

PAPER – 1 : FINANCIAL REPORTING

Question No.1 is compulsory and 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) From the following information, value the inventories as on 31st March, 2015:

Raw material has been purchased @ ` 125 per kg. Prices of raw material are on the decline. The finished goods being manufactured with the raw material is also being sold at below cost. The stock of raw material is of 15000 kg and the replacement cost of raw material is ` 100 per kg.

Cost of finished goods per kg. is as under:

	` per kg
Material cost	125
Direct labour cost	20
Direct variable production overhead	10

Fixed production overhead for the year for a normal capacity of 1,00,000 kgs of production is ` 10 lacs. At the year end, there were 2,000 kgs of finished goods in stock. Net realisable value of finished goods ` 140 per kg.

- (b) SMC Limited is having a plant (an asset) whose carrying amount as on 1-10-2012* is ` 38,000 lacs and the plant was having a useful life till 31-3-2020. The estimated residual value is ` 900 lacs. The selling price on 31st March, 2015 is expected to be ` 20,000 lacs and the cost of disposal is expected to be ` 100 lacs.

The expected cash flows from the plant are as under:

Financial year	Cash flow
2015-16	4,100
2016-17	5,900
2017-18	6,000
2018-19	7,800
2019-20	4,500

* Read the carrying amount of the asset as on 1.10.2012 as the cost of the asset as on 1.10.2012.

The company expects the discount rate of 10%. Discount factor @ 10% for 1, 2, 3, 4 and 5 years are 0.909, 0.826, 0.751, 0.683 and 0.621 respectively. The company provides depreciation on straight line basis. You are required to determine as at 31st March, 2015:

- (i) The value in use of the plant.
 - (ii) The impairment loss, if any
 - (iii) The revised carrying amount for the financial year ending 31st March, 2015.
- (c) A company sells the goods with right to return. The following pattern has been observed:

Timeframe of return from date of purchase	% of cumulative sales
Within 10 days	5%
Between 11 days and 20 days	7 %
Between 21 days and 30 days	8%
Between 31 days and 45 days	9 %

Company has made sale of ` 30 lacs in the month of February 2015 and of ` 36 lacs in the month of March, 2015. The total sales for the financial year have been ` 450 lacs and the cost of sales was ` 360 lacs.

Determine the amount of provision to be made and revenue to be recognised in accordance with AS 9. A year may be considered of 360 days.

- (d) Saurav Limited reported a profit before tax of ` 8.00 lacs for the 2nd quarter ending on 30th September 2014. On enquiry, following issues were noticed:
- (i) The property tax of ` 60,000 paid during the quarter for the full year has been recognised in full.
 - (ii) 1/5th of ` 15 lacs being marketing promotional expenses incurred on 23rd September, 2014 has been recognised based on past experience of higher sales in the last quarter of the year.
 - (iii) 50% of the loss of ` 2 lacs incurred on disposal of a business segment has been allocated to this quarter.
 - (iv) Cumulative loss of ` 3 lacs resulting from the change in the method of valuation of inventory was recognised in 2<sup>nd</sup> quarter, which included ` 2 lacs related to earlier quarters.
 - (v) Gain of ` 15 lacs from sale of Investments sold in 1st quarter was apportioned equally over the full year.

You are required to give proper treatment as required by AS 25 on Interim Financial Reporting and to recast the adjusted profit before tax for the 2nd quarter.

(4 x 5 = 20 Marks)

Answer

- (a) As per AS 2 (Revised) on 'Valuation of Inventories', materials and other supplies held for use in the production of inventories are not written down below cost if the finished product in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Cost per kg. of finished goods can be computed as follows:

	₹
Material cost	125
Direct labour cost	20
Direct variable production overhead	10
Fixed production overhead $\left(\frac{₹ 10,00,000}{1,00,000 \text{ kgs}} \right)$	<u>10</u>
Cost of Finished Goods per Unit	<u>165</u>

NRV of finished goods = ₹ 140/kg

Value of finished goods inventory = Cost of finished goods or NRV whichever is less

Thus, value of 2,000 kgs of finished goods held as inventory at the year-end will be

$$= ₹ 2,80,000 (2,000 \text{ kgs.} \times ₹ 140)$$

Since cost of finished goods exceed its NRV, raw materials will be valued at Replacement Cost.

Value of raw materials held as inventory = 15,000 kgs $\times$ ₹ 100 = ₹ 15,00,000

- (b) (i) **Calculation of value in use**

Year	Cash Flow	Discount @ 10%	Discounted cash flow
2015-16	4,100	0.909	3,726.90
2016-17	5,900	0.826	4,873.40
2017-18	6,000	0.751	4,506.00
2018-19	7,800	0.683	5,327.40
2019-20	4,500	0.621	2,794.50
	(residual value) 900	0.621	<u>558.90</u>
			<u>21,787.10</u>

(ii) Impairment loss as on 31.3.2015

Calculation of carrying amount:

Original cost = ₹ 38,000 lacs

$$\text{Depreciation for 2.5 years} = \left[\left(\frac{38,000 - 900}{7.5} \times 2.5 \right) \right] = ₹ 12,366.67 \text{ lacs}$$

Carrying amount on 31st March, 2015 = [38,000 - 12,366.67] = ₹ 25,633.33 lacs

Net Selling Price = S.P - Cost of disposal

$$= ₹ 20,000 \text{ lacs} - ₹ 100 \text{ lacs} = ₹ 19,900 \text{ lacs}$$

Recoverable amount = higher of value in use and net selling price

$$\text{i.e. ₹ 21,787.10 lacs}$$

$$\text{Impairment Loss} = ₹ 25,633.33 - ₹ 21,787.10 = ₹ 3,846.23 \text{ lacs}$$

(iii) Revised carrying amount = ₹ 21,787.10 lacs

Note: The carrying value of the asset as on 1.10.2012 is considered as the cost of the asset and it is assumed that the asset has been purchased on that date.

(c) Accounting treatment for recognition of revenue

Revenue in respect of sale of goods is recognised fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provisions for returns based on previous experiences.

Therefore, sale of ₹ 30,00,000 and ₹ 36,00,000 made in the month of February and March, 2015 will be recognized at full value.

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

It is assumed that the sales has been made evenly throughout the month and every month is of 30 days based on the information given in the question i.e. a year is of 360 days.

Sales during	Sales value (` in lacs)	Sales value (cumulative) (` in lacs)	Likely returns (%)	Likely returns (` in lacs)	Provision @ 20% (` in lacs) (Refer W.N.)
Last 10 days of March	36/3 or 12	12	5%	0.600	0.120
Previous 10 days of March	36/3 or 12	24	7%	1.680	0.336
Previous 10 days of March	36/3 or 12	36	8%	2.880	0.576
Last 15 days of February	30/2 or 15	51	9%	<u>4.590</u>	<u>0.918</u>
Total				<u>9.75</u>	<u>1.950</u>

Working Note:

Calculation of Profit % on sales

	(` in lacs)
Sales for the year	450
Less: Cost of sales	<u>(360)</u>
Profit	<u>90</u>
Profit mark up on sales $(90/450) \times 100 = 20\%$	

Note: The above solution is on the basis of the facts given in the question.

The heading of Column 1 is “the time frame of sales return from the date of purchase”. However, the time ranges given in three out of four rows in column 1 is not reckoned from the date of purchase but from the date after the close of the previous range. Further, the heading of column 2 is “% of cumulative sales”. However, they are stand-alone ranges commencing from the date after the close of the previous range. The two sets of data which are not exactly in line with each other may give rise to alternative computation of amount of provision.

Alternatively, AS 9 provides that Revenue should not be recognized until the goods have formally been accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has been elapsed. Based on this, an alternative view can be taken whereby the revenue shall not be recognized in full. In such a case, the revised sales will be as follows:

		(` in lacs)
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Revised Sales when estimated sales return is 9.75 lacs	450 – 9.75	440.25
Revised Cost of Sales	440.25 x 80%	352.20
Revised Gross Profit		88.05
Given Gross Profit		90
Reduction in Gross Profit		1.95
Reduction in receivables and sales		9.75
Inventory will stand increased by		7.80

- (d) As per para 36 of AS 25 “Interim Financial Reporting”, seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date until it is appropriate to defer at the end of the enterprise’s financial year. Therefore, loss on disposal of a business segment and gain on sale of investment incurred in 1st quarter should be recognised in the 1st quarter only. Similarly, marketing promotional expenses incurred in the 2nd quarter should be charged in the 2nd quarter only since it is a one-time expense & done occasionally.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. Accordingly, the change in the method of inventory valuation is a change in the accounting policy. Therefore, the prior interim periods’ financial statements should be restated by applying the change in the method of valuation retrospectively. An expense i.e. property tax related to the entire year is apportioned on time basis.

Accordingly, the adjusted profit before tax for the 2nd quarter will be as follows:

Statement showing Adjusted Profit/Loss Before Tax for the second quarter

	(` in lacs)
Profit before tax (as reported)	8.00
Add: Property tax being an annual charge should be allocated to all quarters	0.45
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively & not by charging to one quarter only [`(3-1) lacs]	<u>2</u>
	10.45
Less: Sales promotion expenses (4/5 of ` 15 lacs)	(12)
Loss on disposal of a business segment (2-1)	(1)
Gain on sale of investment (occasional gain should not be apportioned over the full year $\left(\frac{15}{4} \times 1\right)$)	<u>(3.75)</u>

Adjusted loss for the 2 nd quarter	(6.30)
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Note: The above solution is given on the assumption that the loss on disposal of a business segment is incurred in the 2nd quarter and only 50% of it is allocated to the quarter. Therefore, full loss should be reported in the 2nd quarter.

However, in case it is assumed that the loss on disposal of a business segment was incurred in the first quarter and 50% of the same has been allocated to the 2nd quarter, the allocation of loss on disposal of business segment will be added back and the adjusted loss for the 2nd quarter would be ` 4.30 lacs instead of ` 6.30 lacs.

Question 2

XY Limited has been incorporated with an authorised capital of ` 70 lacs equity shares of ` 10 each and ` 4 lacs preference shares of ` 100 each.

The subscribers to the Memorandum of Association have subscribed and paid for 1 lac equity shares. The expenses for incorporation incurred amounted to ` 8.09 lacs.

XY Limited desires to amalgamate X Limited and Y Limited as at 1st April, 2015*. Following information is available:

Balance Sheet as on 31st March, 2015

	(` in lacs)	
	X Limited	Y Limited
Liabilities		
Equity Shares (FV ` 100)	750	725
10% Preference shares (FV ` 100)	420	180
Reserves and Surplus		
Revaluation Reserve	125	75
Capital reserve	270	190
Statutory Reserves	60	40
Profit and Loss Account	35	12
Loan funds		
Secured Loans		
12.5% Debentures (FV ` 100)	50	28
Unsecured Loans	25	0
Current Liabilities		
Trade Payables	165	75

* Read 1st April, 2015 as 31st March, 2015.

	<i>Total</i>	<u>1,900</u>	<u>1,325</u>
Assets			
Fixed Assets			
Land and Building		470	290
Plant and Machinery		310	210
Investments		75	50
Current Assets			
Trade Receivables		345	270
Inventories		345	254
Cash and cash equivalents		<u>355</u>	<u>251</u>
	<i>Total</i>	<u>1,900</u>	<u>1,325</u>

Before amalgamation, X Ltd. and Y Ltd. will make the following adjustments in their balance-sheets:

- (i) Pay off the unsecured loans
- (ii) X Limited will revalue its Land and Building by enhancing the book value by 10% and Y Limited will revalue the Land and Building at ` 330 lacs.
- (iii) Y Limited will revalue its Plant and Machinery at ` 220 lacs.
- (iv) Investment will be disposed off. X Limited sold its investments for ` 67 lacs and Y Limited disposed the same for ` 52 lacs.
- (v) Debenture holders of X Limited and Y Limited will be discharged by XY Limited by issue of 15% debentures of ` 100 each for such an amount which will not put any additional burden of interest outgo on XY Limited than presently payable by X Limited and Y Limited.
- (vi) Preference shareholders of X Limited and Y Limited will be issued 15% Preference Shares in XY Limited in the ratio 2: 3 i.e. 2 shares will be issued for every 3 shares held at a premium of ` 25.
- (vii) Equity shares in XY Limited will be issued as under:
 - (a) Shareholders of X Limited in the ratio of 4:1 @ ` 35 per share; and
 - (b) Shareholders of Y Limited in the ratio of 3:1 @ ` 32 per share.
- (viii) Statutory reserves having met its purpose will be merged with Capital Reserves.

Prepare the amalgamated Balance Sheet of XY Limited as on 31st March, 2015 as per Schedule III to the Companies Act, 2013 with Notes to Accounts. (16 Marks)

Answer

Balance Sheet of XY Ltd.

As on 31st March, 2015

Particulars	Note No.	(` in lacs)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	927.50
(b) Reserves and Surplus	2	2060.41
(2) Non-Current Liabilities		
Long-term borrowings	3	65.00
(3) Current Liabilities		
Trade payables	4	240.00
Total		3,292.91
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	1,377
(2) Current assets		
(a) Inventories	6	599
(b) Trade Receivables	7	615
(c) Cash & Cash equivalents	8	701.91
Total		3,292.91

Notes to Accounts

	(` in lacs)	(` in lacs)
1. Share Capital		
Authorised share capital		
70 lacs Equity shares @ ` 10 each		700
4 lacs 15% Preference shares @ ` 100 each		<u>400</u>
		<u>1,100</u>
Issued share capital		
52.75 lacs Equity Shares of ` 10 each	527.50	

	4 lacs 15% Preference shares of 100 each (Out of the above 51.75 lacs Equity shares and 4 lacs Preference shares are issued for consideration other than cash)	<u>400.00</u>	927.50
2.	Reserves and surplus		
	Capital Reserve (W.N.1)	740.00	
	Securities Premium (W.N.5)	1,328.50	
	Profit and Loss A/c (Incorporation expenses)	<u>(8.09)</u>	2,060.41
3.	Long Term Borrowings		
	15% Debentures of ` 100 each		
	X Ltd.	41.67	
	Y Ltd.	<u>23.33</u>	65.00
4.	Trade payables		
	X Ltd.	165.00	
	Y Ltd.	<u>75.00</u>	240.00
5.	Tangible assets		
	Land & Building		
	X Ltd.	517.00	
	Y Ltd.	<u>330.00</u>	847.00
	Plant & Machinery		
	X Ltd.	310.00	
	Y Ltd.	<u>220.00</u>	<u>530.00</u>
			<u>1,377.00</u>
6.	Inventories		
	X Ltd.	345.00	
	Y Ltd.	<u>254.00</u>	599.00
7.	Trade Receivables		
	X Ltd.	345.00	
	Y Ltd.	<u>270.00</u>	615.00
8.	Cash and Cash equivalents		
	X Ltd. (W.N.2)	397.00	
	Y Ltd. (W.N.2)	<u>303.00</u>	700.00

XY Ltd.		
Received from subscribers of shares	10.00	
Less: Incorporation expenses paid	<u>(8.09)</u>	<u>1.91</u>
		<u>701.91</u>

Note: As per AS 26 preliminary expenses are charged to Profit and loss account in the year in which it is incurred. Accordingly, the treatment for incorporation expense has been done.

Working Note

1. Calculation of Capital Reserve on amalgamation

	(` in lacs)			
		X Ltd.		Y Ltd.
<i>Assets taken over:</i>				
Land and Building	(470 x 110%)	517		330
Plant and Machinery		310		220
Inventory		345		254
Trade receivables		345		270
Cash and Bank (W.N.2)		<u>397</u>		<u>303</u>
		1,914		1,377
<i>Less : Liabilities taken over:</i>				
13% Debentures (W.N.3)	41.67		23.33	
Trade payables	<u>165.00</u>	<u>(206.67)</u>	<u>75.00</u>	<u>(98.33)</u>
Net Assets taken over		1707.33		1,278.67
Less: Purchase consideration (W.N.4)		<u>(1,400)</u>		<u>(846)</u>
Capital Reserve		<u>307.33</u>		<u>432.67</u>
Total capital reserve (307.33 + 432.67) = 740.00 lacs				

2. Calculation of Cash and Cash Equivalents

	X Ltd.	Y Ltd.
	` in lacs	` in lacs
Balance as per Balance Sheet	355.00	251.00
Less: Payment for unsecured loans	(25.00)	-
Add: Receipt from sale of investments	<u>67.00</u>	<u>52.00</u>
	<u>397.00</u>	<u>303.00</u>

3. Calculation of 15% Debentures issued by XY Ltd. to

	X Ltd. ` In lacs	Y Ltd. ` In lacs
$50 \times \frac{12.5}{15}$	41.67	
$28 \times \frac{12.5}{15}$		23.33

4. Computation of Purchase consideration (On Payment Basis)

		(` in lacs)	
		X Ltd.	Y Ltd.
(1)	15% Preference Shares: (4.20/3) x 2 = 2.80 lacs shares @ ` 125 each (1.80/3) x 2 = 1.20 lacs shares @ ` 125 each	350	150
2.	Equity Shares: (4 x 7,50,000) = 30,00,000 equity shares @ ` 35 each (3 x 7,25,000) = 21,75,000 equity shares @ ` 32 each	1050	696
		<u>1,400</u>	<u>846</u>

5. Calculation of Securities Premium

	` in lacs
15% Preference Shares issued at premium of ` 25 each (4 lacs x ` 25 each)	100
Equity Shares issued to - X Ltd. (30 lacs x ` 25 each)	750
Y Ltd. (21.75 lacs x ` 22 each)	<u>478.50</u>
	<u>1328.50</u>

Question 3

Draw the consolidated Balance sheet as on 31st March, 2015 as per Schedule-III with Notes to Accounts (following indirect method) based on the following information:

Balance Sheet as on 31st March, 2015

			(` in lacs)
Liabilities	P	Q	R
Share Capital			

Equity Share Capital (FV ` 100)	600	400	100
Reserves and Surplus			
Reserves	40	10	20
Surplus in Profit and Loss Account	60	40	30
Current Liabilities			
Trade Payable	30	10	35
Other Payable			
Q Limited			15
R Limited	<u>50</u>	<u>-</u>	<u>-</u>
Total	<u>780</u>	<u>460</u>	<u>200</u>
			(` in lacs)
Assets	P	Q	R
Fixed Assets (Net of Depreciation)	230	150	100
Investments			
Q Limited	320		
R Limited	40	100	
Current Assets			
Inventories	50	30	40
Trade Receivables	60	50	20
Other Receivable			
R Limited		40	
P Limited			30
Bank Balance	<u>80</u>	<u>90</u>	<u>10</u>
Total	<u>780</u>	<u>460</u>	<u>200</u>

Additional Information:

- (a) P Limited acquired 1,50,000 (cum bonus) shares of Q Limited and 30,000 shares of R Limited and Q Limited acquired 50,000 shares of R Limited on 29th March, 2014*.
- (b) Q Limited fixed 1st April, 2014** as record date for allotment of bonus share in the ratio of 1:1 and the same were duly allotted.
- (c) P Limited proposed dividend @ 7.50% for the year ended on 31st March, 2015.
- (d) In December 2014, Q Limited invoiced goods to P Limited for ` 30 lacs on a load of 25%

* Read 29th March, 2014 as 31st March, 2014.

** Read 1st April, 2014 as 31st March, 2014.

on cost. $\frac{1}{3}$ rd of such goods are in stock with P Limited as at the end of the year.

- (e) R Limited sold to Q Limited on 1st January 2015, an asset costing ` 20 lacs and made a profit of 20% on invoice value. Q has provided depreciation @ 10% per annum on such assets.
- (f) As on 31st March 2014, the balances in reserves and profit and loss account of Q Limited were ` 5 lacs and ` 15 lacs respectively.
- (g) R Limited made a profit of ` 12.40 lacs during the current year. During the year, ` 0.55 lacs was received from insurance company against loss of stock due to flood which occurred on 31st January 2014 in which goods worth ` 0.75 lacs were damaged and were part of R's stock as on 31st March, 2014.
- (h) R Limited transferred, at the year-end on 31st March, 2015, an amount from Profit and Loss account to Reserves which equals to 20% of the reported aggregate figures of Reserves and Profit and Loss account in the balance-sheet. (16 Marks)

Answer

**Consolidated Balance Sheet of P Ltd. and its subsidiaries
as on 31.3.2015**

Particulars	Note No.	` in lacs
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	600.00
(b) Reserves and Surplus	2	87.964
(2) Minority Interest (W.N.6)		146.666
(3) Current Liabilities		
(a) Trade payables	3	75.00
(b) Short term provision	4	45.00
(c) Other current liabilities	5	20.00
Total		974.63
II. Assets		
(1) Non-current assets		
Fixed assets		
(a) Tangible assets	6	475.125
(b) Intangible assets	7	46.505
(2) Current assets		
(a) Inventories	8	118.00

(b) Trade receivables	9	130.00
(c) Cash & cash equivalents	10	205.00
Total		974.63

Notes to Accounts

		`in lacs	`in lacs
1.	Share Capital		
	Equity Shares of ` 100 each		600.00
2.	Reserves and surplus		
	Reserves (W. N.8)	50.50	
	Profit & Loss A/c (W. N.8)	<u>37.464</u>	87.964
3.	Trade Payables		
	P Ltd.	30.00	
	Q Ltd.	10.00	
	R Ltd.	<u>35.00</u>	75.00
4.	Short term Provision		
	Proposed dividend (600 x 7.5%)		45.00
5.	Other current liabilities		
	Other payables of P Ltd. to R Ltd.	50.00	
	Less: Other receivables of R Ltd. from P Ltd.	<u>(30.00)</u>	20.00
6.	Tangible assets (All Fixed assets are assumed as tangible in nature)		
	P Ltd.	230.00	
	Q Ltd.	150.00	
	R Ltd.	<u>100.00</u>	
		480.00	
	Less: Unrealized gain (W.N.9)	<u>(4.875)</u>	475.125
7.	Intangible assets		
	Goodwill (W.N.7)		46.505
8	Inventories		
	P Ltd.	50.00	
	Q Ltd.	30.00	
	R Ltd.	<u>40.00</u>	

		120.00	
	Less: Unrealized gain	<u>(2.00)</u>	118.00
9.	Trade Receivables		
	P Ltd.	60.00	
	Q Ltd.	50.00	
	R Ltd.	<u>20.00</u>	130.00
10.	Cash & cash equivalents		
	Cash in transit (W.N.11)	25.00	
	Bank balance		
	P Ltd.	80.00	
	Q Ltd.	90.00	
	R Ltd.	<u>10.00</u>	205

Working Notes**1. Shareholding Pattern**

	Number of Shares (in lacs)	% age of Holding
<i>In Q Ltd.:</i>		
P Ltd. (1,50,000 + 1,50,000)	300	75%
Minority Interest	100	25%
<i>In R Ltd.:</i>		
P Ltd.	30	30%
Q Ltd.	50	50%
Minority Interest	20	20%

2. Calculation of pre-acquisition reserves of R Ltd.

	` in lacs	Nature
Closing balance as on 31.3.2015	20.00	
Less: Transfer from Profit and Loss Account in 2014-2015	<u>(10.00)</u>	Post
Opening balance as on 1.4.2014	<u>10.00</u>	Pre

3. Calculation of pre-acquisition Profit and Loss Account of R Ltd.

		` in lacs	Nature
Closing balance		30.00	
Less: Profit earned during the year	12.40		
Add back: Loss of the previous year*	<u>0.20</u>	<u>(12.60)</u>	Post

Opening balance		17.40	Pre
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Since loss on damaged goods (` 0.75 lacs – ` 0.55 lacs = ` 0.20 lacs) relates to last year, it is added back to current year's profit and deducted from last year's profit i.e. pre acquisition reserve.

4. Analysis of profits of R Ltd.

	Pre-acquisition	Post-acquisition	
	Capital Profit ` in lacs	Revenue Reserve ` in lacs	Revenue Profit ` in lacs
Reserves	10.00	10.00	--
Profit & Loss Account	<u>17.40</u>	--	<u>12.60</u>
	<u>27.40</u>	<u>10.00</u>	<u>12.60</u>
P Ltd [30%]	8.22	3.00	3.78
Q Ltd. [50%]	13.70	5.00	6.30
Minority Interest [20%]	5.48	2.00	2.52

5. Analysis of Reserves and surplus of Q Ltd. by indirect approach

	Pre-acquisition	Post-acquisition	
	Capital Profit ` in lacs	Revenue Reserve ` in lacs	Revenue Profit ` in lacs
Reserves	5.00	5.00	--
Profit & Loss Account	<u>15.00</u>	--	<u>25.00</u>
	20.00	5.00	25.00
Share of Q Ltd.'s profit in R Ltd.	13.70	5.00	6.30
Share of unrealized gain on asset	--	--	<u>(2.437)</u>
	<u>33.70</u>	<u>10.00</u>	<u>28.863</u>
P Ltd. 75%	25.275	7.50	21.647
Minority Interest 25%	8.425	2.50	7.216

6. Minority Interest

	Q Ltd. ` in lacs	R Ltd. ` in lacs
Share Capital	100	20
Capital Profit	8.425	5.48
Revenue Profit : Reserves	2.50	2.00

Profit & Loss Account	7.216	2.52
Unrealised gain on assets		(0.975)
Unrealised Profit on inventory	<u>(0.50)</u>	<u>-</u>
	<u>117.641</u>	<u>29.025</u>
Total Minority Interest: ` 117.641+ ` 29.025 = ` 146.666		

7. Cost of Control

	<i>P Ltd. in Q Ltd.</i> ` in lacs	<i>P Ltd. and Q Ltd. in R Ltd.</i> ` in lacs
	75%	80%
Amount Invested	320	140
Less: Share capital	(300)	(80)
Capital Profit	<u>(25.275)</u>	<u>(8.22)</u>
Goodwill/(Capital Reserve)	<u>(5.275)</u>	<u>51.78</u>
Net Goodwill	46.505	

8. Reserves and Profit and Loss Account balances in the Consolidated Balance Sheet

	<i>Reserves</i> ` in lacs	<i>Profit and Loss A/c</i> ` in lacs
Balance in Books of P Ltd.	40.00	60.00
Add: Shares of Post Acquisition Profits:		
From R Ltd.	3.00	3.78
From Q Ltd	7.50	21.647
Less: Proposed dividend		(45.00)
Less: Unrealised Profit on stock (30x1/3x25/125x75%)		(1.50)
Less: Unrealised Profit on asset		<u>(1.463)</u>
	<u>50.50</u>	<u>37.464</u>

9. Calculation of Unrealized Profit on Asset ` in lacs

Invoice value of an asset (20/80) x 100	25.00
Cost	<u>(20.00)</u>
Unrealized Profit on Asset	5.00
Less: Depreciation on it (5x10%x3/12)	<u>(0.125)</u>

Unrealised gain of R Ltd.	<u>4.875</u>
---------------------------	--------------

	<u>` in lacs</u>
P Ltd. 30% to be adjusted from Consolidated Profit and Loss Account	1.463
Q Ltd. 50% to be adjusted from Analysis of Profit of Q Ltd.	2.437
Minority Interest 20% to be adjusted from Minority Interest	<u>0.975</u>
	<u>4.875</u>

10. Calculation of Unrealized Profit on Inventory ` in lacs

Profit earned by Q Ltd. on inventory 30x1/3 x 25/125	<u>2.00</u>
To be adjusted from inventory	
And 75% of it is adjusted from Consolidated Profit and Loss Account	1.50
25% of it to be adjusted from Minority Interest	<u>0.50</u>

11. Inter-Company Owings

	<u>` in lacs</u>
Q Ltd. to receive from R Ltd.	40.00
Less: Trade payable appearing in the B/S of R Ltd.	<u>(15.00)</u>
Cash-in-transit	<u>25.00</u>

Question 4

- (a) Team Ltd. is a non-banking finance company. It accepts public deposits and also deals in hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31-3-2013.

Few machines were sold on hire purchase basis. The hire purchase price was set at ` lacs as against the cash price of ` 80 lacs. ` 20 lacs were payable as down payment and the balance was payable in 5 equal installments. The hire vendor collected first installment as on 31-3-2014, but could not collect the second installment which was due on 31-03-2015. The company was finalizing accounts for the year ended on 31-3-2015. Till 15-4-2015, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10.42%.

Required:

- What should be the principal outstanding on 1-4-2014? Should the company recognize finance charge for the year 2014-15 as income?
- What should be the net book value of assets as on 31-3-2015 as per NBFC prudential norms requirement for provisioning?

- (iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by the RBI?
- (b) Lovely Limited has advanced staff loan of ₹ 50 lacs to its employees on 1st July, 2014 at a concessional rate of 6% per annum, to be repaid in 5 semi-annual installments along with interest thereon. The prevailing rate is 8% per annum.

Find out the value at which the loan should initially be recognised and its amortisation till closure thereof. Also give necessary journal entries with appropriate narration for financial year 2014-15. The discount values at 8% and 4% are as under:

Period	1	2	3	4	5
8%	0.9259	0.8573	0.7938	0.7350	0.6806
4%	0.9615	0.9246	0.8890	0.8548	0.8219

(8 + 8 = 16 Marks)

Answer

- (a) (i) Since, the hire-purchaser paid the first instalment due on 31.3.2014, the notional principal outstanding on 1-4-2014 was ₹ 50.25 lacs (refer W.N.).

In the year ended 31.03.2015, the instalment due of ₹ 16 lacs has not been received. However, it was due on 31.3.2015 i.e. on the balance sheet date, and therefore, it will be classified as standard asset. Team Ltd. will recognise ₹ 5.24 lacs as interest income included in that due instalment as this should be treated as finance charge.

- (ii) **The net book value of the assets as on 31.3.2015**

	₹ in lacs
Overdue instalment	16.00
Instalments not due (₹ 16 lacs x 3)	<u>48.00</u>
	64.00
Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52)	<u>(8.51)</u>
	55.49
Less: Provision as per para 9(2)(i) of NBFC prudential norms (Refer point (iii))	<u>7.49</u>
Net book value of assets.	<u>48.00</u>

- (iii) **Amount of Provision**

	₹ in lacs
Overdue instalment	16.00

Instalments not due (16 lacs x 3)	<u>48.00</u>
	64.00
Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52)	<u>(8.51)</u>
	55.49
Less: Depreciated value (cash price less depreciation for two years on SLM @ 20%*)	<u>(48.00)</u>
Provision to be created as per para 9(2)(i) of NBFC prudential norms	<u>7.49</u>

Since, the instalment of ` 16 lacs not paid, was due on 31.3.15 only, the asset is classified as standard asset. Therefore, no additional provision has been made for it.

Working Note:

It is necessary to segregate the instalments into principal outstanding and interest components by using I.R.R. @ 10.42%.

Time	Opening outstanding amount (a)	Cash flow (b)	Interest @ 10.42% (c) = (a x 10.42%)	Principal repayment (d) = (b – c)	Closing outstanding (e) = (a – d)
31-3-2013		(60)	----	---	60.00
31-3-2014	60.00	16	6.25	9.75	50.25
31-3-2015	50.25	16	5.24	10.76	39.49
31-3-2016	39.49	16	4.11	11.89	27.60
31-3-2017	27.60	16	2.88	13.12	14.48
31-3-2018	14.48	16	1.52	14.48	0.00

(b) (i) Calculation of initial recognition amount of loan to employees

Half Year end	Cash Inflow		Total	P.V. factor @ 4%	Present value
	Principal	Interest @ 3%			
1st	10,00,000	1,50,000	11,50,000	0.9615	11,05,725
2nd	10,00,000	1,20,000	11,20,000	0.9246	10,35,552

* As per NBFC prudential norms laid down by the RBI.

3rd	10,00,000	90,000	10,90,000	0.8890	9,69,010
4th	10,00,000	60,000	10,60,000	0.8548	9,06,088
5th	10,00,000	30,000	10,30,000	0.8219	<u>8,46,557</u>
Present value or Fair value					<u>48,62,932</u>

(ii) Calculation of amortised cost of loan to employees

Year	Amortised cost (Opening balance) [1]	Interest to be recognized @ 4% [2]	Repayment (including interest) [3]	Amortised Cost (Closing balance) [4]=[1]+ [2] – [3]
1st	48,62,932	1,94,517	11,50,000	39,07,449
2nd	39,07,449	1,56,298	11,20,000	29,43,747
3rd	29,43,747	1,17,750	10,90,000	19,71,497
4th	19,71,497	78,860	10,60,000	9,90,357
5th	9,90,357	39,643	10,30,000	Nil

(iii) Journal Entries in the books of Lovely Ltd.
for the financial year 2014-2015 (regarding loan to employees)

	Dr. Amount (`)	Cr. Amount (`)
Staff loan A/c Dr. To Bank A/c (Being the disbursement of loans to staff)	50,00,000	50,00,000
Staff cost A/c (50,00,000 – 48,62,932) Dr. [Refer part (ii)] To Staff loan A/c* (Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of `)	1,37,068	1,37,068
Staff loan A/c Dr. To Interest on staff loan A/c (Being the charge of interest @ market rate	1,94,517	1,94,517

* Loans and receivables should be measured at amortized cost using the effective interest method as per AS 30 'Financial Instruments: Recognition and Measurement'.

of 8% on the loan)			
Bank A/c	Dr.	11,50,000	
To Staff loan A/c			11,50,000
(Being the repayment of first instalment with interest for the year)			
Interest on staff loan A/c	Dr.	1,94,517	
To Profit and loss A/c			1,94,517
(Being transfer of balance of staff loan Interest account to profit and loss account)			
Profit and loss A/c	Dr.	1,37,068	
To Staff cost A/c			1,37,068
(Being transfer of balance of staff cost account to profit and loss account)			

Question 5

- (a) The summarized Balance-Sheet of Rose Limited for the year ended on 31st March, 2013 2014 and 2015 are as follows:

	(` in thousands)		
	31 st March, 2013	31 st March 2014	31 st March 2015
Liabilities			
6,40,000, equity shares of ` 10 each fully paid up	6,400	6,400	6,400
General Reserves	4,800	5,600	6,400
Profit and Loss Account	560	640	960
Trade Payable	2,400	3,200	4,000
Total	14,160	15,840	17,760
Assets			
Goodwill	4,000	3,200	2,400
Tangible Assets (Net)	5,600	6,400	6,400
Inventories	4,000	4,800	5,600
Trade Receivable	80	640	1,760
Cash and Cash Equivalents	480	800	1,600
Total	14,160	15,840	17,760

Additional Information:

- (i) Actual valuations were as under:

Tangible Assets	7,200	8,000	8,800
Inventories	4,800	5600	6,400
Net Profit (Including Opening Balance after writing off depreciation, goodwill, tax provision and transfers to general reserves)	1,680	2,480	3,280

- (ii) Capital employed in the business at market value at the beginning of 2012-13 was ₹ 1,46,40,000 which included cost of goodwill. The normal annual return on average capital employed in the line of business in which Rose Limited is engaged is 12.50%
- (iii) The balance in general reserve as on 1st April, 2012 was ₹ 40 lacs.
- (iv) The goodwill shown as on 31st March, 2013 was purchased on 1st April, 2012 for ₹ 40 lacs and the balance in profit and loss account as on 1st April, 2012 was ₹ 4,80,000.
- (v) Goodwill is to be valued at 5 years' purchase of Super profit by using simple average method.

Find out the average capital employed in each year and total value of business as on 31st March, 2015.

- (b) Agile Limited is a manufacturer-cum-dealer of 'R Tuff' brand of trousers. With passage of time, its brand has been well accepted in the market. The company has been approached by a foreign company engaged in the same trade to enter as partner in its business. Agile, in order to negotiate the deal wants to get its brand valued. The following information based on market research is available:
- (i) Garment industry of which Agile is a constituent, is expected to grow by 9% per annum during the next five years. The present market size of the industry is ₹ 7,500 crores.
- (ii) There are other brands both national and international in the market. The existence of duplicate brands is unavoidable. The share of such players is estimated to be 63% of the total industry market. The market share of other national brands will increase @ 0.25% year on year basis in the next 5 years. The share of international brands is expected to grow 1.5 times of national brands. But the existence of duplicate brands is to fall by 2.5% over the period of next 5 years, spread equally.
- (iii) The expected foreign partner needs the production line of the company to be re-engineered which will lead to an increase in the yield of the company by 3% after one year over the present yield of 10% followed thereafter by further increase of 5 % year on year.

Following the market oriented approach, determine the brand value to be used for negotiation with the foreign company, considering the discount factor for 1st five years as 0.909; 0.826; 0.751; 0.683 and 0.621 (Monetary values in crores to be rounded off to nearest 2 decimal places). (8 + 8 = 16 Marks)

Answer**(a) Total value of business as on 31.03.2015**

	<i>`in thousands</i>
Closing Capital Employed as on 31.3.2015	16,960
Less: Goodwill appearing in the Balance Sheet as purchased goodwill	(2,400)
Add: Goodwill	<u>8,225</u>
Total Value of Business	<u>22,785</u>

Working Notes:**1. Calculation of Average Capital Employed**

	31.3.2013 <i>`in thousands</i>	31.3.2014 <i>`in thousands</i>	31.3.2015 <i>`in thousands</i>
Purchased Goodwill*	4,000	3,200	2,400
Tangible Assets	7,200	8,000	8,800
Inventories	4,800	5,600	6,400
Trade Receivables	80	640	1,760
Cash & Cash Equivalents	<u>480</u>	<u>800</u>	<u>1,600</u>
	16,560	18,240	20,960
Less: Trade payables	<u>(2,400)</u>	<u>(3,200)</u>	<u>(4,000)</u>
Closing Capital	14,160	15,040	16,960
Add: Opening Capital Employed	<u>14,640</u>	<u>14,160</u>	<u>15,040</u>
Total	<u>28,800</u>	<u>29,200</u>	<u>32,000</u>
Average Capital Employed	<u>14,400</u>	<u>14,600</u>	<u>16,000</u>

*Since the goodwill has been purchased, it is taken as a part of Capital employed. However, writing off of the goodwill is an extra-ordinary item, therefore not considered while calculating Future Maintainable Profit.

2. Valuation of Goodwill**(i) Future Maintainable Profit**

	31.3.2013 `in thousands	31.3.2014 `in thousands	31.3.2015 `in thousands
Future Maintainable Profit	1,680	2,480	3,280
Less :Opening Profit	(480)	(560)	(640)
Add: Appreciation of closing inventory	800	800	800
Less: Appreciation of opening inventory	-	(800)	(800)
Add: Transferred to General Reserve	800	800	800
Goodwill written off		<u>800</u>	<u>800</u>
	2,800	3,520	4,240
Less: Normal Return @ 12.5% on ACE	<u>(1,800)</u>	<u>(1,825)</u>	<u>(2,000)</u>
(ii) Super Profit	<u>1,000</u>	<u>1,695</u>	<u>2,240</u>

$$(iii) \text{ Average Super Profit} = \left[\frac{1,000 + 1,695 + 2,240}{3} \right] = 1,645 \text{ thousands}$$

(iv) **Value of Goodwill** at five years' purchase

$$= \text{` } 1,645 \text{ thousands} \times 5 = \text{` } 8,225 \text{ thousands}$$

(b) Market Share of Agile Ltd.

Calculation of Last year's market share = 100% – 63% = 37%

Increase or decrease in market share of other players $[0.25 + (.25 \times 150\%) - 2.5/5] = 0.125\%$ i.e. increase in others' market share every year over the period of 5 years. Hence, market share of Agile Ltd. is expected to decrease by 0.125% every year over the period of 5 years, from the current level of 37%.

Brand Valuation under Market Approach

Year	Market Size (` in Crores)	Market Share of Agile Ltd.	Market Share (` in Crores)	Expected Profit (` in Crores)	Discount Factor	Discounted Cash Flow (` in Crores)
1	7500 x 109% = 8,175	36.875%	3014.53	@ 10% = 301.45	0.909	274.02
2	8,175 x 109% = 8910.75	36.75%	3274.70	@ 13% = 425.71	0.826	351.64

3	8,910.75x 109% = 9712.72	36.625%	3557.28	@18% = 640.31	0.751	480.87
4	9,712.72 x 109% = 10,586.86	36.5%	3864.20	@23% = 888.77	0.683	607.03
5	10,586.86 x 109% = 11,539.68	36.375%	4197.56	@28% = 1,175.32	0.621	<u>729.87</u>
	Brand Value					<u>2,443.43</u>

Brand Value of Agile Ltd. under Market Oriented Approach is 2,443.43 crores.

Question 6

- (a) Famous Corporation has been preparing Value Added Statements for the past five years. The Human Resource Manager of the company has suggested introducing a value added incentive scheme to motivate the employees for their better performance. To introduce the scheme, it is proposed that the best index performance (favourable to employer) i.e. Employee Costs to Added Value for the last five years, will be used as the target index for future calculations of the bonus to be paid.

After the target index is determined, any actual improvement in the index will be rewarded. The employer and the employee will be sharing any such improvement in the ratio of 1:2. The bonus is given at the end of the year, after the profit for the year is determined.

The following information is available for the last 5 years.

Value Added Statement for 5 years

	`in thousands				
Particulars	2010	2011	2012	2013	2014
Sales	5,600	7,600	9,200	10,400	12,000
Less: bought in goods, Services	<u>2,560</u>	<u>4,000</u>	<u>5,000</u>	<u>5,600</u>	<u>6,400</u>
Added Value	<u>3,040</u>	<u>3,600</u>	<u>4,200</u>	<u>4,800</u>	<u>5,600</u>
Employee Costs	1,300	1,520	1,680	1,968	2,240
Dividend	200	300	400	480	600
Taxes	640	760	840	1000	1,120
Depreciation	520	620	720	880	1,120
Debenture Interest	80	80	80	80	80
Retaining Earnings	<u>300</u>	<u>320</u>	<u>480</u>	<u>392</u>	<u>440</u>
Added Value	<u>3,040</u>	<u>3,600</u>	<u>4,200</u>	<u>4,800</u>	<u>5,600</u>

Summarised Profit and Loss Account for the year ended on 31st March, 2015.

		(` in thousand)
Particulars		Amount
Income		
Sales less returns	13,600	
Dividends and Interest	500	
Miscellaneous Income	<u>500</u>	14,600
Expenditure		
Production and Operational Expenses		
Cost of Materials	5,000	
Wages & Salaries	1,800	
Other Manufacturing Expenses	<u>1,400</u>	8,200
Administrative Expenses		
Administrative Salaries	600	
Administration Expenses	<u>600</u>	1,200
Selling and Distribution Expenses		
Selling and Distribution Salaries	120	
Selling Expenses	<u>400</u>	520
Financial Expenses		
Debenture Interest		80
Depreciation		<u>1,520</u>
Total Expenditure		<u>11,520</u>
Profit before taxation		3,080
Provision for taxation		<u>770</u>
Profit after taxation		<u>2,310</u>

From the above information, prepare Value Added Statement for the year 2014-15 and determine the amount of bonus payable to employees, if any.

- (b) Give major differences between IFRS and AS (applicable in India) with respect to Property, Plant and Equipment. (8 + 8 = 16 Marks)

Answer**(a) 1. Calculation of Target index**

	(` in thousands)				
Year	2010	2011	2012	2013	2014
Employees cost	1,300	1,520	1,680	1,968	2,240
Value added	3,040	3,600	4,200	4,800	5,600
Percentage of 'Employee cost' to 'Value added'	42.76%	42.22%	40%	41%	40%

Target index percentage is taken as least of the above from the employer's viewpoint i.e. 40%.

2. Value Added Statement for the year 2014-15

	(` in thousands)	(` in thousands)
Sales		13,600
Less: Cost of bought in goods & services		
Materials consumed	5,000	
Other manufacturing expenses	1,400	
Administrative expenses	600	
Selling expenses	<u>400</u>	<u>(7,400)</u>
		6,200
Add: Miscellaneous income		500
Dividends and interest		<u>500</u>
Value Added		<u><u>7,200</u></u>

3. Employee cost for 2014-15

	(` in thousands)
Wages and salaries	1,800
Administrative salaries	600
Selling and distribution salaries	<u>120</u>
	<u><u>2,520</u></u>

- 4. Calculation of target employee cost** = Target Index Percentage x Value added
 = 40% x ` 7,200 thousands = ` 2,880 thousands

5. Calculation of savings

Target employee cost = ` 2,880 thousands

Less: Actual Cost = (₹ 2,520 thousands)

Saving = ₹ 360 thousands

6. Calculation of Bonus payable for the year 2014-15:

2/3 of savings is Bonus Payable = ₹ 360 thousands x 2/3 = ₹ 240 thousands.

(b) Property, Plant and Equipment

	IFRS	AS
Wider Definition	Tangible items that are held for use in the production or supply of goods or service, for rentals to others, or for administrative purpose; and are expected to be used during more than one period.	Fixed Asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the ordinary course of business.
Initial Measurement of cost	Initial measurement of cost also includes: a) Fair value gains or losses on qualifying cash flow hedges relating to the purchase of Property, Plant and Equipment (PPE) in a foreign currency b) Cost of dismantling and removing the item or restoring the site on which PPE is located.	No specific guideline on the Measurement of gains/ losses on qualifying cash flow hedges and capitalization of dismantling and site restoration cost
Capitalization	It mandates component Accounting. Each major part of the plant to be depreciated separately.	AS 10 does not require full adoption of component Accounting. It is stated that accounting of asset may be improved through allocation of cost to various parts of the asset.
Depreciation Method	A variety of depreciation methods can be used to allocate the depreciable amount on systematic basis over its useful life.	Either SLM or WDV can be followed.
Change in Depreciation	Changes in the depreciation method are considered as	Changes in the depreciation method are considered as

Method	change in accounting estimate. Prospective effect in current period is made.	change in accounting Policies and effects to be quantified and disclosed. Retrospective effect in computation of depreciation is given.
Review of Useful Life and Residual Value	Re-assessment of useful life and residual value is required at least at each financial year end	AS 10 does not specify any such requirement.
Subsequent Costs	Cost of replacement is to be capitalized. The carrying amounts of those parts that are replaced is to be derecognized.	Replacement cost is expensed. No requirement for decapitalizing the carrying amount of replaced items
Major inspection cost and overhaul expenditure	The cost of major inspection and overhaul expenses are to be capitalized.	The expenditure that increases the benefit over previously assessed capacity is capitalized. The inspection cost and overhaul expenses are expensed.
Revaluation	If an entity adopts the revaluation model, revaluation is required to be made with regular period to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.	No specific requirement on frequency of revaluation.
Group Revaluation	If an item of PPE is revalued, then the entire class of PPE to which that asset belongs to be revalued.	Revaluation approach is adhoc in nature.
Depreciation on revaluation	Depreciation on revalued portion cannot be recouped out of revaluation reserve.	Depreciation on revalued portion can be recouped out of revaluation reserve.

Question 7

Answer any **FOUR** of the following:

- (a) AB Limited acquired at the start of the financial year a fixed assets from USA at a price of US \$ 1,25,000 and made a down payment of US \$ 25,000. The exchange rate was 61.50 per dollar at the date of transaction. The balance amount was payable in 4 equal half yearly installments with interest @ 8% per annum. The exchange rate on due dates of installment has been ` 61.60; ` 61.80; ` 61.90; and ` 62.10. The asset was under construction during the period of six months from its acquisition. Ascertain the amount to be capitalized and the gain or loss to be recognized in each of the years.

- (b) HS Limited manufactures goods and caters to both national and international markets. As on 31st March, 2015, it has the following stocks in its warehouse at factory:

Goods meant for national market - Sale value of ` 100 lacs

Goods meant for international market - Export value of ` 50 lacs

The company has a policy to mark up the products for national markets at one-third of cost while those for exports are marked up at 150% of its cost. Excise duty on goods is payable @ 12.36%. The management is of the opinion that excise is payable only on clearance of goods from factory and as such the same should not be a part of cost of inventory.

You are required to guide the company in the light of relevant guidance note.

- (c) Krishna sold goods to Madhav for ` 100 crores against an export order of Madhav. Subsequent to the sale by Krishna, the export order of Madhav was cancelled for unavoidable reasons. Madhav decided to sell the goods in local market, provided a price discount is allowed by Krishna. Krishna acceded to the request of Madhav. Advise how the discount given shall be dealt in the books of accounts of Krishna.
- (d) A company desires to make provision in respect of its non-moving or slow moving items of stock. The following information is available:

	` in lacs	
Particulars	Current year	Previous year
Value of Closing Stock	169	105
Provision based on No. of issues during the year	4.50	4.00
Provision based on products technicality	5.50	4.25

The company has been making provisions based on number of issues. However, from this year, the management has decided to make provision based on technical evaluation.

Explain whether such change will amount to change in 'accounting policy'. Also draw a suitable note, if in your view the proposed change requires the same to be given in the financial statement of the current year.

- (e) *Lucky P Limited has been assessed to Income-tax, in which a demand of ` 10 lacs has been made. The company has gone in appeal. The company has deposited ` 6.00 lacs against the demand, on being pursued by the department. The company has been advised by its counsel that there is 80% chance of losing in respect of one of the grounds which may end up confirming the demand of ` 4.00 lacs, while on other grounds, there is fair chance of winning the appeal. How the company should treat the same while preparing the final accounts for the year ending 31st March, 2015? (4 x 4 = 16 Marks)*

Answer

- (a) As per AS 16, 'Borrowing Costs', an asset will be considered as a qualifying asset only when it takes substantial period of time to get ready for its intended use. Ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In the given case, since the asset was under construction for the period of six months from its acquisition, it is considered as a non-qualifying asset in ordinary case. Accordingly, borrowing cost will not be capitalized at all.

Further, a company may opt to capitalize the exchange difference 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, or to recognised as income or as expenses in the period in which they arise

Applying the provisions of AS 11 (option to capitalize) amount to be capitalized in each of the years will be as follows:

Purpose		Amount to be capitalised	Interest to be charged to profit and loss account
		`	`
Initial cost at the time of acquisition of fixed asset	US \$ 1,25,000 x ` 61.50	76,87,500	
On payment of 1 st instalment	US \$ 25,000 x ` (61.60 - 61.50)	2,500	
Interest paid with 1 st instalment	(1,00,000 x 8% x 6/12) x 61.60		2,46,400
On payment of 2 nd instalment	US \$ 25,000 x ` (61.80 - 61.50)	7,500	
Interest paid with 2 nd instalment	(75,000 x 8% x 6/12) x 61.80		1,85,400
Exchange difference on	US \$ 50,000 x ` (61.80 -		

closing balance of long term foreign currency	61.50)	<u>15,000</u>	
At the end of the year 1		<u>77,12,500</u>	<u>4,31,800</u>
On payment of 3 rd instalment	US \$ 25,000 x ` (61.90 - 61.80)	2,500	
Interest paid with 3 rd instalment	(50,000 x 8% x 6/12) x 61.90		1,23,800
On payment of 4 th instalment	US \$ 25,000 x ` (62.10 - 61.80)	7,500	
Interest paid with 4 th instalment	(25,000 x 8% x 6/12) x 62.10		<u>62,100</u>
At the end of the year 2		<u>10,000</u>	<u>1,85,900</u>

The entire amount of exchange difference of ` 35,000 (15,000 + 10,000) will be capitalized to 'Fixed Asset account'. This capitalized exchange difference will be depreciated over the useful life of the asset.

- (b) 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.

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.

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.

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.

- (c) Krishna had sold goods to Madhav for ₹ 100 crores and the sale was completed in all respects. Madhav's decision to sell the same in the domestic market does not affect the amount recorded as sales by Krishna. The price discount allowed on request of Madhav shall not be considered in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself.

Now, as far as Krishna is concerned, there is a reduction in the receivable, which has arisen subsequent to the sale due to cancellation of export order. Therefore, it would be appropriate to make a separate provision to reflect the discount rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be recognised to the profit and loss account and not shown as deduction from the sales figure.

- (d) 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 activities, 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 circumstances 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.

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.

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.

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.

"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."

- (e) As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognised when:
- (a) an enterprise has a present obligation as a result of a past event;

- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

However, where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability.

In the given case, there is a present obligation of demand of `10 lacs raised by the Income-tax department. As per the advise by the counsel, the outflow of resources upto ` 4 lacs is more likely to happen to settle the obligation since there is 80% probability of losing on one ground. Therefore, a provision of ` 4 lacs shall be made in the books of account for the year ended 31st March, 2015.

However, in respect of other grounds, there are fair chances of winning the appeal. Thus, no provision is required to be made for the remaining amount of ` 6,00,000 and it should be shown as contingent liability in the books of the company while preparing the final accounts for the year ended 31st March, 2015.

The company paid ` 6 lacs against demand on being pursued by the department but created a provision of ` 4 lacs only. Hence it is expecting to get a refund in due course. Till the final settlement of the case, ` 6 lacs paid against income tax demand will appear under the heading 'Non-current/Current Loans and Advances' and 'Provision for taxation' under the heading Long/Short term Provisions', based on the expected date of settlement.