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SUGGESTED SOLUTION

FINAL MAY 2019 EXAM

SUBJECT- FR

Test Code – FNJ 7110

BRANCH - () (Date :)

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Answer 1:

S Ltd.

Balance Sheet as at 1st April, 2018

Particulars	Note No.	(Rs. in crore)
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	125
(b) Reserves and Surplus	2	375
(2) **Non-Current Liabilities**		
Long-term borrowings	3	200
Total		700
II. **Assets**		
(1) **Non-current assets**		
(a) Fixed assets		
Tangible assets	4	300
(2) **Current assets**	5	400
Total		700

(3 marks)

Notes to Accounts

		(Rs. in Crore)	(Rs. in Crore)
1.	**Share Capital**		
	6.5 crores equity shares of Rs. 10 each (of the above shares, 2.5 crores equity shares are allotted as fully paid-up for consideration other than cash)	65	
	60 lakhs 10% Preference shares of Rs. 100 each	60	125
2.	**Reserves and surplus**		
	As per last Balance Sheet	150	
	Capital Reserve (W.N.)	225	375
3.	**Long Term Borrowings**		
	Secured Loans:		
	As per last Balance Sheet	100	
	Taken over on absorption of B Ltd.	100	200
4.	**Tangible Assets**		
	As per last Balance Sheet	150	
	Taken over on absorption of B Ltd.	150	300
5.	**Current assets**		
	As per last Balance Sheet	200	
	Taken over on absorption of B Ltd.	200	400

(5 marks)

Valuation of shares on intrinsic value basis **(3 marks)**

(i)	B Ltd.	S Ltd.
	(Rs. in crores)	
Equity share capital	50	40
Reserves and Surplus	200	150
	250	190
Goodwill agreed upon	40	75
Increase in the value of fixed assets		
(Present worth less book value)	(200-150) 50	(429-150) 279
Revalued Net Worth	340	544
(ii)	B Ltd.	S Ltd.
Number of Equity shares	5 crores	4 crores
Intrinsic value per equity share	Rs. 68	Rs. 136
(iii) Ratio of intrinsic value of shares in the two companies	1 : 2	

Since the shares are to be issued at par, the number of equity shares of Rs. 10 each to be issued to maintain the intrinsic net worth = 5 crores /2 = 2.5 crores

(i) Statement to prove the accuracy of workings **(2 marks)**

	S Ltd.	(Rs. in crores)
(1)	Equity share capital (after absorption) [40 + (2.5 x 10)]	65
	Reserves and Surplus (after absorption) [WN]	375
		440
	Add: Unrecorded value of goodwill Rs. (40 + 75) [Since a this considered while calculating the intrinsic value]	115
	Add: Unrecorded incremental value of fixed assets Rs. (50+279) [Since at his considered while calculating the intrinsic value]	329
		884
(2)	Number of equity shares	6.5 crores
(3)	Intrinsic value of an equity share (884/6.5)	Rs. 136

Working Note:

Calculation of Capital Reserve on Absorption **(2 marks)**

	(Rs. in crores)
Fixed Assets taken over	150
Net current assets taken over	200
	350
Less: Secured loans taken over	(100)
Net Assets taken over	250
Less: Purchase consideration	(25)
Capital Reserve	225
Add : Current Reserves & Surplus	150
Reserves & Surplus after absorption	375

Answer 2:

(A)

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2018

(1) Carrying value of intangible as on 31.03.2018:

At the end of financial year 31st March 2018, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2017).

(2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2018. This expenditure will not form part of the cost of the production process recognized in the balance sheet. **(2 marks)**

(ii) For the year ending 31.03.2019

(1) Expenditure to be charged to Profit and Loss account: **(1.5 marks)**

	(Rs. in lakhs)
Carrying Amount as on 31.03.2018	28
Expenditure during 2018 –2019	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03. 2019.

(2) Carrying value of intangible as on 31.03.2019: **(1.5 marks)**

	(Rs.in lakhs)
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2019	72

(B)

Paragraph 46A of AS 11, 'The Effects of Changes in Foreign Exchange Rates' states that

(i) The exchange differences 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 the acquisition of a depreciable capital asset, **can be added to or deducted from the cost of the asset** and shall be **depreciated over the balance life** of the asset.

(ii) To exercise the above option, an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a **term of twelve months or more** at the date of origination of the asset or the liability. **(2 marks)**

In the given case, the company borrowed on 9 January 2018 for payment of imported second hand machineries by way of buyers' credit payable on 9 July 2018. Thus, the foreign currency monetary item, buyer's credit, has a term of less than twelve months at the date of origination of the buyers' credit. Therefore, the exchange differences on settlement of monetary items, ie payment to the vendor, should be recognised as income or as expenses in the period in which they arise in accordance with paragraph 13 of AS 11.

Accordingly, the treatment given is not in accordance with AS 11.

The company has correctly recognised the exchange difference of Rs. 4,43,250 arising on reporting of buyers' credit at rates different from those at which they were initially recorded during the period as loss in Statement of Profit and Loss. However, the gain capitalised on payment to the vendor is not as per AS 11. Such gain should also be shown in the Statement of Profit and Loss.

The company cannot capitalise the loss of Rs. 4,43,250 proportionately for 8 machines which were put to use as at 31 March, 2018.
In the given case, the company has imported second hand machines. Therefore, except for the shipping and installation of the machine, the machines were already in the condition of ready for use. Further, the evidence that 8 machines were put to use by 31 March 2018 within less than 3 months of their import indicates that the machines do not necessarily take a substantial period of time to get ready for its intended use. Therefore, the company can neither capitalise the interest cost of $ 3056 nor the actual loss on rollover of buyers' credit. The treatment given by the company of capitalising the borrowing costs as per the given facts, is incorrect and should be recognised in interest expense in the Statement of Profit and Loss. **(3 marks)**

Answer 3:
(A)

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 "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. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.

(2) 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.

Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances. **(5 marks)**

(B)

(i) Calculation of Annual Lease Payment **(1.5 marks)**

	Rs.
Cost of the equipment	6,00,000
Less: PV of unguaranteed residual value for 3 years @ 8% (Rs. 80,000 x 0.7938)	(63,504)
Fair value to be recovered from 3 years Annual Lease Payment	5,36,496
Annuity for 3 years @ 8% (0.9259 + 0.8573 + 0.7938)	2.577
Annual Lease Payment (Rs. 5,36,496 / Annuity for 3 years @ 8%)	2,08,186

(ii) Unearned Finance Income **(1.5 marks)**

Total lease payments [Rs. 2,08,186 x 3]	6,24,558
Add: Residual value	80,000

Gross Investments	7,04,558
Less: Present/Fair value of Investments	(6,00,000)
Unearned Finance Income	1,04,558

(ii) Segregation of Finance Income (All figures in Rs.) **(2 marks)**

Year	Lease Rentals	Finance Charges @ 8% on outstanding amount of the year	Repayment	Outstanding Amount
	a	b	c	d
		(d of previous year x 8%)	a – b	(d = d of previous year – c of current year)
0				6,00,000
I	2,08,186	48,000	1,60,186	4,39,814
II	2,08,186	35,185	1,73,001	2,66,813
III	2,08,186	21,373**	1,86,813	80,000*
	6,24,558	1,04,558	5,20,000	

* This amount is unguaranteed residual value of equipment i.e. Rs. 80,000.
** Difference in interest value is due to approximation.

(C)

(i) As per AS 12 "Accounting for Govt. Grants", amount refundable in respect of a grant related to revenue should be **applied first against any unamortized deferred credit** remaining in respect of the grant. To the extent the **amount refundable exceeds** any such deferred credit, the amount **should be charged to profit and loss statement**.

In this case the grant refunded is Rs. 360 lakhs and balance in deferred income account is Rs. 330 lakhs. Therefore, Rs. 30 lakhs shall be charged to the profit and loss account for the year 2016-2017.

There will be no effect on the carrying value of the plant and depreciation charge on it will be same as charged in the earlier years. **(2.5 marks)**

(ii) As per AS 12, the **amount refundable** in respect of grant which was related to **specific fixed assets** should be **recorded by increasing the book value of the assets by the amount refundable.** Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

Therefore, in this case the book value of the plant shall be increased by Rs. 360 lakhs. The increased cost of Rs. 360 lakhs of the plant should be amortized over remaining 9 years. Depreciation charged during the year 2016 -2017 shall be 1440/12 + 360/9 = Rs. 120 lakhs +Rs. 40 lakhs= Rs.160 lakhs. **(2.5 marks)**

Answer 4:

(A)

Cash Flow Statement of X Ltd.

for the year ended 31st March, 2016 (Direct Method) **(5 marks)**

Particulars	Rs.	Rs.
Cash flow from Operating Activities:		
Cash received from sale of goods	1,50,000	
Cash received from trade receivables	1,60,000	
Trade commission received	40,000	3,50,000
Less: Payment for cash purchases	1,30,000	
Payment to trade payables	1,44,000	
Office expenses	25,000	
Rent	50,000	
Payment of Income-tax	30,000	(3,79,000)
Net cash used in Operating Activities		(29,000)

(B)

Calculation of the result of first quarter as per AS 25

Particulars		(Rs. in crores)
Result of first quarter ending 31st March, 2016		
Turnover		100
Other Income		Nil
Total (a)		100
Less: Changes in inventories		Nil
Salaries and other expenses		60
Administrative and selling expenses (4 + 8)		12
Total (b)		72
Profit (a)-(b)		28

As per AS 25 on Interim Financial Reporting, the income and expense should be recognised when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

The expenditure of Rs. 42 crores made in the first quarter shall be charge in that quarter only

i.e. when they are earned and incurred. Therefore, the argument given by Astro Corporation relating to deferment of Rs. 42 crore is not tenable as expenditures are uniform throughout all quarters. **(5 marks)**