FINAL – MAY 2018

PAPER 1: FINANCIAL REPORTING

Test Code: F T P 1

Branch (MULTIPLE) Date : 18.3

(100 Marks)

Note: ***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)

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise. However, Ministry of Corporate Affairs has amended AS 11 according to which exchange difference arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset. The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items. Thus the company can capitalize the exchange differences arising due to long term loans linked with the acquisition of fixed assets. **(1 mark)**

Transaction 1: Calculation of exchange difference on fixed assets **(2 ½ marks)**

Foreign Exchange Liability = $\frac{\boxed{5{,}000}}{50}$ = US \$ 100 lakhs

Exchange Difference = US \$ 100 lakhs x (` 54.98 – ` 50) = ` 498 lakhs.

Loss due to exchange difference amounting ` added in the carrying value of fixed assets. amount will be provided in the remaining years

498 lakhs will be capitalised and Depreciation on the unamortised

Transaction 2: Soft loan exchange difference (US \$ 1 lakh i.e. ` 50 lakhs) **(2 ½ marks)**

Value of loan 31.3.17 = US \$ 1 lakh x 54.98 = ` 54,98,000

AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.

Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2017 = US $ 1.00 lakh x ` (54.98 – 50) = ` 4.98 lakh.

Loan account is to be increased to 54.98 Iakh and FCMITD account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual instalments, ` 4.98 lakh/3 =

` 1.66 lakh is to be charged in Profit and Loss Account for the year ended

31st March, 2017 and balance in FCMITD A/c ` (4.98 lakh – 1.66 lakh) = ` 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.

Note: The above answer is given on the basis that the company has availed the option under para 46A of AS 11.

(b) As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which the key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise. **(2 marks)**

In the given case, Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price. **(2 marks)**

Hence the contention of Chief Accountant of Arohi Ltd. is wrong. **(1 mark)**

(c) In the given case, Aqua Ltd. offers to pay ` 60 per share to Bose Ltd. (2 ½ marks)

The share exchange ratio would be $\frac{60}{150} = 0.4$

It means, Aqua Ltd. would give 0.4 share for every one share of Bose Ltd. In other words, Aqua Ltd. would give 2 shares for 5 shares of Bose Ltd.

The total number of shares to be issued by Aqua Ltd. to Bose Ltd.

= 3,00,000× 0.4 = 1,20,000 shares

Total number of shares of Aqua Ltd. after acquisition of Bose Ltd.

= 7,20,000 + 1,20,000 = 8,40,000 shares

Calculation of E.P.S. of the amalgamated company = $\frac{\text{Total Net Profit after Interest and Tax}}{\text{Total Number of shares}}$

=43,20,000 / 8,40,000

=` 5.14 per share **(2 ½ marks)**

After amalgamation, the EPS of Aqua Ltd., will improve from ` 5 to ` 5.14.

Note: Earnings per share of Bose Ltd., i.e. ` 2.50 per share as given in the question, does not tally with the calculation i.e. 7,20,000 / 3,00,000 = ` 2.40 per share. However, the above solution has been given on the basis of EPS of Bose Ltd. as given in the question.

(d) (1) **Statement showing valuation of Raw Material and Finished Goods at cost (2 marks)**

Raw Material A	*` per unit*
Cost price	400
Less: Excise duty on which CENVAT credit is receivable	(20)
	380
Add: Freight inward	40
Unloading charges	20
Total cost	440
Finished Goods B	*` per unit*
Raw materials consumed	440
Direct labour	120
Direct overhead	80
Fixed overhead (` 4,00,000/20,000 units)	20
Total cost	660

(2) **(a) When Net Realisable Value (NRV) of the Finished Goods B is ` 800* per unit (1 1/2 marks)**

NRV is greater than the cost of Finished Goods B i.e. ` 660 per unit

Hence, Raw Material and Finished Goods will be valued at cost

Accordingly, value of closing stock will be:

	Quantity	*Rate*	*Amount (`)*
Raw Material A	1,000	440	4,40,000
Finished Goods B	2,400	660	15,84,000
Total cost of closing stock			20,24,000

(b) When Net Realisable Value of the Finished Goods B is ` 600* per unit (1 ½ marks)

NRV is less than the cost of Finished Goods B i.e. ` 660 per unit

Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV.

Accordingly, value of closing stock will be:

	Quantity	*Rate*	*Amount (`)*
Raw Material A	1,000	300	3,00,000
Finished Goods B	2,400	600	14,40,000
Total cost of closing stock			17,40,000

Question 2

Consolidated Balance Sheet of Rich Ltd. (6 marks) and its subsidiary Poor Ltd. as on 31st March, 2012

Particulars	Note No.	(` in Lacs)
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	12,000
(b) Reserves and Surplus	2	7,159

(2) **Minority Interest [W. No. 6]**		3,120
(3) **Current Liabilities**		
(a) Trade payables	3	2,802
(b) Short term provisions	4	1,249
(c) Other current liabilities	5	1,200
Total		27,530
II. **Assets**		
(1) **Non-current assets** Fixed assets		
Tangible assets	6	14,954
(2) **Current assets**		
(a) Inventories	7	5,885
(b) Trade receivables	8	4,477
(c) Cash and cash equivalents	9	1,694
(d) Short term loans and advances	10	520
Total		27,530

Notes to Accounts

			(` in lacs)	(` in lacs)
1.	Share Capital			
	Authorised			15,000
	Issued and Subscribed:			
	Equity shares of ` 10 each, fully paid up			12,000
2.	Reserves and surplus **(1 mark)**			
	Capital Reserve (Note 5)		1,320	
	General Reserve (` 2,784 + 108)		2,892	
	Profit and Loss Account:			
	Rich Ltd.	` 2,715		
	Less: Dividend wrongly credited ` 360			
	Unrealised Profit ` 20	(` 380)		
		` 2,335		
	Add: Share in Poor Ltd.'s			
	Revenue profits	` 612	2,947	7,159
3.	Trade payables			
	Bills Payable			
	Rich Ltd.	` 372		
	Poor Ltd.	` 160		
		` 532		
	Less: Mutual owing	` (45)	487	
	Sundry Creditors			
	Rich Ltd.	1,461		
	Poor Ltd.	854	2,315	2,802

4.	Short term provisions Provision for Taxation			
	Rich Ltd..		855	
	Poor Ltd.		394	1,249
5.	Other current liabilities			
	Proposed Dividend			
	Rich Ltd..			1,200
6.	Tangible assets			
	Land and Buildings			
	Rich Ltd..		2,718	
	Plant and Machinery			
	Rich Ltd..	` 4,905		
	Poor Ltd.	` 4,900	9,805	
	Furniture and Fittings			
	Rich Ltd...	` 1,845		
	Poor Ltd.	` 586	2,431	14,954
7.	Inventories			
	Stock **(1/2 mark)**			
	Rich Ltd..		3,949	
	Poor Ltd.		1,956	
			5,905	
	Less: Unrealised profit		(20)	5,885
8.	Trade receivables			
	Debtors			
	Rich Ltd..	` 2,600		
	Poor Ltd.	` 1,363	3,963	
	Bills Receivable **(1/2 mark)**			
	Rich Ltd..	` 360		
	Poor Ltd.	` 199		
		` 559		
	Less: Mutual Owing	` (45)	514	4,477
9.	Cash and cash equivalents Cash and Bank Balances			
	Rich Ltd..		1,490	
	Poor Ltd.		204	1,694
10.	Short term loans and advances			
	Sundry Advances			
	Rich Ltd..			520

Working Notes:
(7 marks)

1. **Poor Ltd.'s General Reserve Account**

		` in lakhs			` in lakhs
To	Bonus to Equity Shareholders	1,800	By	Balance b/d	3,000

To	Balance c/d	1,380	By	Profit and Loss A/c (Balancing figure)	180
		3,180			3,180

2. **Poor Ltd.'s Profit and Loss Account**

		` in lakhs			` in lakhs
To	General Reserve	180	By	Balance b/d	1,200
To	Dividend paid (20% on `3,000 lakhs)	600	By	Net Profit for the year* (Balancing figure)	1,200
To	Balance c/d	1,620			
		2,400			2,400

*Out of ` 1,200 lakhs profit for the year, ` 180 lakhs has been transferred to reserves.

3. **Distribution of Revenue profits**

	` in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of Rich Ltd. 60% (General Reserve ` 108 + Profit and Loss Account ` 612)	(720)
Share of Minority Shareholders (40%)	480

4. **Calculation of Capital Profits**

	` in lakhs
General Reserve on the date of acquisition less bonus shares (` 3,000 – ` 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (` 1,200 – ` 600)	600
	1,800

Rich. Ltd.'s share = 60% of ` 1,800 lakhs = ` 1,080 lakhs

Minority interest = ` 1,800 – ` 1,080 = ` 720 lakhs

5. **Calculation of capital reserve**

	` in lakhs
Paid up value of shares held (60% of `4,800)	2,880
Add: Share in capital profits	1,080
	3,960
Less: Cost of shares less dividend received (` 3,000 – ` 360)	(2,640)
Capital reserve	1,320

6. **Calculation of Minority Interest**

	` in lakhs
40% of share capital (40% of ` 4,800)	1,920
Add: Share in revenue profits	480
Share in capital profits	720
	3,120

7. **Unrealised profit in respect of stock**

` 100 lakhs ´ $\frac{25}{125}$ = ` 20 lakhs

Question 3

a. (3 marks)

Year 1	Employee compensation expense A/c	Dr.	13,69,010	
	To Stock Options Outstanding A/c			13,69,010
	(Being compensation expense recognised in respect of the ESOP)			
Year 2	Employee compensation expense A/c	Dr.	11,22,740	
	To Stock Options Outstanding A/c			11,22,740
	(Being compensation expense recognised in respect of the ESOP)			
Year 3	Employee compensation expense A/c	Dr.	12,88,250	
	To Stock Options Outstanding A/c			12,88,250
	(Being compensation expense recognised in respect of ESOP)			
Year 5	Bank A/c @ ` 50	Dr.	30,00,000	
	Stock Options Outstanding A/c @ ` 15	Dr.	9,00,000	
	To Share Capital A/c @ ` 10			6,00,000
	To Securities Premium A/c @ ` 55			33,00,000
	(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)			
Year 6	Bank A/c @ ` 50	Dr.	90,00,000	
	Stock Options Outstanding A/c @ ` 15	Dr.	27,00,000	
	To Share Capital A/c @ ` 10			18,00,000
	To Securities Premium A/c @ ` 55			99,00,000
	(Being shares issued to the employees against the options vested in them in pursuance of the Employee Stock Option Plan)			
	Stock Options Outstanding A/c	Dr.	1,80,000	
	To General Reserve			1,80,000
	(Being the balance standing to the credit of the Stock Options Outstanding Account, in respect of vested options expired unexercised, transferred to the general reserve)			

Working Notes:

1. The enterprise estimates the fair value of the options expected to vest at the end of the vesting period as below: **(1/2 mark)**

   No. of options expected to vest = 300 x 1,000 x 0.97 x 0.97 x 0.97 = 2,73,802 options

Fair value of options expected to vest = 2,73,802 options x `  15 = ` 41,07,030

2. As the enterprise still expects actual forfeitures to average 3 per cent per year over the 3-year vesting period, therefore, it recognizes ` 41,07,030/3 towards the employee services. **(1/2 mark)**

3. The revised number of options expected to vest **(2 mark)**

   = 2,49,175 (3,00,000 x .94 x .94 x .94).

   The fair value of revised options expected to vest

   = `  37,37,625 (2,49,175 x ` 15).

   The expense to be recognised during the year is determined as below:

Revised total fair value	` 37,37,625
Revised cumulative expense at the end of year 2	
= (` 37,37,625 x 2/3)	` 24,91,750
Less: Expense already recognised in year 1	` 13,69,010
Expense to be recognised in year 2	` 11,22,740

4. The expense to be recognised during the year is determined as below: No. of **(2 mark)**options actually vested = 840 x 300 = 2,52,000

Fair value of options actually vested (`  2,52,000 x ` 15) =	` 37,80,000
Expense already recognised	` 24,91,750
Expense to be recognised in year 3	` 12,88,250

b.

Computation of Fair Value at Initial Recognition
(2 marks)

Year	Estimated Cash Flows	PVIF @8%	Present Value
	`		`
1/4/2016		1	Nil
31/3/2017	2,00,000	0.9259	1,85,180
31/3/2018	2,00,000	0.8573	1,71,460
31/3/2019	2,00,000	0.7938	1,58,760
31/3/2020	2,00,000	0.7350	1,47,000
31/3/2021	2,00,000	0.6806	1,36,120
31/3/2022	60,000 See Working note	0.6302	37,812
31/3/2023	60,000 See Working note	0.5835	35,010
Fair Value of Loan			8,71,342

Working Notes:

Computation of Interest to be paid on 31/3/2022 and 31/3/2023
(2 marks)

Year	Cash Flows	Principal	Interest	Cumulative

		outstanding		Interest
	`	`	`	`
31/3/2017	2,00,000	8,00,000	40,000	40,000
31/3/2018	2,00,000	6,00,000	32,000	72,000
31/3/2019	2,00,000	4,00,000	24,000	96,000
31/3/2020	2,00,000	2,00,000	16,000	1,12,000
31/3/2021	2,00,000	Nil	8,000	1,20,000
31/3/2022	60,000 (1,20,000/2)			
31/3/2023	60,000 (1,20,000/2)			

Computation of Fair Value Loss (1 mark

	`
Fair Value of Loan	8,71,342
Loan Amount	(10,00,000)
Fair Value Loss	(1,28,658)

Journal Entry at Initial Recognition (1 mark)

Date	Particulars		Dr.	Cr.
			`	`
1/4/2016	Loans to Employee A/c	Dr.	8,71,342	
	Employee Benefits A/c	Dr.	1,28,658	
	To Bank A/c			10,00,000

Note: The fair value measurement is of other than level 1. Therefore, an entity should defer the day 1 gain / loss over the term of the financial asset. Hence,
` 1,28,358 will be amortised over a period of 7 years. Since, there is no guidance on how to amortise the same, the simplest way is to amortise the difference in line with the interest accruals so that there is no impact on Profit or Loss.

Employee benefit is transferred to Statement of Profit and Loss.

Computation of Interest on Amortised Cost (1 marks)

Year	Opening Balance (1) `	Interest @ 8% (2) `	Repayment (3) `	Closing Balance (1+2-3) `
1/4/2016				8,71,342
31/3/2017	8,71,342	69,707	2,00,000	7,41,049
31/3/2018	7,41,049	59,284	2,00,000	6,00,333
31/3/2019	6,00,333	48,027	2,00,000	4,48,360
31/3/2020	4,48,360	35,869	2,00,000	2,84,229
31/3/2021	2,84,229	22,738	2,00,000	1,06,967
31/3/2022	1,06,967	8,557	60,000	55,524
31/3/2023	55,524	4,476	60,000	Nil

Journal Entry on 31/3/2017 (1 marks)

Date	Particulars	Dr. `	Cr. `
31/3/2017	Loans to Employee A/c To Interest Accrued A/c	69,707	 69,707
31/3/2017	Bank A/c To Loan to Employees	2,00,000	 2,00,000

Note: Similar entries would be done at the end of each year.

Question 4

a.

			(` in lakhs)
(1)	**Average Capital employed (1 ½ marks)**	As at 31.3.2010	As at 31.3.2011
	Current cost of fixed assets other than non-trade investments	2,200.0	2,532.8
	Current cost of stock	670.0	750.0
	Debtors	340.0	222.8
	Cash and Bank	92.5	100.0
		3,302.5	3,605.6
	Less: Outside Liabilities:		
	Term loans	370.0	330.0
	Sundry creditors	70.0	96.0
	Tax provision	22.5	25.0
		462.5	451.0
	Capital Employed	2,840.0	3,154.6
	Average Capital Employed at current value = $\frac{2,840.0 + 3,154.6}{2}$		2,997.3
(2)	**Future maintainable profit (1 ½ marks)**		
	Increase in General Reserve		50
	Increase in Profit and Loss Account		55
	Proposed Dividend		250
	Profit after tax		355
	Pre-tax profit = $\frac{355}{1-0.5}$		710.00
	Less: Non-trading income	49.00	
	Exchange loss on creditors [1.2 lakhs ´ (21.5 – 16.5)]	6.00	
	Subsidy	120.00	
			(175.00)
			535.00
	Add: Exchange gain on debtors [0.7 lakhs ´ (21.5 – 17.5)]	2.80	
	R & D costs	247.00	
	Stock adjustment	30.00	279.80
	Adjusted pre-tax profit		814.80
	Less: Tax @ 40%		325.92
	Future maintainable profit		488.88

Valuation of Goodwill (2 marks)

		(` in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{488.88}{0.15}\right)$	3,259.20
	Less: Average Capital Employed	2,997.30
	Goodwill	261.90

(2)	Super Profit Method	
	Future Maintainable Profit	488.88
	Normal Profit @ 15% on average capital employed	449.60
	Goodwill	39.28

Under capitalization method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes: (3 marks)

		(` in lakhs)
(1)	Stock adjustment	
	Difference between current cost and historical cost of closing stock	150.00
	Difference between current cost and historical cost of opening stock	120.00
		30.00
(2)	Debtors' adjustment	
	Value of foreign exchange debtors at the closing exchange rate ($ 70,000 ´ 21.5)	15.05
	Value of foreign exchange debtors at the original exchange rate ($ 70,000 ´ 17.5)	12.25
		2.80
(3)	Creditors' adjustment	
	Foreign exchange creditors at the closing exchange rate ($ 1,20,000 ´ 21.5)	25.80
	Foreign exchange creditors at the original exchange rate ($ 1,20,000 ´ 16.5)	19.80
		6.00

(b) **As per IFRS:** On the basis of principles of the IAS 18, IFRIC 15, Agreement for Construction of Real Estate, prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control. **(1 ½ mark)**

Carve out: IFRIC 15 has not been included in Ind AS 18 to scope out such agreements from Ind AS 18. A separate guidance note on accounting for real estate developers (for Ind AS compliant entities) has been issued by the ICAI to address the matter. **(1 ½ mark)**

Reason: It was observed that requirement will lead to recognition of revenue in the financial statements by real estate developers based on the completion method, i.e., only in the last year of the completion of project. It was felt that in case the revenue for the whole project is recognised in the last year of completion of project, it will not reflect the true performance of the business of the real estate developer. Further, it was felt that since Ind AS 11 requires recognition of revenue of all construction contracts by reference to stage of completion, it may lead to inappropriate accounting in case of certain real estate development projects in case this Ind AS is applied for all real estate development projects. Therefore, it was considered appropriate that rather than making changes in Ind AS 11 or Ind AS 18, a separate Guidance note (for Ind AS-compliant entities) should be issued in line with the Guidance note on Accounting for Real Estate Transactions issued by the Institute of Chartered Accountants of India (for entities on which AS are applicable). **(5 mark)**

Question 5

a.

Addition Ltd.

Gross Valued Added Statement for the year ended 31st March, 2011 (7 marks)

	(` in lakhs)	(` in lakhs)	
Sales		890	
Less: Cost of bought in materials and services:			
Production and operational expenses*			
(293 + 59 +109)	461		
Administration expenses (33 – 9)	24		
Interest on working capital loan	9		
Excise duty (Refer W.N)	35.20	529.20	
Value added by manufacturing and trading activities		360.80	
Add: Other income		55	
Total Value Added		415.80	
Application of Value Added			%
To Employees			
Salaries, Wages, Gratuities etc.		82	19.72
To Directors			
Salaries and commission		9	2.16
To Government			
Cess and local taxes (98 - 35.20)	62.80		
Income-tax	27		
		89.80	21.60
To Providers of capital			
Interest on Debentures	2		
Interest on Fixed loan (10+8)	18		
Dividend	95		
		115	27.66
To Provide for maintenance and expansion of the company			
Depreciation	17		
General Reserve	45		
Deferred tax	3		
Retained profits (65-10)	55		

19. As no increase or decrease in stock is given in the question, therefore, it is assumed that whatever raw material and stores were bought, had been consumed.

			120	28.86
			415.80	100

Working Note:

Calculation of Excise duty (1 mark)

Excise duty is 10% of ` 352 lakhs (i.e. 293+59) = ` 35.20 lakhs

b.

Total funds raised by a Mutual Fund company = 17.5 x10 lakhs = 175 lakhs **(1/2 mark for each calculation)**

(` in lakhs)

		`	`
Opening bank balance (175-160-9)		6	
Add: Proceeds from sale of securities		125	
Add: Dividend received		3	
Less:			134
Cost of securities purchased	90		
Management expenses (` 5 lakhs x 3 months)	15		
Realised gains distributed [80% of (` 125 lakhs – ` 100 lakhs)]	20		
Dividend distributed (80% of ` 3 lakhs)	2.40		127.40
Closing Bank Balance			6.60
Closing Market value of portfolio			175.00
Closing Net Assets			181.60
No. of units (in lakhs)			10.00
Closing NAV = ` 181.60 lakhs divided by 10 lakh units	=		` 18.16

Question 6

(i) **Journal Entries* in the books of Part Ltd.(3 marks)**

			(` in lakhs) Dr.	Cr.
(a)	Bank account (Current assets)	Dr.	135	
	To Investments			115
	To Profit and loss account (Reserves & surplus)			20
	(Being sales of investments at a profit of `20 lakhs)			
(b)	Debentures account (Loan funds)	Dr.	150	
	To Bank account (Current assets)			150
	(Being redemption of debentures at par)			
(c)	Current liabilities account	Dr.	210	
	Provision for depreciation account	Dr.	160	
	Reserves and surplus	Dr.	400	
	To Fixed assets account			340
	To Current assets account			430
	(Being assets and liabilities pertaining to B division taken out of the books on transfer of the division to Apart Ltd.)			

10. Any other alternative set of entries, with same net effect on various accounts may be given.

(ii) Part Ltd.'s Balance Sheet (After Demerger) (4 marks)

as on 1.4.2011

	` in lakhs	` in lakhs
Fixed assets		
Gross block	650	
Less: Depreciation	225	425
Net current assets		
Current assets (W.N.3)	335	
Less: Current liabilities	185	150
		575
Financed by		
Shareholders' funds		
Equity share capital	300	
Reserve and surplus (W.N.1)	25	325
Loan funds (W.N.2)		250
		575

(iii) Initial Balance Sheet of Apart Ltd.

as on 1.4.2011 (5 marks)

	` in lakhs	` in lakhs
Fixed assets		280
Goodwill (W.N.4)		210
Net current assets:		
Current assets	320	
Less: Current liabilities	210	110
		600
Financed by		
Shareholders' funds: (Authorised share capital ` 800)		
Equity share capital (issued for acquisition of business)		600
		600

Working Notes: (4 marks)

		` in lakhs
1.	**Reserves and surplus of Part Ltd.**	
	Balance as on 31st March, 2011	405
	Add: Profit on sale of investments	20
		425
	Less: Adjustment for difference on demerger	400
	Balance shown in balance sheet after demerger	25
2.	**Loan funds of Part Ltd.**	
	Balance as on 31st March, 2011	400
	Less: Debentures redeemed	150
	Balance shown in balance sheet after demerger	250

3.	**Current assets of Part Ltd.**		
	Balance as on 31st March, 2011		350
	Add: Cash received from sale of investments		135
			485
	Less: Cash paid for redemption of debentures		150
	Balance shown in balance sheet after demerger		335

4. **Calculation of goodwill for Apart Ltd.**

Purchase consideration (300 x 2)		600
Less: Assets sold		
Fixed assets	280	
Current assets	320	
	600	
Less: Current liabilities	210	390
Goodwill		210

Question 7

Answer any four of the following

a. Carve Out in Ind AS 32 vis-à-vis IAS 32

***As per IFRS*:** As per accounting treatment prescribed under IAS 32, equity conversion option in case of foreign currency denominated convertible bonds is considered a derivative liability which is embedded in the bond. Gains or losses arising on account of change in fair value of the derivative need to be recognised in the Statement of Profit and Loss as per IAS 32. **(1 marks)**

***Carve out*:** In Ind AS 32, an exception has been included to the definition of 'financial liability' in paragraph 11 (b) (ii), whereby conversion option in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments is classified as an equity instrument if the exercise price is fixed in any currency. **(1 marks)**

***Reasons*:** This treatment as per IAS 32 is not appropriate in instruments, such as, Foreign Currency Convertible Bonds (FCCBs) since the number of shares convertible on the exercise of the option remains fixed and the amount at which the option is to be exercised in terms of foreign currency is also fixed; merely the difference in the currency should not affect the nature of derivative, i.e., the option. Further, the fair value of the option is based on the fair value of the share prices of the company. If there is decrease in the share price, the fair value of derivative liability would also decrease which would result in recognition of gain in the statement of profit and loss. This would bring unintended volatility in the statement of profit and loss due to volatility in share prices. This will also not give a true and fair view of the liability as in this situation, when the share prices fall, the option will not be exercised. However, it has been considered that if such option is classified as equity, fair value changes would not be required to be recognised. Accordingly, the exception has been made in definition of financial liability in Ind AS 32. **(2 marks)**

b.

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. **(2 marks)**

Thus,

a. Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).
b. A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
   i. Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances. **(2 marks)**

c. As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', due to uncertainties inherent in business activiti es, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. An estimate may have to be revised if changes occur regarding the circums tances on which the estimate was based, or as a result of new information, more experience or subsequent developments. Accordingly, the basis of provisioning either on 'number of issues' or on 'technical evaluation' is the basis of making estimates.

(1 mark)

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. **(1 mark)**

The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. Further, if the company is able to demonstrate satisfactorily that having regard to circumstances, provision made on the basis of 'technical evaluation' provides more satisfactory results than provision based on 'number of issues' then the company can change the basis of making the provision. **(1/2 mark)**

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving/slow moving inventory from ` 4.5 lacs to ` 5.5 lacs is also not material. The following disclosure shall be made for such change in the financial statements of the company for the current year. **(1/2 mark)**

"The company has provided for non-moving/slow moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ` 1 lac." **(1 mark)**

d. **Case 1:** It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

In determining the value in use of A and B plus C, M Ltd. adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A's products. **(2 marks)**

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently because:

there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M Ltd. as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent. **(2 marks)**

e. As per the Central Excise Act, 1944, excise duty is levied upon the manufacture or production of excisable goods. According to Central Excise Rules, 2002, excise duty should be collected at the time of removal of goods from factory premises or factory warehouse. The levy of excise duty is upon the manufacture or production, the collection part of it is shifted to the stage of removal.

Guidance Note on Accounting Treatment for Excise Duty says that excise duty is a duty on manufacture or production of excisable goods in India. As explained in the Guidance Note, the liability for excise duty arises at the point of time at which the manufacture is completed. The excise duty paid or provided on finished goods should, therefore, be included in the inventory valuation. **(1 mark)**

Further, the Guidance Note states that excise duty should be considered as a manufacturing expense and like other manufacturing expenses are considered as an element of cost for the purpose of inventory valuation, excise duty should also be considered as an element of cost while valuing the inventory. **(1 mark)**

Therefore, in the given case of HS Ltd., the management's contention that excise duty is payable only on clearance of goods and hence is not a cost, is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 12.36% on the selling price, that is, ` 100 lacs for valuation of stock. **(1 mark)**

Excise duty on goods meant for exports, should be provided for, since the liability for excise duty arises when the manufacture of the goods is completed. However, if it is assumed that all the conditions specified in the Rule 19 of the Central Excise Rules, 2002 regarding export of excisable goods without payment of duty are fulfilled by HS Ltd., excise duty may not be provided for.

Thus, Excise duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation. **(1 mark)**

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