



J.K. SHAH[®]
TEST SERIES
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SUGGESTED SOLUTION

FINAL May 2019 EXAM

SUBJECT- FR

Test Code – FNJ 7126

BRANCH - () (Date :)

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Answer 1:**(A)**

	Amt. in Crores
Enterprise value of Y Ltd RS. 4 crores x 8	32.00
Less: Long-term loan	5.00
Equity value	27.00

	Amt. in Crores
Fair value of 5% holding based on EV/EBITDA multiple	1.350
Less: Non-controlling discount (70/500 i.e., 14%)	0.189
Fair value of 5% equity shares	1.161

(5 Marks)**(B)**

In this case, Company A Ltd. has issued warrants entitling the shareholders to purchase equity shares of the Company at a fixed price. Hence, it constitutes a contractual arrangement for issuance of fixed number of shares against fixed amount of cash.

Now, evaluating this contract under definition of derivative –

- (i) The value of warrant changes in response to change in value of underlying equity shares;
- (ii) This involves no initial net investment
- (iii) It shall be settled at a future date.

Hence, this warrant meets the definition of derivative.

Applying definition of equity under Ind AS 32, a derivative contract that will be settled by exchange of fixed number of equity shares for fixed amount of cash meets definition of equity instrument. The above contract is derivative contract that will be settled by issue of fixed number of own equity instruments by A Ltd. for fixed amount of cash and hence, meets definition of equity instrument.

(5 marks)**Answer 2:****(A)**

Accrual is one of the fundamental bases of accounting for preparation of financial statements as per Ind AS-1. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position by non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability therefore should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting.

(5 marks)**(B)**

Adjustment of assets and liabilities is to be made if event relates to the condition existing on the balance sheet date and provides additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In this case the fire took place on 27th March, 2017 before the date of balance sheet and debtors are declared insolvent on

15th April, 2017, the event of 15th April, 2017 only provides the additional evidence to estimate the amount of loss.

Accordingly, adequate provision for impairment in debtors should be created to cover the loss arising out of insolvency for the year ended 31st March, 2017. **(5 marks)**

Answer 3:

(A)

Cash flows arising from taxes on income shall be separately disclosed and classified as cash flow from operating activities, unless they can be specifically identified with financing and investing activities. Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in the statement of cash flows. While tax expense may be identified with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. Example: If we strictly go by classification of taxes in accordance with the nature of the related transaction, tax impact of short-term capital gain should be classified as investing activity. Suppose, the entity is incurring business losses, the same gets adjusted against short-term capital gain for tax purposes. Accordingly, showing tax impact of short-term capital gain and business losses separately is impracticable. Therefore, tax paid is usually classified as cash flows from operating activity. However, where it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows, tax cash flows are classified as investing or financing activities. Examples: tax payment by way of long-term capital gain on sale of land which was used as property, plant and equipment (PPE), tax payment on dividend received from a foreign company shall be classified as investing activity. Similarly, dividend distribution tax under section 115-0 of Income-tax Act, 1961 viz., and preference and equity dividend distribution tax is considered as an integral part of financing activities. **(5 marks)**

(B)

Result of the first quarter ending 30th June

	(Rs. in crores)
1. Turnover	50
2. Other Income	Nil
Total	50
Less: Changes in inventories	Nil
Salaries and other cost	30
Administrative and selling Exps. (8+2)	10
Total	40
Profit	10

Note - As per the Ind AS 34 the income and expense should be recognized when they are earned and incurred respectively. Seasonal incomes will be recognized when they occur. Therefore the argument of the Induga Corporation is not as per Ind AS 34. **(5 marks)**

Answer 4:**(A)**

- (i) The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.

However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement. **(4 marks)**

- (ii) The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.

If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. **(4 marks)**

(B)**Balance Sheet of Sheep Ltd. as on 01.10.2016 (after absorption of Bear Ltd.)**

I	Assets	Note	Amount (Rs.)
1.	Non-Current Assets		
	(a) Property, Plant and Equipment		
	(i) Tangible (1211875+375000)		15,87,225
	(ii) Intangible		97,320
2.	Current Assets		
	(a) Inventories (300000+436800)		7,36,800
	(b) Financial Assets		
	(i) Trade Receivables (410000+98700)		508,700
	(ii) Cash and Cash Equivalentents (669625 + 266950)		<u>9,36,575</u>
	Total		38,66,620
II	Equity and Liabilities		
1.	Equity Fund		
	(a) Share Capital	1	15,76,000
	(b) Other Equity	2	17,49,620

2. Current Liabilities

(a) Financial Liabilities

(i) Trade Payables (381000+160000) 5,41,000**Total** **38,66,620**

(6 marks)

Notes to the Balance Sheet**Note 1: Equity Share Capital**

(1 mark)

Particulars**Amt. (Rs.)**

Issued, subscribed and paid up (105,000+52600) 157600 equity shares

@ Rs. 10 each 15,76,000

Note 2: Other Equity

(1 mark)

Particulars**Amt. (Rs.)**

(a) Securities Premium (52,600 shares x 11.20) 5,89,120

(b) General Reserve 8,16,900

(c) Surplus (Balance in Profit and loss account) 3,43,600**17,49,620****Workings:****(i) Computation of Revised balances on 01.10.2016**

(2 marks)

	Sheep Ltd.				Bear Ltd.			
	Building	Machinery & Furniture	P & L A/c.	Bank	Building	Machinery & Furniture	Bank	P & L A/c.
Opening Balances	9,25,000	3,75,000	1,00,000	3,37,900	3,00,000	1,03,000	85,300	1,00,000
Profit (given)			3,36,000	3,36,000			1,98,000	1,98,000
Depreciation	(69,375)	(18,750)		88,125	(22,500)	(5,150)	27,650	
Dividend at 8%			(84,000)	(84,000)			(40,000)	(40,000)
DDT at 10%			(8,400)	(8,400)			(4,000)	(4,000)
	8,55,625	3,56,250	3,43,600	6,69,625	2,77,500	97,850	2,66,950	2,54,000

(ii) Computation of Purchase Consideration

(2 marks)

Net assets**Sheep Ltd.****Bear Ltd.**

Goodwill (as agreed upon) - 97,350

Fixed assets (machinery & Furniture + Building) WN 1 12,11,875 3,75,350

Stock + 12% thereon	3,36,000	4,36,800
Debtors less 5% for Sheep & 6% for Bear	3,89,500	98,700
Bank Balance (WN2)	6,69,625	2,66,950
Total Assets	26,07,000	12,75,120
Less: Liabilities (Trade Payables)	(3,81,000)	(1,60,000)
Net assets/Worth	22,26,000	11,15,120
No. of equity shares of Rs. 10 each	1,05,000	50,000
Intrinsic value per share	21.20	22.30

Purchase consideration for Bear Ltd is Rs. 11,15,120 to be settled by issue of 52,600 shares
(11,15,120/21.20)