FINAL CA – NOV 2018

SUB: FINANCIAL REPORTING

Topics: Holding Company Accounts, ESOP, HRA, Economic Value Added Statement

Test Code – CF4

Branch (MULTIPLE) (Date :)

(50 Marks)

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*Note: **All** questions are compulsory.*

Question 1 (15 marks)

1. **Basic information:**

Holding Co.: A Ltd.	**Date of consolidation:** 31 March 2012	**% Holding** = 80%
Subsidiary Co.: B Ltd.	**Date of control:** 1 April 2011	**Minority Interest** = 20%

2. **Cost of Control:**

Particulars	Rs. (in 000's)
Investment in B Ltd.	
- Equity Shares	3,840.00
- Preference Shares	640.00
Less: Paid up value of investment	
- Equity Shares	(960.00)
- Preference Shares	(640.00)
Less: Pre-acquisition Capital Profits (W.N.5)	(550.40)
Less: Pre-acquisition dividend	(153.60)
Goodwill / (Capital Reserve)	**2,176.00**

3. **Minority Interest:**

Particulars	Rs. (in 000's)
Share Capital	
- Equity Shares	240.00
- Preference Shares	160.00
Share in proposed preference dividend (112 x 20%)	22.40
Share in Pre-acquisition Profits/(Losses) (W.N.5)	137.60
Share in Post-acquisition Profits/(Losses) (W.N.5)	162.80
	722.80

4. **Consolidated Reserves:**

Particulars	General reserve Rs. (in 000's)	Profit and loss a/c Rs. (in 000's)
Balance of A Ltd.	3,800.00	3,200.00
Share of A Ltd. in Post-acquisition Profits/(Losses)	-	651.20
Pre-acquisition dividend (192 x 80%)	-	(153.60)
Share in proposed preference dividend (112 x 80%)	-	89.60
	3,800.00	**3,787.20**

5. Analysis of Reserves and Surplus of B Ltd.

Particulars	Pre-acquisition Profits/(Losses)	Post-acquisition Profits/(Losses)
General Reserve	80.00	-
Less: Minority Interest (20%)	**16.00**	**-**
Share of A Ltd.	**64.00**	**-**
Profit and loss account (W.N.1)	448.00	880.00
Less: Cancellation of loss in respect of sale of inventory to A Ltd. (20,000/2)	-	10.00
Add/Less: Revaluation of assets (W.N.2)		
- Plant and machinery	400.00	-
- Furniture	(240.00)	-
Add/Less: Depreciation effect revaluation of assets (W.N.2)		
- Plant and machinery		(100.00)
- Furniture		24.00
	608.00	814.00
Less: Minority Interest (20%)	**121.60**	**162.80**
Share of A Ltd.	**486.40**	**651.20**

W.N.1: Profit and loss account*

Balance as on 31 March 2012 = Rs.1,440 **(Rs. In 000's)**

Balance as on 1 April 2011	640.00	Addition during 2011-12	992.00
Less: Dividend for 2010-11	(192.00)	Less: Proposed preference dividend	(112.00)
Pre-acquisition Profits/(Losses)	**448.00**	**Post-acquisition Profits/(Losses)**	**880.00**

W.N.2: Revaluation of fixed assets:

(a) Plant and machinery:

Particulars	Rs. In 000's
Book value as on 1 April 2011 (1,200 / 75%)	1,600
Amount of increase (25% x 1,600)	400

Computation of depreciation effect on revaluation:

Particulars	Rs. In 000's
Depreciation on revalued amount (1,600 + 400) x 25%	500
Less: Depreciation on already charged (1,600 x 25%)	(400)
Increase in depreciation	**100**

(b) Furniture:

Particulars	Rs. In 000's
Book value as on 1 April 2011 (1,080 / 90%)	1,200
Amount of decrease (20% x 1,200)	240

Computation of depreciation effect on revaluation:

Particulars	Rs. In 000's
Depreciation on revalued amount (1,200 - 240) x 10%	96
Less: Depreciation on already charged (1,200 x 10%)	(120)
Decrease in depreciation	**(24)**

6. Consolidated Balance Sheet of A Ltd. and its Subsidiary B Ltd. as at 31 March 2012

Particulars	Note No.	Rs. In 000's
EQUITY AND LIABILITIES		
Shareholders' funds		
(a) Share capital	1	6,000.00
(b) Reserves and surplus	2	7,587.20
		13,587.20
Minority Interest		722.80
Current liabilities		
(a) Trade payables (600 + 640 -240)		1,000.00
		1,000.00
TOTAL		**15,310.00**
ASSETS		
Non-current assets		
(a) Fixed assets		
(i) Tangible assets	3	7,684.00
(i) Intangible assets - Goodwill on consolidation		2,176.00
		9,860.00
Current assets		
(a) Inventory (1,360 + 808 + 10)		2,178.00
(b) Trade receivables (1,120 + 632 - 240)		1,512.00
(c) Cash and cash equivalents (1,320 + 440)	6	1,760.00
		5,450.00
TOTAL		**15,310.00**

Notes to accounts:

Note 1: Share Capital

Particulars	Rs. In 000's
Authorised:	
…….. Equity Shares of Rs…. each	-
	-
Issued, subscribed and fully paid-up:	
6,00,000 Equity Shares of Rs.10 each	6,000.00
	6,000.00

Note 2: Reserves and Surplus

Particulars	Rs.
(a) Profit and loss a/c	3,787.20
(b) General Reserve	3,800.00
	7,587.20

Note 3: Tangible fixed assets

Particulars	Rs.
(a) Plant and machinery (4,120 + 1,200 + 400 - 100)	5,620.00
(b) Furniture (1,200 + 1,080 - 240 + 24)	2,064.00
	7,684.00

Note 4: Contingent liability

Particulars	Rs.
(a) Claim for damages payable to contractor	155.00
	155.00

*Note: The P&L balance as on 1 April 2011 is after payment of preference dividend because question specifies that out of this profit, equity dividend has been paid which means that preference dividend was already paid.

Question 2 (15 marks)

Fair value under equity settlement = 250 shares x Rs. 68 = Rs. 17,000

Fair value under cash settlement = 200 shares x Rs. 70 = Rs. 14,000

So, fair value of equity component = Rs. 17,000 - Rs. 14,000 = Rs. 3,000

Fair value of liability component = Rs.14,000

Fair value of liability component should be accounted for as per cash- settled employee share-based plan. Fair value of equity component should be accounted for as per equity-settled employee share-based payment plan.

Amounts to be recognised for liability component:

	Particulars	31.12.10	31.12.11	31.12.12
A	Fair value of share without restrictions	75	80	85
B	Closing provision required	5,000	10,667	17,000
		[200 x 75 x 1 /3]	[200 x 80 x 2/3]	[200x85 x 3/3]
C	Opening provision	-	5,000	10,667
D	**Expense for the year (B - C)**	**5,000**	**5,667**	**6,333**

Amounts to be recognised for equity component:

	Particulars	31.12.10	31.12.11	31.12.12
A	Cumulative expense to be recognised till date	1,000 [3,000 x 1/3]	2,000 [3,000 x 2/3]	3,000 [3,000 x 3/3]
B	Cumulative expense already recognised	-	1,000	2,000
C	**Expense for the year (A - B)**	**1,000**	**1,000**	**1,000**

Journal Entries in the Books of ABC Ltd.

Date	Particulars		Debit (Rs.)	Credit (Rs.)
31.12.2010	Employee compensation expense A/c To Provision for liability component of employee share-based payment plan A/c (Being expense recognised in respect of liability component of the plan with cash alternative)	Dr.	5,000	5,000
31.12.2010	Employee compensation expense A/c To Stock options outstanding A/c (Being expense recognised in respect of equity component of the plan with cash alternative)	Dr.	1,000	1,000
31.12.2011	Employee compensation expense A/c To Provision for liability component of employee share-based payment plan A/c (Being expense recognised in respect of liability component of the plan with cash alternative)	Dr.	5,667	5,667
31.12.2011	Employee compensation expense A/c To Stock options outstanding A/c (Being expense recognised in respect of equity component of the plan with cash alternative)	Dr.	1,000	1,000
31.12.2012	Employee compensation expense A/c To Provision for liability component of employee share-based payment plan A/c (Being expense recognised in respect of liability component of the plan with cash alternative)	Dr.	6,333	6,333
31.12.2012	Employee compensation expense A/c To Stock options outstanding A/c (Being expense recognised in respect of equity component of the plan with cash alternative)	Dr.	1,000	1,000
	Case (1) - When cash settlement is made: Provision for liability component of employee share-based payment plan A/c To Bank A/c (Being cash paid under the plan with cash alternative)	Dr.	17,000	17,000
	Stock options outstanding A/c To General reserve A/c (Being balance in the equity account transferred to general reserve)	Dr.	3,000	3,000
	Case (2) - When equity settlement is made: Stock options outstanding A/c Provision for liability component of employee share-based To Share capital A/c To Securities premium A/c (Being shares issued under the plan on exercise of equity alternative)	Dr.	3,000 17,000	2,500 17,500

Question 3 (8 marks)

Value Limited

Computation of Economic Value Added

Economic Value Added	` in lakhs
Net Operating Profit after Tax (Refer W.N. 5)	1,372.00
Add: Interest on Long-term Fund (Refer W.N. 2)	28.00
	1,400.00
Less: Cost of Capital (` 6,400 lakhs × 15.77%) (Refer W.N. 3 and 4)	1,009. 28
Economic Value Added	390. 72

Working Notes:

(1) **Cost of Equity** = Risk free Rate + Beta factor (Market rate – Risk free rate) 9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%

(2) **Cost of Debt**

	` in lakhs
Interest	40
Less: Tax (30%)	12
Interest after Tax	28

Cost of debt = $\frac{28}{400} \times 100 = 7\%$

(3) **Weighted Average Cost of Capital**

		` in lakhs
Cost of Equity	` 6,000 lakhs × 16.35% (W.N.1)	981
Cost of Debt	` 400 lakhs × 7% (W.N.2)	28
		1009

WACC = $\frac{1,009}{6,400}$ =15.77% (approx.)

(4) **Capital Employed**

			` *in lakhs*

Share Capital	2,000
Reserves and Surplus	4,000
Long-term debts	400
	6,400

(5) **Net operating Profit after Tax**

	` *in lakhs*
Profit before Interest + Tax	2,000
Interest	40
	1,960
Tax (30% on ` 1,960 lakhs)	588
Operating Profit after Tax	1,372

Question 4 (6 marks)

Jaggi and Lau suggested a model for valuation of human resources. According to them, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. They referred group to homogeneous employees whether working in the same department or division of the organization or not. They believed that an individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. Accordingly, they developed a model which attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Merit

Jaggi and Lau model approached the valuation of human resources on the basis of grouping of employees. Under this method, calculations get simplified and the chances of errors get reduced.

Demerit

1. This model ignores individual skills of the employees. The varied skills of the employees are not recognized in the valuation process under Jaggi and Lau model.
2. The performance of a group may be seriously affected in the event of exit of a single individual.

Question 5 (6 marks)

(b) Computation of EVA

Particulars	*` in crores*
Net Operating Profit after Tax (NOPAT)	252.00
Less: Cost of Operating Capital Employed (COCE) [13.25% of ` 1,100]	(145.75)
Economic Value Added (EVA)	106.25

Working Notes:

(v) Cost of Debt = Interest Rate (1 – Tax Rate) = 15% (1 - 30) = 10.50%

(vi) Cost of Preference Share = 15%

(vii) Cost of Equity = Risk Free Rate + (Beta x Equity Market Risk Premium)

(15.5% - 9%) + (1.5 x 9) = 20%

(viii) Total Capital Employed = 800 + 100 + 300 = 1,200 crores

5. WACC = $\frac{800}{1,200} \times 10.50\% + \frac{100}{1,200} \times 15\% + \frac{300}{1,200} \times 20\%$

= 7% + 1.25% + 5% = 13.25%

6. Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT - Interest}} = \frac{\text{EBIT}}{\text{EBIT} - 120} = 1.5$

EBIT = (120 x 1.5)/0.5 = 360

3. Net Operating Profit after Tax = 360 - 30% of 360 = 252

4. Operating Capital Employed = Total Capital Employed - Non-Operating Capital Employed

1,200 -100 = 1,100 crores

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