FINAL CA – May 2018
Financial Reporting
Test Code – F24
Branch: MULTIPLE Date: 07.01.2018

(50 Marks)

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

Question 1 (8 marks)

A. Calculation of expenses to be recognised in respect of the liability component at the end of each year

(3 marks)

Year 1	
Provisions required at the year-end 1,000 x 52.00 x 1/3=	17,333
Less provision at the beginning of the year	Nill
Expenses for the year	17,333
Year 2	
Provisions required at the year-end 1,000 x 55.00 x 2/3=	36,667
Less provision at the beginning of the year	17,333
Expenses for the year	19,334
Year 3	
Provisions required at the year-end 1,000 x 60.00 =	60,000
Less provision at the beginning of the year	36,667
Expenses for the year	23,333

B. **Journal Entries for each year**

Year	Particulars			
1. **(1 mark)**	Employee compensation expenses A/c	Dr.	17,333	
	To Provision for liability component of employee share –based payment plan (Being compensation expense recognized in respect of liability component of employee share-based payment plan with cash alternative)			17,333
	Employee compensation expenses A/c	Dr.	2,533	
	To Stock Option Outstanding A/c (Being compensation expense recognized in respect of equity component of employee share-based payment plan with cash alternative)			2,533
2. **(1 mark)**	Employee compensation expenses A/c	Dr.	19,334	
	To Provision for liability component of employee share –based payment plan (Being compensation expense recognized in respect of liability component of employee share-based payment plan with cash alternative)			19,334
	Employee compensation expenses A/c	Dr.	2,533	
	To Stock Option Outstanding A/c			2,533

	(Being compensation expense recognized in respect of equity component of employee share-based payment plan with cash alternative)		
3. **(1 mark)**	Employee compensation expenses A/c Dr. To Provision for liability component of employee share –based payment plan (Being compensation expense recognized in respect of liability component of employee share-based payment plan with cash alternative)	23,333	23,333
	Employee compensation expenses A/c Dr. To Stock Option Outstanding A/c (Being compensation expense recognized in respect of equity component of employee share-based payment plan with cash alternative)	2,533	2,533
(1 mark)	**On settlement for each year** **Scenario 1:** The Cash alternative Provision for liability component of employee share based payment plan Dr. To Bank A/c (Being cash paid on exercise of cash alternative under the employee share based payment plan)	60,000	60,000
	Stock Options Outstanding A/c Dr. To General Reserve (Being the balance standing to the credit of the Stock Options Outstanding Account transferred to the general reserve upon exercise of cash alternative)	7,600	7,600
(1 mark)	**Scenario 2: The equity alternative** Stock Option Outstanding A/c Dr. Provision for liability component of employee Dr. To Share Capital A/c (1,000 shares x 10) To Securities Premium A/c (Being shares issued on exercise of equity alternative under the employee share based payment plan)	7,600 60,000	10,000 57,600

Working Note: (1 mark)

The employee share-based payment plan granted by the enterprise has two components, viz., (i) a liability component, i.e., the employees' right to demand settlement in cash, and (ii) an equity component, i.e., the employees' right to demand settlement in shares rather than in cash. The enterprise measures, on the grant date, the fair value of two components as below:

Fair value under equity settlement 1,200 shares x 48	=	57,600
Fair value under cash settlement 1,000 shares x 50	=	<u>50,000</u>
Fair value of the equity component (57,600-50,000)	=	<u>7,600</u>
Fair value of the liability component	=	50,000

The expense to be recognised in respect of the equity component at the end of each year is one third of the fair value (` 7,600) determined above.

Question 2 (8 marks)

(a) E.V.A. = Operating Profit – Taxes paid – (Capital Employed x WACC)

= NOPAT - (Capital Employed x WACC)

= 2,24,000 – (15,00,000 x 13.74%)

= ` 2,24,000 – ` 2,06,100 = ` 17,900.

2 marks

Working Notes

1. Operating Capital

	`
Equity share capital	10,00,000
Reserve & Surplus	3,00,000
12% Preference share capital	2,00,000
10% Debentures	4,00,000
Total	19,00,000
Less: Non-trade (non-operating) investment	4,00,000
Capital Employed	15,00,000

2 marks

2. Calculation of NOPAT `

PBT = Profit after tax + taxes (2,00,000 x 40/60) = 2,00,000 + 1,33,333	3,33,333
Add: Interest expenses (4,00,000 x 10%)	40,000
Operating PBIT	3,73,333
Less: Tax @ 40%	(1,49,333)
NOPAT	2,24,000

2 marks

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

Nature	*Amount*	*Calculation*	*Cost*
Cost of debt	4,00,000	Kd =10% (1 - 0.40) x 4,00,000/19,00,000	1.26%
Cost of Preference share capital	2,00,000	Kp = 12% x 2,00,000/19,00,000	1.26%
Cost of Equity	13,00,000	Ke = [8% + 1.2 (15% - 8%)] x 13,00,000/19,00,000	11.22%
	19,00,000	Total	13.74%

2 marks

Question 3 (16 marks)

Consolidated Balance Sheet of Vinyl Ltd. with its Subsidiary Sind Ltd. and Jointly Controlled Entity Hind Ltd. as on 31st March, 2016 (5 marks)

Particulars	Note No.	

Equity and Liabilities		
(1) Shareholder's Funds		
(a)Share Capital	1	50,00,000
(b)Reserves and Surplus	2	93,58,150
(2) Non –current Liabilities		
Long –term borrowings	3	21,00,000
(3) Current Liabilities		
(a) Trade Payables	4	10,98,175
(b) Short-term provisions	5	16,96,110
Total		1,92,52,435
II. Assets		
(1) Non –current assets		
Fixed assets		
(a) Tangibles assets	6	1,35,18,200
(b) Intangible assets (W.N.6)		29,28,120
(2) Current assets		
(a) Inventories	7	14,04,055
(b) Trade receivables	8	8,95,285
(c) Cash and cash equivalents	9	5,06,775
Total		1,92,52,435

Notes to Accounts (4 marks)

1.	Share Capital			
	Equity Capital 5,00,000 shares of '10 each			50,00,000
	(out of the above 3,00,000 shares of '10 each have been issued for consideration other than cash)			
2.	Reserves Surplus			
	Retained Earnings(w.N.4)		58,20,000	
	Capital Reserve (W.N.5)		11,38,150	
	Securities Premium (W.N.7)		24,00,000	93,58,150
3.	Long Term Borrowings			
	10% Debentures			
	Vinyl Ltd.	12,00,000		
	Add: Issued to Sind Ltd.	9,00,000		21,00,000
4.	Trade Payables			
	Vinyl Ltd.	4,26,860		
	Sind Ltd.	3,48,620		
	Hind Ltd.(50%)	3,22,695		
5.	Short –term provisions			
	Provision for taxes			
	Vinyl Ltd.	5,98,300		
	Sind Ltd.	8,36,210		
	Hind Ltd.(50%)	2,61,600		16,96,110
6.	Tangible assets			
	Fixed assets (assumed to be tangible in nature)			

	Vinyl Ltd.	47,22,400		
	Sind Ltd.	27,63,000		
	Hind Ltd.(50%)	11,45,300		
	Plant and Machinery			
	Vinyl Ltd.	28,39,860		
	Sind Ltd.	13,61,200		
	Hind Ltd.(50%)	6,86,440	48,87,500	1,35,18,200
7.	Inventories			
	Vinyl Ltd.	8,16,400		
	Sind Ltd.	4,28,350		
	Hind Ltd.(50%)	1,59,305		14,04,055
8.	Trade Receivable			
	Vinyl Ltd.	4,29,550		
	Sind Ltd.	3,15,720		
	Hind Ltd.(50%)	1,50,015		8,95,285
9.	Cash and cash equivalents			
	Vinyl Ltd.	2,76,950		
	Sind Ltd.	1,74,710		
	Hind Ltd.(50%)	55,115		5,06,775

Working Notes: (7 marks)

1. **Purchase consideration paid to Subsidiary Sind Ltd.**

Earnings per share for the year 31st March,2015

$=\frac{180000}{150000\ equity\ shares}$= 1.20 per share

Marketing per share = 1.20 x10(i.e. P/E ratio) = 12 per share

Purchase consideration = 12 x 1,50,000shares =18,00,000

Purchase consideration to be paid as under

10% Debentures		9,00,000
Equity shares (50,000 shares of 18 each)	9,00,000	
		18,00,00

2. **Consideration paid to Jointly Controlled Entity Hind Ltd.**

Total market value (as given)	90,00,000
50%share acquired by Vinyl Ltd. (2,50,000 shares x@18 each)	45,00,000

3. **Analysis of General reserve of Sind Ltd. As on 31st March ,2016**

Retained earnings given in balance sheet on 31.3.2016	23,58,150
Less :Current profit for the year ended 31.3.2016(Post acquisition)	(9,20,000)
Pre-acquisition retained earnings	14,38,150

4. **Retained Earnings in the Consolidated Balance Sheet as per Proportionate Consolidation Method**

Balance in Vinyl Ltd. Balance sheet	48,60,000
Add: Share in post –acquisition profit of Sind Ltd.	9,20,000
Add :Share in post –acquisition profits of Hind Ltd.	
(5,60,000 x 50%) (joint venture)	2,80,000
	60,60,000

Less :Goodwill (written off)	(2,40,000)
	58,20,000

5. Capital Reserve

Amount Paid for Sind Ltd.		18,00,000
Less Paid up value of shares	15,00,000	
Pre-acquisition profit(W.N.3)	14,38,150	(29,38,150)
Capital Reserve		11,38,150

6. Goodwill

Amount paid for 50% shares of Hind Ltd.	45,00,000
Less: Paid up value of shares(17,00,000 x50%)	(8,50,000)
Pre-acquisition (15,23,760 -5,60,000) x 50%	(4,81,880)
Goodwill	31,68,120
Less Impairment (Written off)	(2,40,000)
	29,28,120

7. Securities Premium

Issued to Sind Ltd.(50,000 x8)	4,00,000
Issued to Hind Ltd.(2,50,000 x8)	20,00,000
	24,00,000

Question 4 (8 marks)

Capital Base = ` 2,00,00,000

Actual Profit = ` 22,00,000

Target Profit @ 12.5% = ` 25,00,000

Expected Profit on employing the particular executive

= ` 25,00,000 + ` 5,00,000 = ` 30,00,000

Additional Profit = Expected Profit – Actual Profit

= ` 30,00,000 – ` 22,00,000 = ` 8,00,000

Maximum bid price = $\frac{\text{Additional Profit}}{\text{Rate of Return on Investment}} = \frac{8,00,000}{12.5} \times 100 =$ ` 64,00,000

Maximum salary that can be offered = 12.5% of ` 64,00,000 i.e., ` 8,00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., ` 8,00,000.

Question 5 (10 marks)

It is necessary to segregate the instalments into principal outstanding and interest components by using I.R.R. @ 10.42%. **(3 marks)**

(` in lakhs)

Time	*Opening outstanding amount (a)*	*Cash flow (b)*	*Interest (c)*	*Principal repayment (d)*	*Closing outstanding (e)*
31-3-2009		*(-) 60*	*-----*	*---*	*60.00*
31-3-2010	*60.00*	*16*	*6.25*	*9.75*	*50.25*
31-3-2011	*50.25*	*16*	*5.24*	*10.76*	*39.49*
31-3-2012	*39.49*	*16*	*4.11*	*11.88*	*27.60*
31-3-2013	*27.60*	*16*	*2.88*	*13.12*	*14.48*
31-3-2014	*14.48*	*16*	*1.52*	*14.49*	*0.00*

(i) As the hire-purchaser paid the first instalment, the notional principal outstanding on 1-4-2010 was `50.25 lakhs. Provider Ltd. Should not recognize 5.24 lakhs as interest income as this should be treated as finance charge (not collected). (Refer W.N.1) **(2 marks)**

(ii) The net book value of the assets as on 31-3-2011 **(3 marks)** (Refer to note 2)

	` in lakhs
Over due instalment	16.00
Instalments not due (`*16 lakhs x 3)*	48.00
	64.00
Less: Finance charge (not collected)	5.24
	58.76
Less: Instalments not due	48.00
Net book value of assets for Provider Ltd.	10.76

(iii) The asset under hire purchase should be classified as sub -standard and a provision should be should be made at 10% of net book value of assets. i.e. ` 10.76 lakhs = ` 1.08 lakhs as per NBFC Prudential Norms laid down by RBI. **(2 marks)**

Working Notes:

1. Cash price is ` 80 lakhs. Down payment is ` 20 lakhs. Therefore principal value of asset for purchasing company's point of view as on 31-3-2009 is ` 60 lakhs (i.e. ` 80 lakhs – ` 20 lakhs). When company pays first instalment of ` 16 lakhs, it pays interest @ 10.42% for one year, i.e. ` 6.25 lakhs and repayment of principal in this instalment is of ` 9.75 (i.e.16 -6.25). The principal outstanding on 1-4-2010 is ` 50.25 lakhs (i.e ` 60 lakhs – ` 9.75 lakhs)
2. As per Para 8(2)(ii)(b) of NBFC Prudential Norms (Reserve Bank of India) Directions 1988 , provision is to be made at the rate of 10% of the net book value which is to be calculated as follows (as per Para 8(2)(ii):

Total Dues (Over due and future instalment)	------------
Less: Finance Charge not credited to profit and loss Account	------------
Less: Depreciated value of the underlying asset	------------

Net Book Value	------------

Depreciated Value= Original Cost – Depreciation Charge @20% p.a. on S.L.M. computed notionally on new asset.

= For second hand asset, actual acquisition cost is treated as original cost.

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