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) Tee Ltd. closes its books of accounts every year on 31 March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31 March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15 April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31 March 2020. ***(5 Marks)***

(b) Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues:

(i) The company has its plants at 3 different locations. It has to shut down one of its plants due to internal reasons. The said plant site is under a rental agreement till 31.3.2021. The rent per month is ₹ 80,000. If the company cancels the agreement, it has to pay a penal amount equal to six month's rent. The company also has an option to sub-let the site at a rent of ₹ 45,000 per month.

(ii) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

(iii) The company had committed to supply a consignment worth ₹ 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% of the value is to be paid. While the consignment was in transit, one of the trucks carrying goods worth ₹ 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed for the compensation.

Give your answers based on relevant Accounting standard. **(5 Marks)**

(c) From the following data of Smart Ltd., prepare cash flow statement from Operating activities using direct method as per AS 3:

	31.03.2020 (₹)	*31.03.2019 (₹)*
Current Assets:		
Inventory	*1,20,000*	*1,65,000*
Trade receivables	*2,05,000*	*1,88,000*
Cash & cash equivalents	*35,000*	*20,500*
Current Liabilities:		
Trade payable	*1,95,000*	*2,15,000*
Provision for tax	*48,000*	*65,000*

Summary of Statement of Profit and Loss		
Sales	*85,50,000*	
Less: Cost of sales	*(56,00,000)*	*29,50,000*
Other Income		
Interest income	*20,000*	
Fire insurance claim received	*1,10,000*	*1,30,000*
		30,80,000
Depreciation	*(24,000)*	
Administrative and selling expenses	*(15,40,000)*	

Interest expenses	*(36,000)*	
Foreign exchange loss	*(18,000)*	*(16,18,000)*
Net Profit before tax and extraordinary income		*14,62,000*
Income Tax		*(95,000)*
Net Profit		*13,67,000*

Additional information:

(1) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.

(2) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

(5 Marks)

(d) From the following information provided by XYZ Limited you are required to compute the closing inventory:

Raw Material P

Closing balance	*600 units*
	₹ per unit
Cost price including GST	*250*
ITC available	*20*
Freight inward	*30*
Handling charges	*15*
Replacement cost	*180*

Finished goods Q

Closing balance	*1500 units*
	₹ per unit
Material consumed	*250*
Direct labour	*70*
Direct overhead	*30*

Total fixed overhead for the year was ₹ 3,00,000 on a normal capacity of 30,000 units while actual production has been of 25,000 units

Calculate the value of closing stock, when

(i) Net realisable value of the finished good Q is ₹ 450 per unit

(ii) Net Realisable value of the Finished Good Q is ₹ 340 per unit ***(5 Marks)***

Answer

(a) Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30 June 2020.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

(i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.

(iii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iv) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019-2020 because the violation of the conditions took place in the financial year 2019-2020 and the company must be aware of it.

(b) **(i)** As per AS 29, an 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract is the lower of net cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

In the given case, Saharsh Ltd. is required to pay:

In case of cancellation of agreement:

= ₹ 80,000 x 6 months = ₹ 4,80,000

In case of continuance of agreement (in case of sub-let):

Net of rent paid over rent collected from sub-tenant (₹80,000-45,000) x 12 = ₹ 4,20,000.

Lower of the above is to be provided for i.e. ₹ 4,20,000 is to be provided for.

(ii) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

(iii) Loss due to accident ₹ 30,00,000

Insurance claim receivable by company = ₹ 30,00,000 x 90% = (₹ 27,00,000)

Loss to be recognised in the books for 2019-2020 ₹ 3,00,000

Insurance claim receivable to be recorded in the books ₹ 27,00,000

Compensation claim by dealer against company to be provided for in the books = ₹ 30,00,000 x 15% = ₹ 4,50,000*

***Note:** Alternatively, the compensation @ 15% can be computed on the whole contract amount of ₹ 1 crore. In such a situation, the compensation should be ₹ 15,00,000 (1 crore x 15%).

(c) **Cash Flow Statement from operating activities of Smart Ltd. for the year ended 31 March 2020 (Direct Method)**

Particulars	₹	₹
Operating Activities:		
Cash received from Trade receivables (W.N. 3)		85,33,000
Less: Cash paid to Suppliers (W.N.2)	55,75,000	
Payment for Administration and Selling expenses	15,40,000	

Payment for Income Tax (W.N.4)	1,12,000	(72,27,000)
		13,06,000
Adjustment for extraordinary items (fire insurance claim)		1,10,000
Net Cash Flow from Operating Activities		14,16,000

Working Notes:

1. Calculation of total purchases

Cost of Sales = Opening stock + Purchases – Cl. Stock

₹ 56,00,000 = ₹ 1,65,000 + Purchases – ₹ 1,20,000

Purchases = ₹ 55,55,000

2. Calculation of cash paid to Suppliers

Trade Payables

	₹		₹
To Bank A/c (balancing figure)	55,75,000	By Balance b/d	2,15,000
To Balance c/d	1,95,000	By Purchases (W.N. 1)	55,55,000
	57,70,000		57,70,000

3. Calculation of cash received from Customers

Trade Receivables

	₹		₹
To Balance b/d	1,88,000	By Bank A/c (balancing figure)	85,33,000
To Sales	85,50,000	By Balance c/d	2,05,000
	87,38,000		87,38,000

4. Calculation of tax paid during the year in cash

Provision for tax

	₹		₹
To Bank A/c (balancing figure)	1,12,000	By Balance b/d	65,000
To Balance c/d	48,000	By Profit and Loss A/c	95,000
	1,60,000		1,60,000

(d) (i) When Net Realizable Value of the Finished Good Q is ₹ 450 per unit

Value of Closing Stock:

	Valuation Base	*Qty.*	*Rate (₹)*	*Amount (₹)*
Raw Material P	Cost	600	275	1,65,000
Finished Good Q	Cost	1,500	360	5,40,000
Total value of closing stock				7,05,000

(ii) When Net Realizable Value of the Finished Goods Q is ₹ 340 per unit

Since NRV of finished goods Q is less than its cost i.e. ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

	Valuation Base	*Qty.*	*Rate (₹)*	*Amount (₹)*
Raw material P	Replacement cost	600	180	1,08,000
Finished good Q	Net Realisable Value	1,500	340	5,10,000
Total value of closing stock				6,18,000

Working Note:

Statement showing calculation of cost of raw material P and finished good Q

Raw Material P	₹
Cost Price (250-20)	230
Add: Freight Inward	30
Handling charges	15
Cost	275
Finished Goods Q	**₹**
Materials consumed	250
Direct Labour	70
Variable overheads	30
Fixed overheads (₹ 3,00,000 / 30,000 units)	10
	360

Question 2

The Summarized Balance Sheets of Gyan Ltd. and Kiran Ltd. as on 31st March 2020 are given below:

	Gyan Ltd. (₹ in lakhs)	Kiran Ltd. (₹ in lakhs)
Liabilities		
Share capital		
Equity share capital of ₹10 each fully paid-up	650	600
10% Preference shares of ₹ 100 each fully paid-up	150	200
Reserves and Surplus		
General Reserve	-	360
Profit and Loss Account	(260)	
Non-Current Liabilities		
12% Debentures	75	100
Loans from Bank	40	-
Current Liabilities		
Bank overdraft	15	-
Trade payables	95	105
Dividend payable	-	60
	765	1,425
Assets		
Non-Current Assets		
Tangible Assets	700	900
Investments (including investment in Gyan Ltd.)	-	250
Current Assets		
Trade receivables	65	135
Cash at bank	-	140
	765	1,425

Gyan Ltd. has acquired the business of Kiran Ltd. as on 31 March 2020 as per following scheme of merger:

(1) Banks agreed to waive-off 50% loan of Gyan Ltd.

(2) Gyan Ltd. will reduce its shares to ₹ 2 per share and then consolidate 5 such shares into one share of ₹ 10 (new share).

(3) Gyan Ltd. will issue 2 equity shares (new) for 3 equity shares of Kiran Ltd. The new shares are to be issued @ ₹ 20 each having a face value of ₹ 10 per share.

(4) Preference shareholders of Kiran Ltd. will be paid off by issuing equivalent number of 10% Preference shares of Gyan Ltd. of ₹ 100 each at a price of ₹ 105 per share.

(5) Dividend of Kiran Ltd. will be paid after merger to the shareholders of Kiran Ltd.

(6) Trade payables of Gyan Ltd. include ₹ 50 lakhs payable to Kiran Ltd.

(7) Kiran Ltd. will cancel its holding of 15 lakh shares of Gyan Ltd. which was held as investment at a cost of ₹ 180 lakhs.

Pass necessary Journal entries in the books of Gyan Ltd. and prepare Balance Sheet after merger. ***(16 Marks)***

Answer

Journal Entries in the books of Gyan Ltd.

Date			*(₹ in lakhs)*	
2020			*Dr.*	*Cr.*
31 March	Loan from bank A/c (40 x 50%)	Dr.	20	
	To Reconstruction A/c			20
	(Being loan from bank waived off to the extent of ₹ 60 thousand)			
	Equity share capital A/c (₹ 10)	Dr.	650	
	To Equity share capital A/c (₹ 2) $\left(\frac{650}{10}\times 2\right)$			130
	To Reconstruction A/c (650 – 130)			520
	(Being Equity share of ₹ 10 each reduced to ₹ 2 each)			
	Equity share capital A/c (₹ 2)	Dr.	130	
	To Equity share capital A/c (₹ 10 each)			130
	(Being 5 Equity shares of ₹ 2 each consolidated to one share of ₹ 10 each)			
	Reconstruction A/c (20 + 520)	Dr.	540	
	To Profit and loss A/c (loss)			260
	To Capital reserve A/c			280
	(Being debit balance of P/L A/c set off against reconstruction account and balance transferred to capital reserve account)			

	Business purchase A/c	Dr.	950	
	To Liquidator of Kiran Ltd.			950
	(Being purchase of business of Kiran Ltd.)			
	Tangible asset A/c	Dr.	900	
	Investment A/c (250 – 180)	Dr.	70	
	Trade receivables A/c	Dr.	135	
	Cash at bank A/c	Dr.	140	
	To Trade payables A/c			105
	To Dividend payable A/c			60
	To 12% Debenture A/c			100
	To Business purchase A/c			950
	To General Reserves A/c [W.N.2]			30
	(Being assets, liabilities and reserves taken over under pooling of interest method)			
	Liquidator of Kiran Ltd. A/c	Dr.	950	
	To Equity share capital A/c			370
	To 10% Preference share capital			200
	To Securities Premium [(37 x 10) + (2 x 5)]			380
	(Being payment made to liquidators of Kiran Ltd. by allotment of 37 lakh @ ₹ 10 new equity shares and 2 lakh preference shares @ ₹ 105)			
	Trade payables A/c	Dr.	50	
	To Trade receivables A/c			50
	(Being mutual owing cancelled)			
	Dividend Payable A/c	Dr.	60	
	To Bank A/c			60
	(Being dividend paid off)			

Balance Sheet of Gyan Ltd. (and reduced) after merger as on 31.3.2020

Particulars	*Note No.*	*(₹ in lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	850
(b) Reserves and Surplus	2	690

(2) Non-Current Liabilities		
Long-term borrowings	3	195
(3) Current Liabilities		
(a) Trade Payables	4	150
(b) Borrowings – Bank overdraft	5	15
Total		1,900
II. Assets		
(1) Non-current assets		
(a) Property, plant and equipment	6	1,600
(b) Investment (250 – 180)	7	70
(2) Current assets		
(a) Trade receivables	8	150
(b) Cash and cash equivalents	9	80
Total		1,900

Notes to Accounts

		(₹ in lakhs)	(₹ in lakhs)
1.	Share Capital		
	50 lakhs (13 lakh + 37 lakh) Equity shares of 10 each fully paid	500	
	(Out of the above, 37 lakh shares have been issued for consideration other than cash)		
	3.5 lakhs (1.5 + 2) 10% Preference share of ₹ 100 each fully paid (Out of which 2 lakhs shares have been issued for consideration other than cash)	350	850
2.	Reserves and Surplus		
	Capital reserve	280	
	Securities Premium	380	
	General reserve	30	690
3.	Non-current Borrowings		
	12% Debentures (75 + 100)	175	
	Loan from bank (40 - 20)	20	195
4.	Trade Payables (95+105-50)		150

5	Current Borrowings		
	Bank overdraft		15
6.	Property, plant and equipment		
	Tangible Assets (700 + 900)		1,600
7.	Investment (250 – 180)		70
8.	Trade Receivables (65 + 135 – 50)		150
9.	Cash and cash equivalents		
	Cash at Bank (140 - 60)		80

Working Notes:

1. Calculation of purchase consideration

	Shares
2 shares of Gyan Ltd. will be issued in exchange of every 3 shares of Kiran Ltd. (i.e. 40,00,000 equity shares of Gyan Ltd will be issued against 60,00,000 equity shares of Kiran Ltd.) (60 lakhs x 2/3)	40,00,000
Less: Shares already held 15,00,000; shares converted in new equity shares 15,00,000/5 = 3,00,000 shares	(3,00,000)
Number of shares to be issued by Gyan Ltd to shareholders of Kiran Ltd.	37,00,000
	₹ in lakhs
Payment to equity shareholders (37 lakhs x ₹ 20)	740
Payment to preference shareholders (2 lakhs x ₹ 105)	210
Total Purchase consideration	950

2. Calculation of Reserve as per AS 14

Reserves as on 31.3.2020 of Kiran Ltd.	₹ 360 lakhs
Less: Cancellation of investment in Gyan Ltd.	(₹ 180 lakhs)
Balance of reserve on the amalgamation date	₹ 180 lakhs

As per AS 14, the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves of the transferee company.

Amount recorded as share capital issued by Gyan Ltd.		
Equity shares (37 lakh shares x ₹ 20)		₹ 740 lakh
Preference shares (2 lakh shares x ₹ 105)		₹ 210 lakh
		₹ 950 lakh
Amount of share capital of Kiran Ltd. - equity shares	₹ 600 lakh	
- preference shares	₹ 200 lakh	₹ 800 lakh
Net adjustment to the reserves of Gyan Ltd		₹ 150 lakh

Hence, net credit to reserves at the time of taking over of assets and liabilities will be

= ₹ 180 lakhs - ₹ 150 lakhs = ₹ 30 lakhs

Question 3

The summarized balance sheet of two companies, P Ltd and Q Ltd. as at 31 March 2020 are given below:

Particulars	*P Ltd (₹)*	*Q Ltd (₹)*
Liabilities:		
Equity shares of 10 each	*4,20,000*	*2,50,000*
7.5% Preference shares (non-convertible) of ₹ 10 each	*3,50,000*	*1,40,000*
Reserves and Surplus		
Reserves and Surplus	*62,000*	*75,000*
Profit and Loss Account	*1,40,000*	*50,000*
Current Liabilities		
Trade Payables	*1,05,000*	*90,000*
P Ltd. balance	*-*	*10,000*
	10,77,000	*6,15,000*
Assets:		
Non-Current Assets		
Plant and Machinery	*3,74,000*	*1,10,000*
Non-Current Investments		
20,000 Equity shares in Q Ltd.	*2,70,000*	*-*
4,200 Equity shares in P Ltd.	*-*	*50,400*
Current Assets		
Trade Receivables	*1,50,000*	*2,30,000*

Q Ltd. balance	*15,000*	*-*
Inventories	*2,30,000*	*1,98,000*
Cash at Bank	*38,000*	*26,600*
	10,77,000	*6,15,000*

The other information is as under:

(i) P Ltd. acquired the shares in Q Ltd. on 1 October 2019. As on 31 March 2019, the plant and machinery stood in the books at ₹ 1,25,000, the reserves at ₹ 75,000 and the profit and loss account at ₹ 20,000. The plant and machinery was revalued by P Ltd. on the date of acquisition of shares of Q Ltd. at ₹ 1,40,000 but no adjustments were made in the books of Q Ltd.

(ii) On 31 March 2019, there was debit balance of ₹ 55,500 in profit and loss account in the books of P Ltd.

(iii) Both the companies have provided depreciation on their fixed assets at 10% per annum.

(iv) No adjustment of preference dividend has been made earlier.

(v) Out of inventory of Q. Ltd. as on 1 October 2019 inventory of ₹ 32,000 was sold to P Ltd. for ₹ 32,500 and which has remained unsold by P Ltd. as on 31 March 2020.

(vi) Cash-in-transit from Q Ltd. to P. Ltd. was ₹ 5,000 as at the close of the accounting year.

You are required to prepare a Consolidated Balance Sheet as on 31 March 2020 as per Schedule III. ***(16 Marks)***

Answer

Consolidated Balance Sheet of P Ltd., and its subsidiary Q Ltd.

as at 31 March 2020

Particulars	*Notes No.*	₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	7,28,000
(b) Reserves and Surplus	2	2,00,747
(2) Minority Interest	3	2,34,103
(3) Current Liabilities		
(a) Trade Payables (1,05,000 + 90,000)		1,95,000
(b) Other current liabilities (Preference dividend of P Ltd.)		26,250
Total		13,84,100

II.	Assets		
	(1) Non-current assets		
	Property, Plant and Equipment	4	5,07,000
	(2) Current assets		
	(a) Inventories (2,30,000 + 1,98,000 - 500)		4,27,500
	(b) Trade receivables (1,50,000 + 2,30,000)		3,80,000
	(c) Cash & Cash equivalents (38,000 + 26,600 + 5,000)		69,600
	Total		13,84,100

Notes to Accounts

				₹
1.	Share capital			
	42,000 Equity shares of ₹ 10 each of P Ltd.		4,20,000	
	Less: Shares held by Q Ltd.		(42,000)	
			3,78,000	
	35,000, 7.5% Preference shares of ₹ 10 each fully paid of P Ltd.		3,50,000	7,28,000
2.	Reserves and Surplus			
(a)	Reserves	62,000		
(b)	Profit & Loss account	1,40,000		
		2,02,000		
	Less: Preference dividend	(26,250)		
		1,75,750		
	Less: Share of Q Ltd. (17,721+13,295)	(31,016)		
		1,44,734		
	Add: Share of revenue profit of Q Ltd.	17,325	1,62,059	
(c)	Capital reserve of P Ltd.	47,088		
	Less: Goodwill of Q Ltd.	(8,400)	38,688	2,00,747
3.	Minority interest			
	Preference shares of Q Ltd.		1,40,000	
	Preference dividend paid by Q Ltd.		10,500	
	Equity shares (20%)		50,000	

	Capital profit (W.N. iv)	29,272	
	Revenue profit (W.N. v)	4,331	2,34,103
4.	Property, plant and equipment		
	P Ltd.	3,74,000	
	Q Ltd. (1,10,000+23,889-889)	1,33,000	5,07,000

Working Notes:

(a) Analysis of profits of Q Ltd. (Pre-allocation of inter-company's share)

		Capital Profit ₹	*Revenue Profit* ₹
Reserves		75,000	
Profit and Loss as on 1.4.2019		20,000	
Profit for the year (50,000 – 20,000)	30,000		
Less: Preference dividend	(10,500)		
	19,500	9,750	9,750
Profit on upward revaluation (W.N. vii)		23,889	
Additional depreciation on upward revaluation (W.N. viii)			(889)
Unrealized gain on inventory		… ……	(500)
		1,28,639	8,361

Note:

Unrealised gain on inventory has been adjusted during computation of capital and revenue profit for using the same in simultaneous equation. Alternatively, adjustment may be made separately.

(b) (i) Analysis of Profits of P Ltd.

		Capital Profit ₹	*Revenue Profit* ₹
Reserves during the year		31,000	31,000
Profit and Loss as on 1.4.2019		(55,500)	
Profit for the year (1,40,000 + 55,500)	1,95,500		
Less: Preference dividend	(26,250)		

1,69,250	84,625	84,625
	60,125	1,15,625

(ii) Capital profits of P Ltd. & Q Ltd. (post allocation of inter-company's share)

Suppose capital profits of P Ltd. = a

and capital profits of Q Ltd. = b

Total Capital profits of P Ltd. = 60,125 + 0.8b (1)

Total Capital profits of Q Ltd. = 1,28,639 + 0.1a (2)

Putting values of equation (2) in (1), we get

a = 60,125 + 0.8 (1,28,639 + 0.1a)

a = 60,125 + 1,02,911 + 0.08a

a – 0.08a = 1,63,036

0.92a = 1,63,036

a = 1,77,213

b = 1,28,639 + 0.1 (1,77,213)

b = 1,28,639 + 17,721

b = 1,46,360

(iii) Revenue profits of P Ltd. and Q Ltd. (post allocation of inter-company's share)

Suppose revenue profits of P Ltd. = x

and revenue profits of Q Ltd.= y

Total Revenue profits of P Ltd. = 1,15,625 + 0.8y (3)

Total Revenue profits of Q Ltd. = 8,361 + 0.1x (4)

By solving the above equations (3) and (4) in line with the equations (1) and (2) of capital profit, we will get

x = 1,32,950 and y = 21,656

		P Ltd. ₹	*Q Ltd.* ₹
(iv)	**Capital Profits**		
	As per W.N. (ia) & (ib)	60,125	1,28,639
	Adjustment as per W.N. (ii) (1,77,213 x 0.1)	(17,721)	17,721
		42,404	1,46,360
	Minority Interest (20%)		(29,272)
	Share of P Ltd.		1,17,088

(v)	**Revenue Profits**		
	As per W.N. (ia) & (ib)	1,15,625	8,361
	Adjustment as per W.N. (iii) (1,32,950 x 0.1)	(13,295)	13,295
		1,02,330	21,656
	Minority interest of Q Ltd. @ 20%	-	(4,331)
	Share of P Ltd. in Q Ltd.	17,325	17,325
		1,19,655	
(vi)	**Cost of Control**		
	(a) Cost of investment of P Ltd. in Q Ltd.		2,70,000
	Less: Paid up value of shares (20,000 x ₹ 10)	2,00,000	
	Capital Profits	1,17,088	(3,17,088)
	Capital Reserve		47,088
	(b) Cost of investment of Q Ltd. in P Ltd.		50,400
	Less: Paid up value of shares held		(42,000)
	Goodwill		8,400
(vii)	**Plant and Machinery as on 1.4.2019** (1,10,000 x 100 / 90)		1,22,222
	Less: Depreciation upto 30 September 2019		(6,111)
	Value as on 1.10.2019		1,16,111
	Revaluation of Plant and Machinery on 1.10.2019		1,40,000
	Profit on upward revaluation		23,889
(viii)	**Additional depreciation on upward Revaluation of Plant and Machinery**		
	Depreciation for remaining 6 months (1,40,000 x 10% x 6/12)		7,000
	Less: Depreciation already charged (1,22,222 x 10% x 6/12)		(6,111)
			889

Alternatively, the value of plant and machinery may be taken as given in the balance sheet for revaluation and excess depreciation purpose. In such a situation, the answer will be as follows:

Consolidated Balance Sheet of P Ltd., and its subsidiary Q Ltd. as at 31 March 2020

Particulars	*Notes No.*	₹
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	7,28,000
(b) Reserves and Surplus	2	1,98,790
(2) Minority Interest	3	2,33,560
(3) Current Liabilities		
(a) Trade Payables (1,05,000 + 90,000)		1,95,000
(b) Other current liabilities (Preference dividend of P Ltd.)		26,250
Total		13,81,600
II. Assets		
(1) Non-current assets		
Property, Plant and Equipment		5,04,500
(2) Current assets		
(a) Inventories (2,30,000 + 1,98,000 - 500)		4,27,500
(b) Trade receivables (1,50,000 + 2,30,000)		3,80,000
(c) Cash & Cash equivalents (38,000 + 26,600 + 5,000)		69,600
Total		13,81,600

Notes to Accounts

			₹
1.	Share Capital		
	42,000 Equity shares of ₹ 10 each of P Ltd.	4,20,000	
	Less: Shares held by Q Ltd.	(42,000)	
		3,78,000	
	35,000, 7.5% Preference shares of ₹ 10 each fully paid of P Ltd.	3,50,000	7,28,000

2.	Reserves and Surplus			
(a)	Reserves	62,000		
(b)	Profit & Loss account	1,40,000		
		2,02,000		
	Less: Preference dividend	(26,250)		
		1,75,750		
	Less: Share of Q Ltd. (17,492 + 13,307)	(30,799)		
		1,44,951		
	Add: Share of revenue profit of Q Ltd.	17,446	1,62,397	
(c)	Capital Reserve of P Ltd.	44,793		
	Less: Goodwill of Q Ltd.	(8,400)	36,393	1,98,790
3.	Minority Interest			
	Preference shares of Q Ltd.		1,40,000	
	Preference dividend paid by Q Ltd.		10,500	
	Equity shares (20%)		50,000	
	Capital profit (W.N. iv)		28,698	
	Revenue profit (W.N. v)		4,361	2,33,560
4.	Property, Plant and Equipment			
	P Ltd.		3,74,000	
	Q Ltd. (1,10,000 + 21,250 – 750)		1,30,500	5,04,500

Working Notes:

(a) Analysis of profits of Q Ltd. (Pre-allocation of inter-company's share)

		Capital Profit ₹	*Revenue Profit* ₹
Reserves		75,000	
Profit and Loss as on 1.4.2019		20,000	
Profit for the year (50,000 – 20,000)	30,000		
Less: Preference dividend	(10,500)		
	19,500	9,750	9,750
Profit on upward revaluation (W.N. vii)		21,250	

Additional depreciation on upward revaluation (W.N. viii)		(750)
Unrealized gain on inventory	-	(500)
	1,26,000	8,500

Note: Unrealised gain on inventory has been adjusted during computation of capital and revenue profit for using the same in simultaneous equation. Alternatively, adjustment may be made separately.

(b) (i) Analysis of Profits of P Ltd.

		Capital Profit ₹	*Revenue Profit* ₹
Reserves during the year		31,000	31,000
Profit and Loss as on 1.4.2019		(55,500)	
Profit for the year (1,40,000 + 55,500)	1,95,500		
Less: Preference dividend	(26,250)		
	1,69,250	84,625	84,625
		60,125	1,15,625

(ii) Capital profits of P Ltd. & Q Ltd. (post allocation of inter-company's share)

Suppose capital profits of P Ltd. = a

and capital profits of Q Ltd. = b

Total Capital profits of P Ltd. = 60,125 + 0.8b (1)

Total Capital profits of Q Ltd. = 1,26,000 + 0.1a (2)

Putting values of equation (2) in (1), we get

a = 60,125 + 0.8 (1,26,000 + 0.1a)

a = 60,125 + 1,00,800 + 0.08a

a – 0.08a = 1,60,925

0.92a = 1,60,925

a = 1,74,918

b = 1,26,000 + 0.1 (1,74,918)

b = 1,26,000 + 17,492

b = 1,43,492

(iii) Revenue profits of P Ltd. and Q Ltd. (post allocation of inter-company's share)

Suppose revenue profits of P Ltd. = x

and revenue profits of Q Ltd.= y

Total Revenue profits of P Ltd. = 1,15,625 + 0.8y (3)

Total Revenue profits of Q Ltd. = 8,500 + 0.1x (4)

By solving the above equations (3) and (4) in line with the equations (1) and (2) of capital profit, we will get

x =115,625 + 0.8(8,500 + 0.1x)

0.92x = 115,625 + 6,800

x = 1,33,071

y = 8,500 + 0.1 x 1,33,071 = 21,807

x = 1,33,071 and y = 21,807

		P Ltd. ₹	*Q Ltd.* ₹
(iv)	**Capital Profits**		
	As per W.N.(ia) & (ib)	60,125	1,26,000
	Adjustment as per W.N.(ii) (1,77,213 x 0.1)	(17,492)	17,492
		42,633	1,43,492
	Minority Interest (20%)		(28,698)
	Share of P Ltd.		1,14,794
(v)	**Revenue Profits**		
	As per W.N.(ia) & (ib)	1,15,625	8,500
	Adjustment as per W.N. (iii) (1,33,071 x 0.1)	(13,307)	13,307
		1,02,318	21,807
	Minority interest of Q Ltd. @ 20%	-	(4,361)
	Share of P Ltd. in Q Ltd.	17,446	17,446
		1,19,764	
(vi)	**Cost of Control**		
	(a) Cost of investment of P Ltd. in Q Ltd.		2,70,000
	Less: Paid up value of shares (20,000 x ₹ 10)	2,00,000	

	Capital Profits	1,14,794	(3,14,794)
	Capital Reserve		44,794
	(b) Cost of investment of Q Ltd. in P Ltd.		50,400
	Less: Paid up value of shares held		(42,000)
	Goodwill		8,400
(vii)	**Plant and Machinery as on 1.4.2019**		1,25,000
	Less: Depreciation upto 30 September 2019		(6,250)
	Value as on 1 October 2019		1,18,750
	Revaluation of Plant and Machinery on 1 October 2019		1,40,000
	Profit on upward revaluation		21,250
(viii)	**Additional depreciation on upward Revaluation of Plant and Machinery**		
	Depreciation for remaining 6 months (1,40,000 x 10% x 6/12)		7,000
	Less: Depreciation already charged (1,25,000 x 10% x 6/12)		(6,250)
			750

Question 4

(a) State the major changes in Ind AS 2 © AS 2 in respect of the following namely:

(i) Machinery Spares

(ii) Subsequent assessment of Net Realisable value

(iii) Cost Formulae **(5 Marks)**

(b) Define "Investment property" as per Ind AS 40 and state whether the following properties will meet the definition of investment property as per Ind AS.

(i) Owned by a company and leased out under an operating lease.

(ii) Held under Finance lease and Leased out under operating lease.

(iii) Held under Finance lease and leased out under Finance Lease.*

(iv) Property acquired with a view for development and re-sale. **(5 Marks)**

* PS: Read 'Held under Finance lease' as 'Held as right of use asset'.

© *On 1 April 2019, XY Ltd. has issued 20,000, 8% Compulsory Cumulative Convertible Preference Shares (CCCPS) of ₹ 100 each. The dividend is payable at the end of every year. Each preference share is convertible into 5 equity shares of the company at the end of 6th year. The company has incurred a transaction cost of 5% of the value of proceeds. The prevailing market rate for similar instrument without conversion option is 11% per annum.*

You are required to examine the nature of financial instrument as per Ind AS 109 and pass the journal entry at the time of initial recognition.

The following present values of ₹ 1 @ 11% are supplied to you.

Interest Rate	*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*	*Year 6*
11%	*0.901*	*0.812*	*0.731*	*0.659*	*0.593*	*0.535*

(6 Marks)

Answer

(a) The major changes in Ind AS 2 vis-à-vis AS 2 with respect to following are as follows:

(i) **Machinery Spares:** AS 2 explains that inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10 'Property, Plant and Equipment'. Such items are accounted for in accordance with AS 10.

Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.

(ii) **Subsequent Assessment of Net Realisable Value (NRV):** Ind AS 2 provides detailed guidance in case of subsequent assessment of net ecognize value. It also deals with the reversal of the write-down of inventories to net ecognize value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements.

AS 2 does not deal with such reversal.

(iii) **Cost Formulae:** AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

Ind AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.

(b) Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both,

rather than for:

(a) use in the production or supply of goods or services or for administrative purposes;

or

(b) sale in the ordinary course of business.

Appropriate classification of given properties on the basis of above definition as 'Investment property' or 'Not an Investment property' is done as follows:

(i) Owned by a company and leased out under an operating lease: Investment Property

(ii) Held under Finance lease and Leased out under operating lease: Investment Property

(iii) Held under Finance lease* and leased out under Finance lease: Not an Investment Property

(iv) Property acquired with a view for development and re-sale: Not an Investment Property

© Compulsory Cumulative Convertible Preference Shares (CCCPS) have two elements. First- the payment of dividend every year @ 8%. This is a mandatory outflow hence it would constitute as a financial liability to the issuing entity. However, the conversion of preference shares into equity shares at the end of 6th year constitutes an equity element. Hence, it is a compound financial instrument.

Journal Entry to be recorded at the time of initial recognition

Date	Particulars	Debit	Credit
01-Apr-2019	Bank A/c Dr.	19,00,000	
	To 8% Preference Shares (Financial liability)		6,43,112
	To 8% Preference Shares (Equity)		12,56,888
	(Being compulsorily cumulative convertible preference shares issued. Segregated into equity component and liability component)		

Working Notes:

Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor @ 11%	Net present Value
31 March 2020	Dividend	1,60,000	0.901	1,44,160
31 March 2021	Dividend	1,60,000	0.812	1,29,920

* PS: Read 'Held under Finance lease' as 'Held as right of use asset'.

31 March 2022	Dividend	1,60,000	0.731	1,16,960
31 March 2023	Dividend	1,60,000	0.659	1,05,440
31 March 2024	Dividend	1,60,000	0.593	94,880
31 March 2025	Dividend	1,60,000	0.535	85,600
Total Liability Component				6,76,960
Total Proceeds				20,00,000
Total Equity Component (Bal fig)				13,23,040

Allocation of transaction costs

Particulars	Amount (₹)	Expense Allocation (₹)	Net Amount (₹)
Liability Component	6,76,960	33,848	6,43,112
Equity Component	13,23,040	66,152	12,56,888
Total Proceeds	20,00,000	1,00,000	19,00,000

Question 5

The following is the extract of Balance Sheet of Shakti Ltd. as on 31.3.2020:

	₹
I. Equity and Liabilities	
1. Shareholders' funds	
(a) Share Capital	
Equity share capital (Face value ₹ 10)	*10,00,000*
6% Preference share capital (Face value ₹ 10)	*1,50,000*
(b) Reserves and Surplus	*4,30,000*
2. Non-current liabilities	
9% Debentures (Face value ₹ 100)	*4,00,000*
8% Loan from bank	*2,50,000*
3. Current liabilities	
(a) Trade payables	*1,95,000*
(b) Other current liabilities	*1,88,000*
Total	***26,13,000***
II. Assets	
1. ***Non-current assets***	
(a) Property, Plant and Equipment	

		Tangible assets	*8,50,000*
	(b)	*Non-current investments*	*9,00,000*
2.	***Current assets***		
	(a)	*Inventory*	*3,18,000*
	(b)	*Trade receivables (Net)*	*3,80,000*
	©	*Cash and cash equivalents*	*1,65,000*
Total			***26,13,000***

The company is planning to sell its business to a prospective buyer. For this purpose, it seeks professional assistance in valuation of its goodwill. A purchaser wants to acquire all equity shares of the company.

The following additional information is provided to you:

(i) The company will redeem the existing debentures at 10% discount. To finance such redemption, the company will dispose off 50% of its trade investments, which are expected to fetch 105% of its value. The remaining investments are to be taken at market value. These transactions will be prior to purchase of equity shares. Ignore tax impacts on sale of investment.

(ii) The company has made settlement with the bank. 20% of the loan will be repaid and balance loan will be charged at interest of 7% per annum.

(iii) 8% of the debts of the company are not recoverable. The company had made a provision of 5% for doubtful debts and debited to Profit and Loss account in the previous year.

(iv) Other current liabilities include liability on account of dividend payable ₹ 1,50,000.

(v) Goodwill is valued at three years purchase of adjusted average super profit. Normal rate of return on net assets for equity shareholders is 10%.

(vi) Profits for the year 2018-2019 includes government subsidy of ₹ 1,00,000.

(vii) The company had purchased non-trade investment at a cost of ₹ 2,00,000 on 1.10.2018 yielding interest income of 10% per annum.

(viii) The resale value of tangible assets is expected to be ₹ 7,40,000. The rate of depreciation adopted for fixed asset was 5% per annum.

(ix) The inventories of the company are revalued at ₹ 2,95,000.

(x) The profit after tax of last 3 years are given as under:

31.3.2018 ₹ 2,28,000

31.3.2019 ₹ 3,30,000

31.3.2020 ₹ 2,75,400

(xi) The company is planning to restructure its manpower. As a result, a reduction in salary expenses to the extent of ₹ 30,500 is expected in future years.

(xii) The existing tax rate is 30%. Tax rate effective for future years would be 25%.

You are required to ascertain intrinsic value per equity share. Also compute value of share as per dividend yield method if normal rate of dividend in the industry is 12%. ***(16 Marks)***

Answer

Valuation of goodwill: Super profits method

Particulars	₹	₹
Net trading assets attributable to equity share holders		
As computing in (WN 1)	14,60,000	
Less: Preference share Capital	(1,50,000)	13,10,000
Normal Rate of Return (NRR) to equity share holders		10%
Normal Profit available to equity share holders		1,31,000
Future Maintainable Profits (FMP) to equity share holders		
As computed in (W.N.2)	3,14,893	
Less: Preference dividend* (6% of 1,50,000)	(9,000)	3,05,893
Super profits to equity share holders		1,74,893
Goodwill (1,74,893 x 3)		5,24,679

*Since, NRR is given as percentage of net assets attributable to equity shareholders, preference share capital and preference share dividend have been deducted from the net assets and future maintainable profit respectively.

(i) Intrinsic value per equity share

Net Trading Assets attributable to equity shareholders	₹ 13,10,000
Add: Goodwill	₹ 5,24,679
Add: Non-trade Investment	₹ 2,00,000
	₹ 20,34,679
Number of Equity Shares	= 1,00,000 shares
Value per share 20,34,679 / 1,00,000	= ₹ 20.35 (ecogni.)
Hence, intrinsic values of each equity share is	₹ 20.35 per equity share.

(ii) Valuation on dividend yield basis:

Rate of Dividend = $\frac{1,50,000}{10,00,000} \times 100 = 15\%$

Value of fully paid share of ₹ 10 = $\frac{15}{12} \times 10$ = ₹ 12.5

Working Notes:

1. Computation of net trading assets

Particulars	₹	₹
Assets		
i Property, Plant and Equipment	7,40,000	
ii Trade Investment	3,67,500	
iii Inventory	2,95,000	
iv Trade receivables $\frac{3,80,000}{95\%} \times 92\%$	3,68,000	
v Cash & Cash Equivalents (given balance 1,65,000 + sale of investment 3,67,500 – Redemption of debentures 3,60,000 – Bank loan 50,000)	1,22,500	18,93,000
Less: Outside liabilities:		
i 7% Bank loan	2,00,000	
ii Trade Payable	1,95,000	
iii Other Current liability (1,88,000 – 1,50,000)	38,000	(4,33,000)
Net assets		14,60,000

2. Computation of future maintainable profit for the year ended on 31 March

Particulars	*2018*	*2019*	*2020*
Profit after tax	2,28,000	3,30,000	2,75,400
Add: Tax @ 30% (PAT x $\frac{30}{70}$)	97,714	1,41,429	1,18,029
Profit before tax	3,25,714	4,71,429	3,93,429
Less: Interest on non-trade investment	-	(10,000)	(20,000)
Less: Non-recurring Government subsidy	-	(1,00,000)	-

Less: Under valuation of inventories	-	-	(23,000)
Less: Additional provision for doubtful debt	-		(12,000)
Adjusted Profit after tax	3,25,714	3,61,429	3,38,429
Total adjusted profit after tax			10,25,572

Simple average of the profits			3,41,857
Adjustments for items which will not be reflected in future			
Add: Debenture interest			36,000
Add: Excess depreciation due to downward valuation (8,50,000 – 7,40,000) x 5%			5,500
Add: Interest on Bank loan	2,50,000 x 8% =	20,000	
	2,00,000 x 7% =	(14,000)	6,000
Add: Reduction in salary			30,500
			4,19,857
Less: Tax @ 25%			1,04,964
Future maintainable profit [for shareholders- both preference and equity]			3,14,893

Note:

1. Tax effect has been ignored on discount on redemption of debentures and on increase in provision for doubtful debts.
2. Additional depreciation on revaluation of property is ignored at the time of calculation of capital employed. However, it has been considered for calculation of future maintainable profit.

Alternatively, the Government subsidy may be adjusted while calculating Future Maintainable Profit (and not in adjusted average profit) since it is a non-recurring item and will not be received in future. In such a situation, the answer will be as follows:

Valuation of goodwill: Super profits method

Particulars	₹	₹
Net trading assets attributable to equity share holders		
As computing in (WN 1)	14,60,000	
Less: Preference share Capital	(1,50,000)	13,10,000
Normal Rate of Return (NRR) to equity share holders		10%
Normal Profit available to equity shareholders		1,31,000

Future Maintainable Profits (FMP) to equity share holders		
As computed in (WN 2)	2,64,893	
Less: Preference dividend* (6% of 1,50,000)	(9,000)	(2,55,893)
Super profits to equity share holders		1,24,893
Goodwill (1,24,893 x 3)		3,74,679

*Since, NRR is given as percentage of net assets attributable to equity shareholders, preference share capital and preference share dividend have been deducted from the net assets and future maintainable profit respectively.

(i) Intrinsic value per equity share

Net Trading Assets attributable to equity shareholders	₹ 13,10,000
Add: Goodwill	₹ 3,74,679
Add: Non-trade Investment	₹ 2,00,000
	₹ 18,84,679

Number of Equity Shares = 1,00,000 shares

Value per share = 18,84,679/1,00,000 = ₹ 18.85 (ecogni.)

Hence, intrinsic values of each equity share is ₹ 18.85 per equity share.

(ii) Valuation on dividend yield basis:

Rate of Dividend $= \frac{1,50,000}{10,00,000} \times 100 = 15\%$

Value of fully paid share of ₹ 10 = $\frac{15}{12} \times 10 =$ ₹ 12.5

Working Notes:

1. Computation of net trading assets

Particulars	₹	₹
Assets		
i Property, Plant and Equipment	7,40,000	
ii Trade Investment	3,67,500	
iii Inventory	2,95,000	
iv Trade receivables $\frac{3,80,000}{95\%} \times 92\%$	3,68,000	

v	Cash & Cash Equivalents (given balance 1,65,000 + sale of investment 3,67,500 – Redemption of debentures 3,60,000 – Bank loan 50,000)	1,22,500	18,93,000
Less:	Outside liabilities:		
i	7% Bank loan	2,00,000	
ii	Trade Payable	1,95,000	
iii	Other Current liability (1,88,000 – 1,50,000)	38,000	(4,33,000)
	Net assets		14,60,000

2. Computation of future maintainable profit for the year ended on 31 March

Particulars	*2018*	*2019*	*2020*
Profit after tax	2,28,000	3,30,000	2,75,400
Add: Tax @ 30% (PAT x $\frac{30}{70}$)	97,714	1,41,429	1,18,029
Profit before tax	3,25,714	4,71,429	3,93,429
Less: Interest on non-trade investment	-	(10,000)	(20,000)
Less: Additional provision for doubtful debt	-	-	(12,000)
Less: Undervaluation of inventories	-		(23,000)
Adjusted Profit after tax	3,25,714	4,61,429	3,38,429
Total adjusted profit after tax			11,25,572
Simple average of the profits			3,75,191
Adjustments for items which will not be reflected in future			
Add: Debenture interest			36,000
Add: Excess depreciation due to downward valuation (8,50,000 – 7,40,000) x 5%			5,500
Add: Interest on Bank loan 2,50,000 x 8% =		20,000	
2,00,000 x 7% =		(14,000)	6,000
Less: Non-recurring Government subsidy			(1,00,000)
Add: Reduction in salary			30,500
			3,53,191
Less: Tax @ 25%			(88,298)
Future maintainable profit [for shareholders- both preference and equity]			2,64,893

Note:

1. Tax effect has been ignored on discount on redemption of debentures and on increase in provision for doubtful debts.
2. Additional depreciation on revaluation of property is ignored at the time of calculation of capital employed. However, it has been considered for calculation of future maintainable profit.

Question 6

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

Grant date	*1.4.2018*
Number of employees covered	*400*
Number of options granted per employee	*125*
Vesting condition: Continuous employment for 2 years	
Nominal value per share (₹)	*10*
Exercise price per share (₹)	*35*
Vesting date	*31.3.2020*
Exercise date	*1.7.2020*
Fair value of options per share on grant date (₹)	*20*

Position as on 31.3.2019 and 31.3.2020

	31.3.2019	*31.3.2020*
Number of employees expected to satisfy the condition	*370*	*350*
Number of employees left	*20*	*30*
Profit before amortization of ESOP Cost	*₹ 11,25,000*	*₹ 12,50,000*
Fair value per share	*₹ 60*	*₹ 70*
Number of shares outstanding	*1,00,000*	*1,00,000*

Position as on 1.7.2020

Number of employees exercising the option *340*

Compute basic and diluted EPS for the year 2018-2019 and 2019-2020 (Ignore tax impacts). ***(8 Marks)***

(b) *Z Industries Ltd. furnishes the following information from which you are required to calculate the prevailing Economic Value Added of the company.*

Common shares of ₹ 100 each	*10,00,000 shares*
12% Debenture of ₹ 100 each	*3,50,000 units*
Current tax rate	*25%*

Financial Leverage	*1.2 times*
Securities Premium Account	*₹ 120 lakh*
Capital reserve	*₹ 80 lakh*

It is a prevailing practice for companies in the industry to which Z Industries Ltd. belongs to pay at least a dividend of 12% p.a. to its common shareholders. ***(8 Marks)***

Answer

(a) Year 2018-2019

Fair value of option per share = ₹ 20

Number of options expected to vest under the scheme = 370 x 125 = 46,250

Fair value = 46,250 x ₹ 20 = ₹ 9,25,000

Vesting period = 2 years

Value of option ecognize as expense in 2018-19 = ₹ 9,25,000 / 2 = ₹ 4,62,500

Year 2019-2020

Fair value of option per share = ₹ 20

Number of options expected to vest under the scheme = 350 x 125 = 43,750

Fair value = 43,750 x ₹ 20 = ₹ 8,75,000

Vesting period = 2 years

Number of years expired = 2 years

Cumulative value of option to ecognize as expense in 2 years = 8,75,000

Value of option ecognize as expense in 2019-2020 = ₹ 8,75,000 – ₹ 4,62,500

= ₹ 4,12,500

Computation of Basic and Diluted EPS

		2018-2019	*2019-2020*
		₹ 000	*₹ 000*
	Profit before ecognize on of ESOP costs	11,25,000	12,50,000
	Less: ESOP cost amortised	(4,62,500)	(4,12,500)
a	Net profit for shareholders	6,62,500	8,37,500
b	Number of shares outstanding ('000)	1,00,000	1,00,000
c	Basic EPS (a/b)	6.625	8.375
d	Potential Equity (as per W.N. below)	11,875	21,875
e	Total number of shares (b + d)	1,11,875	1,21,875
f	Diluted EPS (a/e)	5.92	6.87

Potential Equity

	2018-2019	*2019-2020*
A. Actual number of employees	380	350
B. Option granted per employee	125	125
C. Number of options outstanding	47,500	43,750
D. Unamortised ESOP cost per option (₹)	10*	Nil
E. Exercise Price (₹ 35)	35	35
F. Expected exercise price to be received (C x E)	16,62,500	15,31,250
G. Unamortised ESOP cost (C x D)	4,75,000	Nil
H. Total proceeds	21,37,500	15,31,250
I. Fair value per share (₹)	60	70
J. Number of shares issued for consideration (H/I)	35,625	21,875
K. Potential Equity (C – J)	11,875	21,875

(b) Computation of Economic Value Added

	₹ in lakhs
Profit after tax	157.5
Add: Interest net of tax = 42 x $\left(\frac{100-25}{100}\right)$	31.5
Net Operating Profit After Tax (NOPAT)	189
Less: Weighted Average Cost of Capital	(175.31)
Economic Value Added	13.69

Working Notes:

1. Calculation of Net Profit after interest and tax

Interest on Debentures = 3,50,000 units x 100 x 12% = ₹ 42,00,000

Therefore, Financial Leverage = $\frac{\text{Profit before Interest \& taxes (PBIT)}}{\text{PBIT less Interest}}$

$1.2 = = \frac{\text{PBIT}}{\text{PBIT} - ₹42,00,000}$

1.2 (PBIT – ₹ 42,00,000) = PBIT

1.2 PBIT – ₹ 50,40,000 = PBIT

1.2 PBIT – PBIT = ₹ 50,40,000

0.2 PBIT = ₹ 50,40,000

PBIT = ₹ 2,52,00,000

Profit after interest but before tax = ₹ 2,52,00,000 – ₹ 42,00,000 =	₹ 2,10,00,000
Less: Income Tax @ 25%	(₹ 52,50,000)
Profit After Interest & Tax	₹ 1,57,50,000

2. Calculation of Weighted Average Cost of Capital (WACC)

		Amount (₹ in lakhs) (1)	Weight (2)	Cost% (3)	WACC% (4) =2x3
Equity Shareholders' fund					
Common Shares	1000				
Securities Premium	120				
Capital Reserves	80	1200	0.77	12	9.24
Debenture holders' fund		350	0.23	9*	2.07
		1,550	1.00		11.31

*Rate of interest on debentures is taken net of tax of 25%

Weighted Average Cost of Capital = Capital Employed x WACC%

= ₹ 1,550 lakhs x 11.31% = 175.31 lakhs

Question 7

Answer any FOUR of the following:

(a) *When revenue will be recognized in the following situation:*

(i) *Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.*

(ii) *Where seller concurrently agrees to repurchase the same goods at a later date.*

(iii) *Where goods are sold to distributors, dealers or others for resale.*

(iv) *Commissions on service rendered as agent on insurance business.*

(b) *XYZ Finance Ltd. is a non-banking finance company. The extract of its balance sheet are as follows:* ***(₹ in lakhs)***

	Amount
Equity and Liabilities	
Paid-up equity capital	*200*
General Reserve	*600*
Non-Current Liabilities	
Loans	*500*

Deposits	*600*
	1,900
Assets	
Non-current assets	
Property Plant and Equipment	*900*
Investments:	
In shares of subsidiaries	*250*
In debentures of group companies	*400*
Current Assets	
Cash and bank balances	*350*
	1,900

You are required to compute 'Net Owned Fund' of XYZ Finance Ltd. as per Non-Banking Financial Company – Systemically Important Non-Deposit taking company and Deposit taking company (Reserve Bank) Directions, 2016.

© *A Mutual Fund raised ₹ 250 lakhs on 1.4.2019 by issue of 25 lakhs units of ₹ 10 per unit. An underwriting arrangement was entered into with ABC Capital Markets Ltd. that agreed to underwrite the entire issue at a commission of 1.2%. The Fund invested 90% of the monies received in the capital market securities to build a portfolio. During the year, the Fund sold securities costing ₹ 25 lakhs at a profit of 20% on selling price and invested the entire money received from sale to buy other securities. The fund management expense for the month amounts to ₹ 5.30 lakhs out of which ₹ 0.80 lakhs were in arrears. The dividend earned was ₹ 2.5 lakhs. The Fund distributed 80% of the realized earnings. The market value of the portfolio on 30.4.2019 was ₹ 304.10 lakhs.*

Determine NA V per unit.

(d) *What are the major changes in Ind AS 116 vis-à-vis notified AS 19 with respect to accounting of Sale and Leaseback transactions? Also, comment on whether the concept of classification of leases plays a role in both the standards.*

(e) *Grey Ltd. had purchased a machinery on 1.4.2011 for ₹ 30 lakhs, which is reflected in its books at written down value of ₹ 17.5 lakhs on 1.4.2016. The company has estimated an upward revaluation of 10% on 1.4.2016 to arrive at the fair value of the asset.*

On 1.4.2018, the machinery was revalued downward by 15% and the company also re-estimated the machinery's remaining life to be 8 years. On 31.3.2020 the machinery was sold for ₹ 9,35,000. The company charges depreciation on Straight Line method.

Prepare Machinery account in the books of Grey Ltd. to record the above transactions.

(4 x 4 = 16 Marks)

Answer

(a) (i) Revenue from sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where seller concurrently agrees to repurchase the same goods at a later date, such transactions are in substance a financing agreement. In such a situation, the resulting cash inflow should not be recognised as revenue.

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

(b) Statement showing computation of 'Net Owned Fund'

S. No			*₹ in lakhs*
	Paid up Equity Capital		200
	Free Reserves		600
(i)		A	800
	Investments		
	In shares of subsidiaries		250
	In debentures of group companies		400
(ii)		B	650
(iii)	10% of A		80
(iv)	Excess of Investment over 10% of A (650 – 80)	C	570
(v)	Net Owned Fund [(A) – (C)] (800 – 570)		230

€ Determination of Net asset value per unit of the fund

	₹ in lakh	*₹ in lakh*	
Opening bank balance [(250 – (250 x 1.2%)) x 10%]	24.70		

Add: Proceeds from sale of securities [(25/80%) x 100%]	31.25		
Dividend received	2.50	58.45	
Less: Cost of securities	31.25		
Fund management expenses (5.30–0.80)	4.50		
Capital gains distributed [80% of (31.25 – 25.00)]	5.00		
Dividends distributed (80% of 2.50)	2.00	(42.75)	
Closing bank balance		15.70	
Closing market value of portfolio		304.10	
		319.80	
Less: Arrears of expenses		(0.80)	
Closing net assets		319.00	
Number of units			25,00,000
Closing Net Assets Value (NAV)			₹ 12.76

(d) Major changes in Ind AS 116 vis-à-vis AS 19 w.r.t. accounting of Sales and Leaseback transactions

Ind AS 116	AS 19
Ind AS 116 eliminates the requirement of classification of leases as either operating or finance lease and introduces a single lease accounting model for lessee, which requires lessee to ecognize assets and liabilities for all leases unless it applies the recognition exemption.	AS 19 requires a lessee to classify leases as either finance leases or operating leases. Same classification is relevant for lessor also under AS 19.
Ind AS 116 requires a seller-lessee and a buyer-lessor to use the definition of sale as per Ind AS 115 to determine whether a sale has occurred in sale and lease back transactions. In Ind AS 116, the approach for computation of gain / loss for a completed sale is different. If the transfer of the underlying asset is a sale, the transaction will be accounted for as a sale and a lease by both the lessee and the lessor.	As per AS 19, if a sale and leaseback transaction results in a finance lease, excess, if any, of the sale proceeds over the carrying amount shall be deferred and amortised by the seller-lessee over the lease term in proportion to depreciation of the leased asset.

If the transfer of the underlying asset is not a sale, then the seller-lessee shall ecognize a finance liability and the buyer-lessor will ecognize a financial asset to be accounted for as per Ind AS 109.	

€ **Machinery A/c**

Date	Particulars	Amount	Date	Particulars	Amount
1.4.11	To Bank / Vendor	30,00,000	31.3.12	By Depreciation (W.N.1)	2,50,000
			31.3.12	By Balance c/d	27,50,000
		30,00,000			30,00,000
1.4.12	To Balance b/d	27,50,000	31.3.13	By Depreciation	2,50,000
			31.3.13	By Balance c/d	25,00,000
		27,50,000			27,50,000
1.4.13	To Balance b/d	25,00,000	31.3.14	By Depreciation	2,50,000
			31.3.14	By Balance c/d	22,50,000
		25,00,000			25,00,000
1.4.14	To Balance b/d	22,50,000	31.3.15	By Depreciation	2,50,000
			31.3.15	By Balance c/d	20,00,000
		22,50,000			22,50,000
1.4.15	To Balance b/d	20,00,000	31.3.16	By Depreciation	2,50,000
			31.3.16	By Balance c/d	17,50,000
		20,00,000			20,00,000
1.4.16	To Balance b/d	17,50,000	31.3.17	By Depreciation (W.N.2)	2,75,000
1.4.16	To Revaluation Reserve @ 10%	1,75,000	31.3.17	By Balance c/d	16,50,000
		19,25,000			19,25,000
1.4.17	To Balance b/d	16,50,000	31.3.18	By Depreciation	2,75,000
			31.3.18	By Balance c/d	13,75,000
		16,50,000			16,50,000

1.4.18	To Balance b/d	13,75,000	31.3.19	By Revaluation Reserve	1,25,000*
			31.3.19	By Profit and Loss A/c	81,250*
			31.3.19	By Depreciation (W.N.3)	1,46,094
			31.3.19	By Balance c/d	10,22,656
		13,75,000			13,75,000
1.4.19	To Balance b/d	10,22,656	31.3.20	By Depreciation	1,46,094
31.3.20	To Profit and Loss A/c (balancing figure)	58,438*	31.3.20	By Bank A/c	9,35,000
		10,81,094			10,81,094

*Note: As per para 44 of AS 10 (revised), an entity has an option either to transfer the value of revaluation reserve to revenue reserve on derecognition of the asset. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an enterprise.

The above Machinery account is drawn on the basis that some of the surplus is transferred every year as the asset is used by an enterprise. However, if the Machinery account may be prepared on the basis that whole of the surplus will be transferred when the asset is disposed. In such a situation on downward revaluation, 'Revaluation reserve account' will be debited by ₹ 1,75,000 and 'Profit and Loss Account' will be debited by ₹ 31,250.

Working Notes:

1. **Calculation of useful life of machinery on 1.4.2011**

   Depreciation charge in 5 years = (30 lakh – 17.5 lakh) = ₹ 12.5 lakh

   Depreciation per year as per Straight Line method = 12.5 lakh/5 years = ₹ 2.5 lakh

   Remaining useful life = ₹ 17.5 lakh / ₹ 2.5 lakh = 7 years

   Total useful life = 5 years + 7 years = 12 years

2. **Depreciation after upward revaluation as on 31.3.2016**

Book value as on 1.4.2016 =	17.5 lakh
Add: 10% upward revaluation =	1.75 lakh
Revalued amount	19.25 lakh

Remaining useful life 7 years (Refer W.N.1)

Depreciation on revalued amount = 19.25 / 7 years = ₹ 2.75 lakh

3. Depreciation after downward revaluation as on 31.3.2018

Book value as on 1.4.2018 =	13.75 lakh
Less: 15% Downward revaluation =	(2.0625 lakh)
Revalued amount	11.6875 lakh

Revised useful life 8 years

Depreciation on revalued amount = 11.6875 / 8 years = ₹ 1.46094 lakh