SUGGESTED SOLUTION

CA FINAL NOVEMBER 2016 EXAM

FINANCIAL REPORTING

Test Code - F N J 6 0 0 2

BRANCH - (MUMBAI) (Date : 19.06.2016)

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Answer-1 :

Balance Sheet of A Ltd. (after absorption of B Ltd.) as on 31st March, 2015

Particulars				Note No.	(Rs.)
I.	**Equity and Liabilities**				
	1.	Shareholders fund			
		a)	Share capital	1	49,73,950
		b)	Reserves and Surplus	2	7,56,040
	2.	Non-current liabilities			
		Long term borrowings			8,00,000
	3.	Current liabilities			9,80,000
		Total			**75,09,990**
II.	**Assets**				
	1.	Non-current Assets			
		Fixed Assets			
		Tangible Assets (Rs. 30,50,000 + Rs. 7,30,000)			37,80,000
	2.	Current Assets			
		a)	Inventories		13,90,000
		b)	Trade receivables		17,20,000
		c)	Cash and Cash equivalents		6,19,990
		Total			**75,09,990**

Notes to Accounts:

		Rs.	Rs.
1.	**Share Capital**		
	4,97,395 Equity Shares of Rs. 10 each fully paid (out of which, 47,395 shares were allotted to vendors for consideration other than cash)		49,73,950
2.	**Reserves and surplus**		
	General Reserve	4,46,000	
	Profit and loss account (Rs. 6,34,000 – Rs. 3,60,000 – Rs. 36,000)	2,38,000	
	Securities premium reserve (47,395 shares x Rs. 1.52)	72,040	7,56,040

(6 Marks)

Workings Notes:

(1) Computation of Net Assets (excluding inter-company investments)

	A Ltd. Rs.	B Ltd. Rs.
Total Assets		
Assets Excluding invest	57,84,000	20,50,000
Dividend receivable	-	72,000
(A)	**57,84,000**	**21,22,000**
External Liabilities		
Current Liabilities	6,00,000	3,80,000
Proposed dividend	3,60,000	-
Dividend Distribution tax @ 10%	36,000	-
10% Debentures		8,00,000
(B)	**9,96,000**	**11,80,000**
Net Assets (A)-(B)	**47,88,000**	**9,42,000**

(2 Marks)

Note:

(1) Dividend distribution tax has been calculated without grossing up.

(2) Since the Preference Shares of B Ltd. do not have priority over the payment of capital and dividend, they have to be treated at par with the equity shares. Both types of shares have the same paid up value.

(2) In view of the above, the proportion of shareholding in B Ltd. is worked out, as follows:

(a) A Ltd. in B. Ltd.

$$\frac{\text{Number of shares held byB Ltd.}}{\text{Total number of Equity and Preference Shares of B Ltd.}} = \frac{30,000}{1,00,000+50,000} = \frac{1}{5}$$

(b) B Ltd. in A Ltd.

$$\frac{\text{Number of shares held by B Ltd.}}{\text{Total number of Equity and A Ltd.}} = \frac{90,000}{4,50,000} = \frac{1}{5}$$

(3) Calculation of intrinsic value of shares:

Let 'a' be the intrinsic value of shares of A Ltd. and „b" be the intrinsic value of shares of B Ltd.

Now, a = Rs. 47,88,000 + 1/5 x b

b = Rs. 9,42,000 + 1/5 x a

By substituting the value of a in b, we get

b = Rs. 9,42,000 + 1/5 (Rs. 47,88,000 + 1/5 x b)

b = Rs. 9,42,000 + 9,57,600 + b/25

$\frac{24b}{25}$ = Rs. 18,99,600

b= Rs. 19,78,750

a = Rs. 47,88,000 + $\frac{19{,}78{,}750}{5}$ =Rs.51,83,750

Intrinsic value of shares of A. Ltd. = $\frac{\text{Rs.}5{,}83{,}750}{4,50,000} = 11.52$

Intrinsic value of shares of B. Ltd. = $\frac{\text{Rs.}19{,}78{,}750}{1{,}00{,}000+50{,}000}$ =Rs.13.19

(2 Marks)

(4) Calculation of Purchase Consideration:

No. of shares held by outside shareholders of B Ltd.

=1,00,000 – 30,000 + 50,000 = 1,20,000

Intrinsic value of shares = 1,20,000 x Rs. 13.19 per share

= 15,82,800

Shares to be issued on the basis of intrinsic value of shares

= $\frac{\text{Rs.}15{,}82{,}800}{Rs.11.52}$	= 1,37,395.83 shares
Less: Shares already held by A Ltd.	= 90,000.00 Shares
Number of shares to be issued	= 47,395.83 shares

(2 Marks)

(5) Total Purchase price

	Rs.
Additional shares in A. Ltd. (47,395 shares of Rs. 11.52)	5,45,990
Cash for fractional shares (0.83 x Rs. 11.52)	10
	5,46,000
Value of 30,000 shares already held by A Ltd.	
(30,000 shares x Rs. 13.19)	3,96,000*
Total	**9,42,000**

* Approximate figure has been considered.

(6) General Reserve

	Rs.
As per balance sheet	3,50,000

Add: Appreciation in the value of shares held B. Ltd. (Rs. 3,96,000 – Rs. 3,00,000)			96,000
Closing balance			4,46,000

(2 Marks)

(7) Bank Balance

		A Ltd. Rs.	B Ltd. Rs.
As per balance sheet		6,24,000	3,20,000
Dividend received			72,000
		6,24,000	3,92,000
Less: Dividend payment	3,60,000		
Dividend tax @ 10%	36,000		
Cash for fraction shares	10	(3,96,010)	
		2,27,990	3,92,000
Total bank balance			6,19,990

(2 Marks)

Answer-2 :

Fair value of an ESPP = Rs. 56 – Rs. 50 = Rs. 6
Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares
Fair value of ESPP which will be recognized as expenses in the year 2014-15
= 40,000 shares x Rs. 6 = Rs. 2,40,000
Vesting period = 1 month
Expenses recognized in 2014-15 = Rs. 2,40,000

(2 Marks)

Journal Entry

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
30.04.2014	Bank A/c (40,000 shares x Rs. 50)	Dr.	20,00,000	
	Employees compensation expense A/c	Dr.	2,40,000	
	To Share Capital A/c (40,000 shares x Rs. 10)			4,00,000
	To Securities Premium (40,000 shares x Rs. 46)			18,40,000
	(Being shares issued under ESPP @ Rs. 50)			

(2 Marks)

Answer-3 :

	Rs. in lakhs	Rs. in lakhs
Opening bank balance [Rs. (100 – 90 - 7) lakhs]	3.00	
Add: Proceeds from sale of securities	40.00	
Dividend received	1.20	44.20
Less: Cost of securities	28.20	
Fund management expenses [Rs. (4.50–0.25) lakhs]	4.25	
Capital gains distributed [75% of Rs. (40.00 – 38.00) lakhs]	1.50	
Dividends distributed (75% of Rs. 1.20 lakhs)	0.90	(34.85)
Closing bank balance		9.35
Closing market value of portfolio		101.90
		111.25
Less: Arrears of expenses		(0.25)

Closing net assets	111.00	
Number of units		10,00,000
Closing Net Assets Value (NAV)		Rs. 11.10

(4 Marks)

Answer-4 :

Calculation of provision required on advances as on 31st March, 2016:

	Amount Rs. in lakhs	Percentage of provision	Provision Rs. in lakhs
Standard assets	16,800	0.30	50.40
Sub-standard assets	1,340	10	134.00
Secured portions of doubtful debts -			
- upto one year	320	20	64.00
- one year to three years	90	30	27.00
- more than three years	30	50	15.00
Unsecured portions of doubtful debts	97	100	97.00
Loss assets	48	100	48.00
			427.00

(4 Marks)

Answer-5 :

Brightex Co. Ltd
Value Added Statement
For the year ended 31st December, 2014

	(Rs. In thousands)	(Rs. In thousands)	% thousands
Sales			6,240
Less: Cost of bought in material and services:			
Production and operational expenses Rs. (4,320 - 8 - 620)		3,692	
Administration expenses Rs. (180 - 5)		175	
Interest on bank overdraft		109	
Interest on working capital loan		20	
Excise duties (Refer to working note)		180	
Other/miscellaneous charges Rs. (444 - 180)		264	(4,440)
Value added by manufacturing and trading activities			1,800
Add: Other income			55
Total Value Added			1,855
Application of Value Added:			
To Pay Employees :			
Salaries to Administrative staff		620	33.42
To Pay Directors:			
Salaries and Commission		5	0.27
To Pay Government:			
Local Tax	8		
Income Tax	55	63	3.40
To Pay Providers of Capital :			
Interest on Fixed Loan	51		

Dividend	160	211	11.37
To Provide for Maintenance and Expansion of the Company:			
Depreciation	16		
Fixed Assets Replacement Reserve	400		
Retained Profit Rs. (600 - 60)	540	956	51.54
		1,855	**100.00**

(4 Marks)

Reconciliation between Total Value Added and Profit before Taxation:

	(Rs. in thousands)	**(Rs. in thousands)**
Profit before Tax		1,155
Add back:		
Depreciation	16	
Salaries to Administrative Staff	620	
Director's Remuneration	5	
Interest on Fixed Loan	51	
Local Tax	8	700
Total Value Added		1,855

(2 Marks)

Working Note:

Calculation of Excise Duty

		(Rs. in thousands)
Interest and other charges		624
Less : Interest on bank overdraft	109	
Interest on loan from ICICI	51	
Interest on loan from IFCI	20	(180)
Excise duties and other/miscellaneous charges		444

(1 Mark)

Assuming that these miscellaneous charges have to be taken for arriving at Value Added (In the first part of Value Added Statement), the excise duty will be computed as follows :

Let excise duty be x; thus miscellaneous/ other charges = Rs. 444 -x

Thus x = 1/10 x [Rs. 6,240 - {Rs. 3692+ Rs. 175+ Rs. 109+ Rs. 20+ x + (Rs.444-x)}]

= 1/10 x [Rs. 6240 - Rs. 4440] = Rs. 180

Other/ miscellaneous charges = Rs. 444 - Rs. 180 = Rs. 264

The above solution is given accordingly.

However, if other/miscellaneous charges are taken as any type of application of Value Added (i.e, to be taken in the application part), then excise duty (x) will be computed as follows:

x = 1/10 x [Rs. 6240 - Rs. (3692 + 175 + 109 + 20 + x)]

x = 1/10 x [Rs. 2244 -x]

11x = Rs. 2244

x = Rs. 204

And thus total value added will be Rs. 2040 + Rs. 55 (other income) = Rs. 2095

And accordingly, application part will be prepared, taking miscellaneous charges.

Rs. ('000) 240 [i.e, Rs. 444 – Rs. 204] as the application of value added. **(1 Mark)**

Answer-6 :

Computation of Economic Value Added (EVA)

Particulars	**(Rs. in lacs)**
Net Operating Profit after Tax (NOPAT)	831.00
Less: Weighted average cost of operating capital employed (13.35% of 2,200) (See W.N.7)	(293.70)
Economic Value Added (EVA)	537.30

(2 Marks)

Working Notes:

1. Net Operating Profit after Tax (NOPAT)

Earnings per share	Rs. 16
No. of Equity Shares	40 lacs
	Rs. in lacs
Profit after Interest, Tax & Preference Dividend [40 lacs x Rs. 16]	640.00
Add: Preference Dividend (15% of Rs. 200 lacs)	30.00
Profit after Tax	670.00
Add: Tax @ 30% [670/70 x 30]	287.14
Profit before Tax	957.14
Add: Interest on Debentures [15% of Rs. 1,600 lacs]	240.00
Profit before Interest & Tax	1,197.14
Less: Income from Non-Trade Investment [10% of Rs. 100 lacs]	(10.00)
Net Operating Profit before Tax	1,187.14
Less: Tax @ 30%	(356.14)
Net Operating Profit after Tax [NOPAT]	831.00

(2 Marks)

2. Cost of Equity = Risk Free Rate + Beta Factor x (Market Rate - Risk Free Rate)
= 9.85% + 1.65 (16.25-9.85) = 20.41%

3. Cost of Preference shares = 15%

4. Cost of Debt = Interest Rate x (1 - tax rate) = 15% x (1 - 0.30) = 10.5%

5. Total Capital Employed = [Equity Share Capital + Retained Earnings + Preference Share Capital + Debentures]
= [400 + (220 - 20) + 200 + 1,600] = 2,400

(1 Mark)

6. Weighted Average Cost of Capital (WACC)

$$= \left(\frac{600}{2,400} \text{ x } 20.41\%\right) + \left(\frac{200}{2,400} \text{ x } 15\%\right) + \left(\frac{1,600}{2,400} \text{ x } 10.5\%\right)$$

= 5.10 + 1.25 + 7% = 13.35%

(1 Mark)

7. Operating Capital Employed

		Rs. in lacs
Total Capital		2,400
Less: Non-operating Capital Employed		
10% Non-Trade Investment	140	
Land and Building held as Investment	20	
Advance given for purchase of a Plant	10	
Capital work-in-progress	30	(200)
Operating Capital Employed		2,200

(2 Marks)

Answer-7 :

Capital Base = Rs. 1,00,00,000
Actual Profit = Rs. 11,00,000
Target Profit @ 12.5% = Rs. 12,50,000

Expected Profit on employing the particular executive
= Rs. 12,50,000 + Rs. 2,50,000 = Rs. 15,00,000

Additional Profit = Expected Profit Actual Profit
= Rs. 15,00,000 Rs. 11,00,000 = Rs. 4,00,000

Maximum bid price = $\frac{\text{Additional Profit}}{\text{Rate of Return on Investment}} = \frac{4,00,000}{12.5} \text{ x } 100 = \text{Rs.}32,00,000$

Maximum salary that can be offered = 12.5% of Rs. 32,00,000 i.e., Rs. 4,00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., Rs.4,00,000.

(6 Marks)