SUGGESTED SOLUTION

CA FINAL NOVEMBER 2016 EXAM

FINANCIAL REPORTING

Test Code - F N J 6 0 5 8

BRANCH - (MUMBAI) (Date :14.08.2016)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

Answer-1:

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 wherepayment promised to be made to an employee at or near retirement presentssignificant difficulties in the determination of periodic charge to the statement ofprofit and loss. The contention of the Company that the settlement allowance will beaccounted for on claim basis is not correct even if company's obligation under thescheme 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 (Revised).

(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 becalculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, thecompany can follow some other method of accounting for settlementallowances.

(5 Marks)

Answer-2 :

Some key differences between Ind AS 1 and Existing AS 1 are:

Ind AS 1 deals with presentation of financial statements, whereas existing AS 1 (issued 1979) deals only with the disclosure of accounting policies. The scope of Ind AS 1 is thus much wider and line by line comparison of the differences with theexisting standard is not possible. However, the major requirements as laid down inInd AS 1 are as follows:

(i) An enterprise shall make an explicit statement in the financial statements ofcompliance with all the Ind AS. Further, Ind AS 1 allows deviation from arequirement of an Accounting standard in case the management concludesthat compliance with Ind AS will be misleading and if the regulatory frameworkrequires or does not prohibit such a departure.

(ii) Ind AS 1 requires presentation and provides criteria for classification ofCurrent / Non-current assets / liabilities.

(iii) Ind AS 1 prohibits presentation of any item as 'Extraordinary Item' in thestatement of profit and loss or in the notes.

(iv) Ind AS 1 requires disclosure of judgments made by management while framingof accounting policies. Also, it requires disclosure of key assumptions aboutthe future and other sources of measurement uncertainty that have significantrisk of causing a material adjustment to the carrying amounts of assets andliabilities within next financial year.

(v) Ind AS 1 requires classification of expenses to be presented based on natureof expenses.

(vi) Ind AS 1 requires presentation of balance sheet as at the beginning of theearliest period when an entity applies an accounting policy retrospectively ormakes a retrospective restatement of items in the financial statements, orwhen it reclassifies items in its financial statements.

(vii) In respect of reclassification of items, Ind AS 1 requires disclosure of nature,amount and reason for reclassification in the notes to financial statements.

(viii) Ind AS 1 requires the financial statements to include a Statement of Changesin Equity to be shown as a separate statement, which, inter alia, includesreconciliation between opening and closing balance for each component ofequity.

(ix) Ind AS 1 requires that an entity shall present a single statement of profit andloss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or losssection presented first followed directly by the other comprehensive incomesection.

(x) As per Ind AS 1, an entity shall include certain comparative information forunderstanding the current period's financial statements.

(xi) Ind AS 1 clarifies that long term loan arrangement need not be classified ascurrent on account of breach of a material provision, for which the lender has agreed to waive before the approval of financial statements for issue.

(10 Marks)

Answer-3 :

Balance Sheet of AB Ltd.

Particulars			**Notes**	**Rs.**
Equity and Liabilities				
1	Shareholders' funds			
	a	Share capital	1	30,80,000
	b	Reserves and Surplus	2	6,17,100
2	Current liabilities			
	a	Other liabilities		38,900
	Total			**37,36,000**
Assets				
1	Non-current assets			
	a	Fixed assets		
		Tangible assets	3	23,09,000
		Intangible assets	4	1,12,000
	b	Non-current investments		1,55,000
2	Current assets			
	a	Inventories (3,58,000 + 2,40,000)		5,98,000
	b	Trade receivables (72,000 +70,000)		1,42,000
	c	Cash and cash equivalents		4,20,000
	Total			**37,36,000**

(5 Marks)

Notes to accounts

			Rs.
1.	Share Capital		
	Authorized share capital		
	3,00,000 equity shares of Rs. 10 each	30,00,000	
	60,000, 8% Cumulative Preference Shares of Rs.10each	60,000	36,00,000
	Equity share capital		
	2,48,000 equity shares of Rs. 10 each		24,80,000
	(Of the above shares, 2,18,000 shares have been issued for consideration other than cash)		
	Preference share capital		
	60,000, 8% cumulative Preference Shares of Rs.10each		6,00,000
	Total		**30,80,000**
2.	Reserves and Surplus		
	Debit balance of Profit and Loss Account		
	Underwriting commission	38,900	
	Preliminary expenses	24,000	(62,900)
	Securities Premium		
	(2,48,000 equity shares x 2.50)	6,20,000	
	(60,000 Preference shares x Rs.1)	60,000	6,80,000
			6,17,100
3.	Tangible assets		
	Building	5,40,000	
	Motor car	1,26,000	
	Plant & machinery	15,10,000	
	Furniture	1,33,000	23,09,000
4	Intangible assets		
	Goodwill (W.N. 4) (15,000 +62,000-65,000)	12,000	
	Patents	1,00,000	1,12,000

(4 Marks)

Working Notes:

1. Mode of discharge of Purchase Consideration of A Ltd.

	Rs.
Cash payment	5,75,000
Equity shares (1,80,000 Shares x Rs. 12.5)	22,50,000
Total Purchase consideration	28,25,000

2. Mode of discharge of Purchase Consideration of B Ltd.

	Rs.
Cash payment	16,000
Equity shares (38,000 shares x Rs. 12.5)	4,75,000
Total Purchase consideration	4,91,000

3. Cash at bank balance in the initial balance sheet of AB Ltd.

Cash and Bank Account

	Rs.		**Rs.**
To Issue of preferenceshares (60,000 x 11)	6,60,000	ByPayment to A ltd.	5,75,000
		By Payment to B ltd.	16,000
		By Preliminary Expenses	24,000
To Equity shares (30,000 x 12.50)	3,75,000	ByBalance c/d	4,20,000
	10,35,000		**10,35,000**

4. Calculation of goodwill/ capital reserve of A Ltd. & B Ltd.

Particulars		**A Ltd.**		**B Ltd.**
Business Purchase A/c		28,25,000		4,91,000
Less: Goodwill			62,000	
Patent A/c	1,00,000		-	
Building A/c	5,40,000		-	
Plant & Mach. A/c	15,10,000		-	
Motor car A/c	-		1,26,000	
Furniture A/c	75,000		58,000	
Investment A/c	1,55,000		-	
Stocks A/c	3,58,000		2,40,000	
Debtors A/c	72,000	(28,10,000)	70,000	(5,56,000)
Goodwill / Capital reserve (Bal. fig.)		15,000		(65,000)

Net goodwill (15,000 +62,000 -65,000) = 12,000

(5 Marks)

Note:

1. As per the information given in the question, only the assets of A Ltd. andB Ltd. are taken over by AB Ltd. Thus the creditors are considered to bepaid by the liquidators of the respective companies and hence being nottaken over by AB Ltd.
2. As per the information given in the second last para of the question, it isstated that the preliminary expenses of AB Ltd. will amount to Rs.24,000 exclusive of the underwriting of Rs. 38,900 payable on the public issue. Ithas been assumed that Rs. 24,000 has been paid and underwritingcommission is still payable in the balance sheet of the amalgamatedcompany.
3. Preliminary expenses and underwriting commission have been written offas per provisions of accounting standards.

(1 Mark)

Answer-4 :

X Computation of Economic Value Added (EVA)

Particulars	(Rs. in thousand)
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

Working Notes:

1. Net Operating Profit after Tax (NOPAT)

Earnings per share	Rs.16
No. of Equity Shares	40 thousand
	Rs. in lacs
Profit after Interest, Tax & Preference Dividend [40 thousand x Rs. 16]	640.00
Add: Preference Dividend (15% of Rs. 200 thousand)	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 thousand]	240.00
Profit before Interest &Tax	1,197.14
Less: Income from Non-trade Investment [10% of Rs. 100 thousand]	(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
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%
7. Operating Capital Employed

		Rs. inthousand
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

(8 Marks)

Answer-4 :

Cost to Company in employing to Mr. X

	Rs.
Salary before tax	
Rs. 4,00,000 x 12 = $\frac{48,00,000}{0.75}$	64,00,000*
Add: Employee's PFcontribution(50,000 x 12)	6,00,000
	70,00,000
Add: Employer's PFcontribution(50,000 x 12)	6,00,000
	76,00,000

(5 Marks)

Capital base

	Rs.
Equity Share Capital paid up (5,00,000 shares of Rs. 75 each)	3,75,00,000
Less: Calls in arrears	(1,00,000)
	3,74,00,000
General Reserve	10,00,000
Profit & Loss A/c (balance) at the beginning of the year	(25,00,000)
Loss for the year	(1,80,000)
8% Debentures	8,000,000
Capital base	4,37,20,000
Target Profit 12.5% of capital base (4,37,20,000)	54,65,000
Profits achieved due to Mr. X 54,65,000+ 10% (54,65,000)	60,11,500

Maximum emoluments that can be paid to Mr. X = Rs. 60,11,500

Thus, the company is advised not to hire him as his CTC Rs. 76,00,000 is more than Rs. 60,11,500

(5 Marks)

Note: It is assumed that the average income tax rate of 25% given in the question is after considering the impact of Rs.3 lakhs p.a. i.e., the exemption amount.