferred its right to receive the principal amount of the loan on its maturity with interest, after retaining rights over 15% of principal and 2% interest that carries Fair Value of ₹ 74,000 and ₹ 4,50,300 respectively. The consideration for the transaction was ₹ 24,80,000.

The interest component retained included 1% fee towards collection of principal and interest that has a Fair Value of ₹ 1,40,200. Defaults, if any are deductible to a maximum extent of the company's claim on principal portion.

You are required to pass the journal entries to record derecognition of the Loan. ***(8 Marks)***

Answer

(a) Calculation of Basic & Diluted EPS

		2016-2017	***2017-2018***
Profit before amortization of ESOP cost		11,20,000	13,40,000
Less: ESOP cost amortised (W.N.2)		(4,32,000)	(3,84,000)
Net profit for shareholders		6,88,000	9,56,000
No. of shares outstanding	(a)	3,00,000	3,00,000
Basic EPS		2.29	3.19
Potential equity (W.N.1)	(b)	14,800	27,200
Total no. of equity shares (a + b)		3,14,800	3,27,200
Diluted EPS		2.19	2.92

Working Notes:

1. Calculation of Potential Equity

		2016-2017	***2017-2018***
a.	Actual no. of employees	370	340
b.	Options granted per employee	200	200
c.	No. of options outstanding	74,000	68,000
d.	Unamortised ESOP cost per option (₹)	(₹ 12-12/2) 6	0

e.	Exercise price (₹)	30	30
f.	Expected exercise price to be received (c x e) (₹)	22,20,000	20,40,000
g.	Unamortised ESOP cost (c x d) (₹)	4,44,000	0
h.	Total proceeds (₹)	26,64,000	20,40,000
i.	Fair value per share	45	50
j.	No. of shares issued for consideration (h/i)	59,200	40,800
k.	Potential Equity (c-j)	14,800	27,200

2. Calculation of ESOP cost to be amortised

	2016-2017	*2017-2018*
Fair value of options per share	₹ 12	₹ 12
No. of options expected to vest under the scheme	(360 x 200) 72,000	(340 x 200) 68,000
Fair value of options	8,64,000	8,16,000
Value of options recognized as expenses	(₹ 8,64,000/ 2) 4,32,000	(₹ 8,16,000 –₹ 4,32,000) 3,84,000

(b) (i) Calculation of securitized component of loan

		₹	₹
Fair Value			30,42,000
Less: Principal strip receivable (fair value)		74,000	
Less: Interest strip receivable (fair value)	3,10,100		
Less: Value of service asset (fair value)	1,40,200	4,50,300	(5,24,300)
			25,17,700

(ii) Apportionment of carrying amount in the ratio of fair values

	Fair value (₹)		Apportionment (₹)
Securitized component of loan	25,17,700	$\frac{25,17,700 \times 25,00,000}{30,42,000}$	20,69,116
Principal strip receivable	74,000	$\frac{74,000 \times 25,00,000}{30,42,000}$	60,815
Interest strip receivable	3,10,100	$\frac{3,10,100 \times 25,00,000}{30,42,000}$	2,54,849

Servicing asset	1,40,200	$\frac{1,40,200 \times 25,00,000}{30,42,000}$	1,15,220

(iii) Entries to record the derecognition of the Loan

		₹	₹
Bank A/c To Loan A/c To Profit & Loss A/c (Being entry for securitization of 85% principal with 17% interest)	Dr.	24,80,000	 20,69,116 4,10,884
Interest strip A/c Servicing asset A/c Principal strip A/c To Loan A/c (Being entry for interest, servicing asset and principal strips received)	Dr. Dr. Dr.	2,54,849 1,15,220 60,815	 4,30,884

Question 6

(a) The summarised Balance Sheets of Lily Ltd. for the past three years are as follows:

(₹ in thousand)

	31st March, 2016	*31st March, 2017*	*31st March, 2018*
Liabilities			
5,50,000 Equity Shares of ₹ 10 each fully paid up	*5,500*	*5,500*	*5,500*
General Reserves	*3,200*	*4,100*	*5,000*
Surplus-Statement of P&L	*420*	*640*	*840*
Trade Payables	*1,800*	*1,500*	*2,000*
Total	*10,920*	*11,740*	*13,340*
Assets			
Goodwill	*2,000*	*1,600*	*1,200*
Tangible Assets (Net)	*4,800*	*5,200*	*5,500*
Inventories	*3,200*	*3,600*	*4,000*
Trade Receivables	*710*	*1,000*	*2,090*
Cash and Cash Equivalents	*210*	*340*	*550*
Total	*10,920*	*11,740*	*13,340*

Additional Information:

(i)	*Actual valuation were as under:*	*31.3.2016*	*31.3.2017*	*31.3.2018*
	Tangible Assets (Net)	*6,000*	*6,400*	*6,800*
	Inventories	*3,600*	*4,000*	*4,400*
	Net Profit (Including opening balance after writing off depreciation, goodwill, tax provision)	*1,260*	*1,880*	*2,500*

(ii) Capital employed in the business at market value at the beginning of 2015-2016 was ₹ 1,22,40,000 which included cost of goodwill. The normal annual return on average capital employed in line of business in which Lily Ltd. is engaged is 15%.

(iii) The balance in General Reserves as on 1st April, 2015 was ₹ 23 Lakhs.

(iv) The goodwill shown on 31st March, 2016 was purchased on 1st April, 2015 for ₹ 20 lakhs and the balance in Statement of Profit & Loss as on 1st April, 2015 was ₹ 3,18,000.

(v) Goodwill is to be valued at 3 years' purchase of super profit by using simple average method.

Find out the average capital employed in each year and total value of business as on 31st March, 2018. ***(8 Marks)***

(b) The investment portfolio of a mutual fund scheme includes 6,000 shares of Leena Ltd. and 5,000 shares of Meena Ltd. acquired on 01.10.2016. The acquisition cost of Leena Ltd.' s shares is ₹ 50 per share while that of Meena Ltd.'s shares is ₹ 65 per share. The market value of these shares at the end of 2016-2017 were ₹ 47 and ₹ 70 per share respectively. On 30.09.2017, shares of both the companies were disposed off realizing ₹ 44 per Leena Ltd.'s share and ₹ 77 per Meena Ltd.'s share. Show important accounting entries with relevant dates in the books of the fund for the accounting year 2016-2017 and 2017-2018.

(8 Marks)

Answer

(a) (i) Total value of business

	₹
Total net asset as on 31.3.2018	1,30,40,000
Less: Goodwill as per Balance Sheet	(12,00,000)
Add: Goodwill as calculated in Working Note 3	1,82,000
Value of Business	1,20,22,000

(ii) Calculation of Average Capital Employed of each year

	31.3.2016 ₹	31.3.2017 ₹	31.3.2018 ₹
Goodwill	20,00,000	16,00,000	12,00,000
Tangible Assets	60,00,000	64,00,000	68,00,000
Inventory (Revalued)	36,00,000	40,00,000	44,00,000
Trade Receivables	7,10,000	10,00,000	20,90,000
Bank Balance	2,10,000	3,40,000	5,50,000
Total Assets	1,25,20,000	1,33,40,000	1,50,40,000
Less: Trade Payables	(18,00,000)	(15,00,000)	(20,00,000)
Closing Capital employed (net assets)	1,07,20,000	1,18,40,000	1,30,40,000
Add: Opening Capital employed	1,22,40,000	1,07,20,000	1,18,40,000
Total	2,29,60,000	2,25,60,000	2,48,80,000
Average Capital employed	1,14,80,000	1,12,80,000	1,24,40,000

Since goodwill has been purchased, it is taken as a part of capital employed.

Working Notes:

1. Calculation of Future Maintainable Profit

	31.3.2016	31.3.2017	31.3.2018
Net Profit as given	12,60,000	18,80,000	25,00,000
Less: Opening Balance	(3,18,000)	(4,20,000)	(6,40,000)
Adjustment for Valuation of Opening Inventory	-	(4,00,000)	(4,00,000)
Add: Adjustment for Valuation of closing inventory	4,00,000	4,00,000	4,00,000
Goodwill written off	-	4,00,000	4,00,000
Adjusted profit	13,42,000	18,60,000	22,60,000

2. Calculation of Super Profit

Average Adjusted profit [(13,42,000 + 18,60,000 + 22,60,000)/3]	18,20,667
Less: 15% Normal Return on average capital employed $\left[\left(\frac{1,14,80,000+1,12,80,000+1,24,40,000}{3}\right) x\ 15\%\right]$	(17,60,000)
Super Profit	60,667

3. **Value of Goodwill**

Value of Goodwill at 3 years' purchase of super profit = ₹ 60,667 x 3 = ₹ 1,82,000 (approx.)

(b) Accounting Entries in the books of fund

S.No.	Date	Particulars		₹	₹
1.	1.10.2016	Investment in Leena Ltd.'s shares A/c (6,000x₹ 50)	Dr.	3,00,000	
		Investment in Meena Ltd.'s shares A/c (5,000 x ₹ 65)	Dr.	3,25,000	
		To Bank A/c			6,25,000
		(Being investment made in Leena Ltd. and Meena Ltd.)			
2.	31.3.2017	Revenue A/c [6,000 x ₹ (50 - 47)]	Dr.	18,000	
		To Investment in Leena Ltd.'s shares A/c			18,000
		(Being provision created for the reduction in the value of Leena Ltd.'s shares)			
3.	31.3.2017	Investment in Meena Ltd.'s shares A/c [5,000 x ₹ (70 - 65)]	Dr.	25,000	
		To Unrealised Appreciation Reserve A/c			25,000
		(Being appreciation in the market value of Meena Ltd.'s shares transferred to Unrealised Appreciation Reserve A/c)			
4.	01.04.2017	Unrealised Appreciation Reserve A/c	Dr.	25,000	
		To Investment in Meena Ltd.'s shares A/c			25,000
		(Being last year's unrealised appreciation reserve balance reversed at the beginning of the current year)			
5.	30.9.2017	Bank A/c (6,000 x ₹ 44)	Dr.	2,64,000	
		Loss on disposal of Investment A/c	Dr.	18,000	
		To Investment in Leena Ltd.'s shares A/c			2,82,000
		(Being shares of Leena Ltd. disposed off at a loss of ₹ 36,000)			
6.	30.9.2017	Revenue A/c	Dr.	18,000	
		To Loss on disposal of Investment A/c			18,000
		(Being net loss on disposal of Leena Ltd.'s shares charged to revenue account)			
7.	30.9.2017	Bank A/c (5,000 x ₹ 77)	Dr.	3,85,000	
		To Investment in Meena Ltd.'s shares A/c			3,25,000
		To Revenue A/c			60,000
		(Being shares of Meena Ltd. disposed off at a profit of ₹ 60,000)			

Alternatively, diminution in the value of shares of Leena Ltd. can directly be credited to 'Investment in Leena Ltd.'s shares A/c' in Entry 2 above instead of crediting it to 'Provision for depreciation A/c'. Accordingly, amount in Journal entries 5 and 6 will also undergo a change.

Question 7

Answer any four of the following:

(a) *On 25th March, 2018 an entity entered into an agreement to purchase a Financial Asset for ₹ 1,00,000, which is the Fair value on that date.*

On Balance Sheet date i.e., 31st March, 2018 the fair value is ₹ 1,05,000 and on settlement date i.e., on 10th April, 2018 fair value is ₹ 1,07,000.

Pass necessary journal entries on trade date and settlement date * *when the asset acquired is measured at FVTPL.*

(Narrations need not be given). ***(4 Marks)***

(b) *Kiran Ltd., acquired 25% of Varun Ltd., shares for ₹ 5,00,000 on 1-6-2017. By such an acquisition, Kiran Ltd. can exercise significant influence over Varun Ltd. During the financial year ending 31-3-2017, Varun Ltd. earned profit of ₹ 1,00,000 and declared a dividend of ₹ 60,000 on 25-8-2017. Varun Ltd., reported earnings of ₹ 3,50,000 for the financial year ending on 31-3-2018 and declared dividend of ₹ 80,000 on 15-7-2018.*

Calculate the carrying amount of investment in:

(i) *Separate financial statement of Kiran Ltd. as on 31-3-2018.*

(ii) *Consolidated financial statements of Kiran Ltd. as on 31-3-2018. (Kiran Ltd., has a subsidiary company)*

(iii) *What will be the carrying amount as on 31-7-2018 in consolidated financial statements?* ***(4 Marks)***

(c) *List out the types of leases. Under what circumstances can a non-cancellable lease be cancelled as per relevant Ind AS.* ***(4 Marks)***

(d) *Vijeta Industries has 40% share in joint venture with Sujata Industries. Vijeta Industries sold a machinery of ₹ 200 lakhs (WDV value), for ₹ 240 lakhs. Calculate how much profit Vijeta Industries should recognize in its book in case the joint venture is a*

- *Jointly controlled operation.*
- *Jointly controlled asset.*
- *Jointly controlled entity.* ***(4 Marks)***

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* Read "Pass necessary journal entries on trade date and settlement date* when….." as "Pass necessary journal entries on trade date and settlement date basis when…..' when the asset acquired is measured at FVTPL.

(e) *Explain revision in Accounting Estimates including recognition in Financial Statement as per Ind AS 8.* ***(4 Marks)***

Answer

(a) (i) Financial Asset at FVTPL – As per Trade Date Accounting Basis

Dates	*Journal Entry*		*Amount*	*Amount*
			(₹)	*(₹)*
25/3/2018	Financial Asset	Dr.	1,00,000	
	To Payables			1,00,000
31/3/2018	Financial Asset	Dr.	5,000	
	To P&L			5,000
10/4/2018	Financial Asset	Dr.	2,000	
	To P&L			2,000
	Payables	Dr.	1,00,000	
	To Cash			1,00,000

(ii) Financial Asset at FVTPL – As per Settlement Date Accounting Basis

Dates	*Journal Entry*		*Amount*	*Amount*
			(₹)	*(₹)*
25/3/2018	No Entry			
31/3/2018	Fair Value Change	Dr.	5,000	
	To P&L			5,000
10/4/2018	Fair Value Change	Dr.	2,000	
	To P&L			2,000
	Financial Asset	Dr.	1,07,000	
	To Cash			1,00,000
	To Fair Value Change			7,000

(b) (i) Carrying amount of investment in Separate Financial Statement of Kiran Ltd. as on 31.03.2018

	₹
Amount paid for investment in Associate (on 1.06.2017)	5,00,000
Less: Pre-acquisition dividend (₹ 60,000 x 25%)	(15,000)
Carrying amount as on 31.3.2018 as per AS 13	4,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Kiran Ltd. as on 31.3.2018 as per AS 23

	₹
Carrying amount as per separate financial statements	4,85,000
Add: Proportionate share of profit of investee as per equity method [(25% of ₹ 3,50,000) x 10/12]	72,917
Carrying amount as on 31.3.2018	5,57,917

(iii) Carrying amount of investment in Consolidated Financial Statement of Kiran Ltd. as on 31.7.2018 as per AS 23

	₹
Carrying amount as on 31.3.2018	5,57,917
Less: Dividend received [(₹ 80,000 x 25%) x 10/12]	(16,667)
Carrying amount as on 31.7.2018	5,41,250

(c) As per Ind AS 17 'Leases', there are two types of leases:

1. **Finance Lease:** A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.
2. **Operating Lease: An operating lease is a lease other than a finance lease.**

A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency;

(b) with the permission of the lessor;

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.

(d) There are two possible assumptions in the given scenario viz:

(i) Machinery sold by Vijeta Industries is on behalf of the Joint Venture

Vijeta Industries will be recognizing 40% shares of profit in its financial statements irrespective of the kind of Joint Venture.

Calculation of share of profit of Vijeta Industries in the Joint Venture would be:

(₹ in lakh)

Sale price of machinery	240
Less: WDV of machinery	(200)

Profit on sale	40
Share of Vijeta Industries (40 lakh x 40%)	16

(ii) Machinery is sold by Vijeta Industries to the Joint Venture

As per AS 27, in case of 'jointly controlled operation' and 'jointly controlled assets' joint venture, the venturer should recognize the profit to the extent of other venturer's interest.

In the instant case, VIjeta Industires should recognize profit of (240 - 200) = 40 × 60% = 24 lakh only.

However, in case of jointly controlled entities, Vijeta Industries should recognize full profit of ₹ 40 lakh in its separate financial statements. However, while preparing consolidated financial statement it should recognize the profit only to the extent of 60% i.e. 24 lakh.

Note: In the absence of clarity in the question, answer on either of the assumption is acceptable.

(e) Revision in Accounting Estimates

An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

A change in accounting estimate is an:

- Adjustment of the carrying amount of an asset or a liability, or
- The amount of the periodic consumption of an asset,

That results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.

Recognizing in Financial Statements

The effect of a change in an accounting estimate shall be recognised prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.