FINAL CA – May 2018
Financial Reporting

Test Code – F75

Branch: Date: 25.02.2018

(50 Marks)

Note: All questions are compulsory.

Question 1 (8 marks)

a. Employees Compensation Account (1 mark)

Year		`	*Year*		`
2010-11	To Provision for Liability (W.N. 3)	1,27,200	2010-11	By Profit & Loss A/c	1,27,200
2011-12	To Provision for Liability (W.N. 3)	1,52,633	2011-12	By Profit & Loss A/c	1,52,633
2012-13	To Provision for Liability (W.N. 3)	2,02,867	2012-13	By Profit & Loss A/c	2,02,867

Provision for Liability Component Account (1 mark)

Year		`	*Year*		`
2010-11	To Balance c/d	1,27,200	2010-11	By Employees Compensation A/c	1,27,200
2011-12	To Balance c/d	2,79,833	2011-12	By Balance b/d	1,27,200
				By Employees Compensation A/c	1,52,633
		2,79,833			2,79,833
2012-13	To Balance c/d	4,82,700	2012-13	By Balance b/d	2,79,833
				By Employees Compensation A/c	2,02,867
		4,82,700			4,82,700

If Employee opts for Cash settlement

Provision for Liability Component Account (1/2 mark)

Year	*Particulars*	`	*Year*	*Particulars*	`
2013-14	To Bank (5000 x ` 96.54)	4,82,700	2013-14	By Balance c/d	4,82,700

If employee opts for Equity Settlement

Provision for Liability Component Account (1/2 mark)

Year	*Particulars*	`	*Year*	*Particulars*	`
2013-14	To ESOP outstanding A/c	4,82,700	2013-14	By Balance c/d	4,82,700

ESOP Outstanding Account
(1 mark)

Year		`	Year		`
2013-14	To Equity Share Capital A/c (6000 x ` 10)	60,000	2013-14	By Provision for Liability Component A/c	4,82,700
	To Securities Premium A/c	12,86,700		By Bank (6,000 x ` 144)	8,64,000
		13,46,700			13,46,700

Working Notes:

(b) Computation of Fair Values (2 mark)

Fair value of shares subject to lock in as on 1st April, 2010	` 60
% of increase in fair value of shares not subjected to lock in	20%
Fair value as on 1st April, 2010 of shares not subject to lock in (60+20%)	` 72
% increase over previous value in respect of fair value on 31.03.2011	6%
Fair value of shares not subject to lock in restriction on 31.03.2011 (72 + 6%)	` 76.32
% increase over previous value in respect of fair value on 31.03.2012	10%
Fair value of shares not subject to lock in restriction on 31.03.2012 (76.32 + 10%)	` 83.95
% increase over previous value in respect of fair value on 31.03.2013	15%
Fair value of shares not subject to lock in restriction on 31.03.2013 (83.95 + 15%)	` 96.54

2. Expense to be recognized in respect of Equity Component (1 mark)

Fair value under Equity Settlement Option (6,000 x ` 60)	3,60,000
Less: Fair value under cash settlement (liability component) option (5,000 x ` 72)	3,60,000
Equity component	Nil
Expenses to be recognized each year for equity component	Nil

3. Expenses to be recognized for Liability Component (1 mark)

	2010-11	*2011-12*	*2012-13*
Number of shares (A)	5000	5000	5000
Fair value at the end of each year (B)	76.32	83.95	96.54
Expenses to be recognized*	1,27,200	1,52,633	2,02,867

*Expenses to be recognized each year has been calculated on the basis:

$$\frac{\text{Fair Value} \times \text{No. of years Expired}}{\text{Vesting Period}} - \text{Expenditure recognised till previous year}$$

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 Evil Ltd.
with its subsidiary Devil Ltd. as on 31st
March, 2013 (6 marks)

		Notes No.	`
I.	Equity and Liabilities		
	(1) Shareholder's Funds		
	(a) Share Capital	1	6,00,000
	(b) Reserves and Surplus	2	1,93,000
	(2) Minority interest (W.N. 4)		1,23,500
	(3) Current Liabilities		
	Trade payables	3	1,70,000
	Total		10,86,500
II.	Assets		
	(1) Non-current assets		
	Fixed assets		
	Tangible assets	4	6,28,000
	Intangible assets	5	50,000
	(2) Current assets		
	(a) Inventories	6	2,13,500
	(b) Trade receivables	7	1,30,000
	(c) Cash and cash equivalents	8	65,000
	Total		10,86,500

Notes to Accounts (4 marks)

			`	`
1.	Share Capital			
	Equity shares of ` 10 each, fully paid up			6,00,000
2.	Reserves and surplus			
	Capital reserve (W.N.3)		33,750	
	General reserve		60,000	
	Profit and loss account (W.N. 6)		99,250	1,93,000
3.	Trade Payables			
	Evil Ltd.	1,00,000		
	Devil Ltd.	80,000		
		1,70,000		
	Less: Mutual indebtedness	(10,000)		1,70,000
4.	Tangible Assets			
	Land and buildings			
	Evil Ltd.	1,00,000		
	Devil Ltd.	1,00,000	2,00,000	

	Plant and machinery				
	Evil Ltd.		2,00,000		
	Devil Ltd.	1,80,000			
	Add: Upward revaluation	50,000			
		2,30,000			
	Less: Excess Depreciation on upward revaluation	(2,000)	2,28,000	4,28,000	6,28,000
5.	Intangible Assets				
	Evil Ltd.			10,000	
	Devil Ltd.			40,000	50,000
6.	Inventories				
	Evil Ltd.			1,17,500	
	Devil Ltd.			1,00,000	
				2,17,500	
	Less: Unrealised profit			(4,000)	2,13,500
7.	Trade receivables				
	Evil Ltd.			50,000	
	Devil Ltd.			90,000	
				1,40,000	
	Less: Mutual indebtness			(10,000)	1,30,000
8.	Cash and cash equivalents				
	Bank Balances				
	Evil Ltd.			45,000	
	Devil Ltd.			20,000	65,000

Working Notes: (6 marks)

1. Analysis of Reserves and Profits of Devil Ltd. as on 31.03.2013

		Pre-acquisition profit upto 1.10.2012 *(Capital profits)*	*Post-acquisition profits (2.10.2012 – 31.3.2013)* *Profit and loss account*
General reserve as on 31.3.2013		50,000	
Profit and loss account as on 31.3.2013	1,00,000		
Less: Opening Balance 60,000			
Less: Dividend for 2011-12 (out of pre-acquisition profits) (30,000)	30,000	30,000	
Profit earned during the year	70,000	35,000	35,000
Upward revaluation of plant and machinery as on 1.10.2012 (W.N.2)		50,000	
Excess depreciation (for 6 months) due to upward revaluation (W.N.2)			(2,000)
Total		1,65,000	33,000
Minority Interest (25%)		41,250	8,250
Share of Evil Ltd. (75%)		1,23,750	24,750

2. Revaluation of Plant & Machinery of Devil Ltd. and its book value as on 31.3.2013

Depreciation during the year = Opening Balance less Closing Balance = 2,00,000 – 1,80,000 = ` 20,000

Depreciation rate = (20,000/2,00,000) x 100 = 10%

(a) Computation of Revaluation Gain / Loss

	`
Revalued Amount on 01.10.2012 (date of acquisition)	2,40,000
Less: Book Value on 01.10.2012 (date of acquisition)	

Value on 01.04.2012	` 2,00,000	1,90,000
Less: Depreciation for 6 months at 10%	(`10,000)	
Revaluation Gain i.e. Capital Profit		50,000

(b) Computation of Depreciation on Revaluation Gain / Loss

	`
Depreciation on Revalued Plant for 6 months = ` 2,40,000 × 6/12 × 10%	12,000
Less: Depreciation already provided on ` 2,00,000 × 6/12 × 10%	(10,000)
Revenue Loss	2,000

3. Calculation of cost of control

		`
Share capital in Devil Ltd.		2,25,000
Add: Capital profit		1,23,750
		3,48,750
Less: Cost of Investments	3,37,500	
Less: Pre-acquisition dividend received for 2011-12	(22,500)	(3,15,000)
Capital Reserve		33,750

4. Calculation of minority interest [25%]

	`
Share capital	75,000
Capital (pre-acquisition) profits [W.N.1]	41,250
Revenue (post-acquisition) profits - Profit and loss [W.N.1]	8,250
	1,24,500
Less: Unrealised profit [W.N. 5]	(1,000)
	1,23,500

5. Stock reserve (plant and machinery)

Unrealised profit = $\frac{16,000 \times 1/3}{}$ = ` 4,000

4/3

To be adjusted from minority interest and consolidated profit and loss account in the ratio of 25:75.

6. Consolidated profit and loss account as on 31.3.2013

		`
Profit and loss account balance of Evil Ltd. as on 31.3.2013	1,00,000	
Less: Pre-acquisition dividend wrongly credited	(22,500)	77,500
Add: Share in post-acquisition profit and loss account of Devil Ltd. (W.N.1)		24,750
Less: Unrealised profit [W.N. 5]		(3,000)
		99,250

Note: Unrealized profits on closing stock have been eliminated to the extent of holding company's share in Profit and Loss Account and balance adjusted in Minority Interest as it relates to upstream transaction.

Question 4 (8 marks)

According to Lev and Schwartz, the value of human capital embodied in a person of age τ is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following formula:

$$V\tau = \sum_{t=\tau}^{t} \frac{I(t)}{(1+r)^{t-\tau}}$$

Where,

*V*τ = the human capital value of a person τ years old. I(t) = the person's

annual earnings up to retirement.

r = a discount rate specific to the person. t = retirement age.

Value of skilled employees: (4 marks)

$$= \frac{50,000}{(1+0.15)^{(65-62)}} + \frac{50,000}{(1+0.15)^{(65-63)}} + \frac{50,000}{(1+0.15)^{(65-64)}}$$

` 32,875.81 + ` 37,807.18 + ` 43,478.26 = ` 1, 14,161.25

Total value of skilled employees is ` 1, 14,161.25 × 20 = ` 22,83,225.

Value of unskilled employees (4 marks)

$$= \frac{30,000}{(1+0.15)^{(62-60)}} + \frac{30,000}{(1+0.15)^{(62-61)}} = \frac{30,000}{(1+0.15)^{2}} + \frac{30,000}{(1+0.15)}$$

= ` 22,684.31 + ` 26,086.96 = ` 48,771.27

Total value of the unskilled employees = ` 48,771.27× 25 = ` 12,19,282

Total value of human resources (skilled and unskilled) = ` 22,83,225 + ` 12,19,282 = ` 35,02,507.

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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