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SUGGESTED ANSWERS

AFQ

PAPER – 1 : FINANCIAL REPORTING (OLD SYLLABUS)

Question 1(a)

Fair value of planned assets 31st March 2010	300,000
Less : Fair value of planned assets 1st April 2009	(200,000)
Less : Contribution received 30th September	(55,000)
Add : Benefits paid on 30th September	25,000
Actual return on planned assets	<u>70,000</u>
Expected return	
On Opening balance 200,000*10.25%	20,500
on Additional amount (55,000-25,000)	
30,000* 5%	1,500
Expected return on planned assets	<u>22,000</u>

Note:

10.25% p.a compounded annually to be converted into half yearly returns

$$(1+r)(1+r) = 1.1025$$

$$r = 0.05 \text{ or } 5\%$$



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Question 1(b)

Foreign exchange difference on principal portion of liability (48 – 45) * \$12.5	37.5
Interest on Rupee equivalent loan \$12.5*45 * 11%	61.875
Interest on \$ loan in rupees 12.5\$* 5% *48	30
Foreign exchange loss treated as borrowing cost	31.875
Foreign exchange loss as exchange loss	5.625

Disclosure summary

Foreign exchange loss	5.625
Borrowing cost	
Exchange loss in nature of interest	31.875
Interest paid	30
Total	67.5

Disclosure if this concept not applied

Foreign exchange loss	37.5
Interest paid	30
Total	67.5

Question 1(c)

(a) Carrying Amount of investment in separate financial statement as on 31.3.2010(As 13)

Cost of investments	200,000
Less : Pre-acquisition dividend received 50000*30%	<u>(15,000)</u>
	185,000

(b) Carrying Amount of investment in consolidated financial statement as on 31.3.2010(As 23)

Cost of investments	200,000
Less : Pre-acquisition dividend received 50000*30%	<u>(15,000)</u>
Add : Share of profits for the year 2009 – 2010 300,000*30%	<u>90,000</u>
	275,000

(c) Carrying Amount of investment in consolidated financial statement as on 30.6.2010(As 23)

Value of investments as on 31.3.2010	275,000
Less : Dividend received for the year 2009-10	
60,000*30%	(18,000)
	<u>257,000</u>

Notes

- (1) Profits of 80,000 for the year 2008-09 is ignored because it would have been considered for cost of Rs.200,000 on 1.6.2009
- (2) Proposed dividend for the year 2009-10 is not considered as per AS 23

Question 1(c)

As on 31.3.2010

	Rs in Lakhs
Carrying amount 500-415-25	60
Recoverable amount	
Value is use 35*(1-0.3)	24.5
Net selling price 30(1-0.2)	24
Higher	24.5
Impairment loss to be charged to P&L	35.5
Carrying amount as on 31.3.2010(After impairment)	24.5

If revaluation reserve of 12 lakhs exists

Impairment loss to be adjusted to against revaluation reserve	12
Balance to be charged off to P&L 35.5 – 12	23.5
Carrying amount as on 31.3.2010 continues to be	24.5

If value in use was 0

Carrying amount	60		
Recoverable amount			
Value in use	0		
Net selling price	0-2	-2	0

Impairment loss 60

Provide for cost of disposal if required under AS 29

Question 2(a)

Basic EPS = $\frac{\text{Profit attributable to Equity shareholders}}{\text{No of equity shares outstanding}}$

Basic EPS = $\frac{1,00,00,000}{20,00,000} = \text{Rs.5}$



Type	Incremental profits	Incremental shares	Incremental EPS	Ranking
Options	0	$100,000 \times \frac{15}{75}$ 20,000	0	I
Preference shares	$800,000 \times 8$	$800,000 \times 2$	<u>74,38,080</u>	
	$64,00,000 + 64,00,000 \times 16.22\%$	16,00,000	16,00,000	
	74,38,080		4.65	III
Debentures	$10,00,00,000 \times 12\% (1 - 0.3)$	<u>$10,00,00,000 \times 4$</u>	<u>84,00,000</u>	
	84,00,000	100	40,00,000	
		40,00,000	2.1	II



Order of dilutive EPS	Diluted EPS	Effect
Type Computation	4.95	Dilutive
Options $\frac{1,00,00,000 + 0}{20,00,000 + 20,000}$		
Debentures $\frac{1,00,00,000 + 0 + 84,00,000}{20,00,000 + 20,000 + 40,00,000}$	3.056	Dilutive
Preference $\frac{100,00,000 + 0 + 84,00,000 + 74,38,080}{20,00,000 + 20,000 + 40,00,000 + 16,00,000}$	3.39	Anti-Dilutive

Dilutive EPS to be reported = 3.056

Question 2(b)

Fair value under equity settlement 1,200 shares x Rs 48	57600
Fair value under cash settlement 1,000 shares x Rs 50	50000
Fair value of the equity component (Rs 57,600 – Rs 50,000)	7600 Equity

	Year1	Year2	Year3
Number of employees expected to satisfy condition	1000	1000	1000
SARs' per employee	52	55	60
Fair value per right(SAR)			
Total Expense in vesting period	(52*1000) 52000	(55*1000) 55000	(60*1000) 60000
Expected Vesting period	3	3	3
Closing balance of SAR	(52,000*1/3) 17333	(55,000*2/3) 36667	(60,000*3/3) 60000
Opening balance of SAR	0	17333	36667
Current year SAR expense	17333	19333	23333



Journal Entries

Employee compensation expense A/c	Dr.	17,333
To Provision for liability component		17,333
Employee compensation expense A/c	Dr.	2,533
To Stock Options Outstanding A/c		2,533
Employee compensation expense A/c	Dr.	19,334
To Provision for liability component		19,334
Employee compensation expense A/c	Dr.	2,533
To Stock Options Outstanding A/c		2,533
Employee compensation expense A/c	Dr.	23,333
To Provision for liability component		23,333

On settlement year

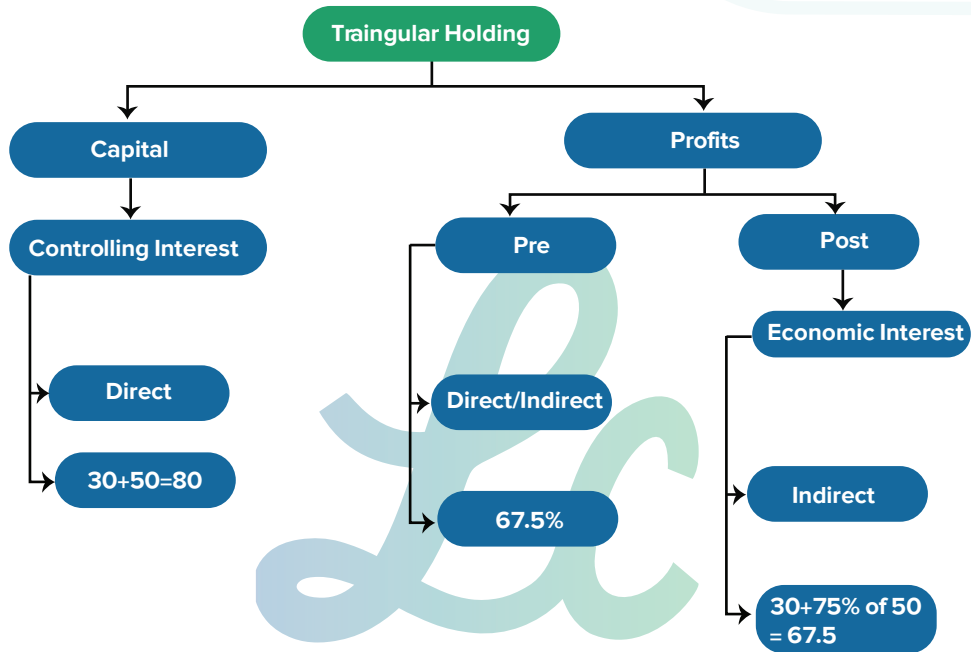
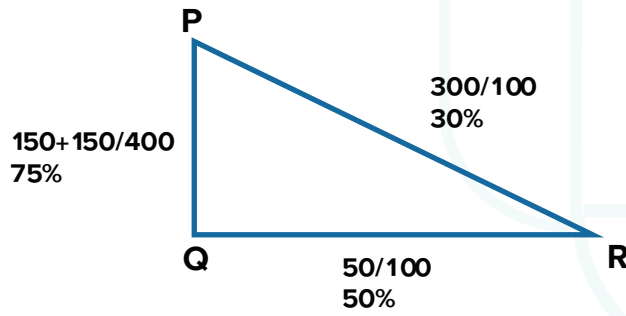
Scenario 1: The cash alternative

Provision for liability component	Dr.	60,000
To Bank A/c		60,000
Stock Options Outstanding A/c	Dr.	7,600
To General Reserve		7,600

Scenario 2: The equity alternative

Stock Options Outstanding A/c	Dr.	7,600
Provision for liability component of employees	Dr.	60,000
To Share Capital A/c (1,000 shares x Rs 10)		10,000
To Securities Premium A/c		57,600

Question 3



(i) Cum bonus shares means the shareholder will have the right to receive bonus shares issued by company which is normal course. Hence P Ltd will have the right to receive bonus shares from Q Ltd.

P Ltd holdings in Q as on 31.3.2015

$$\frac{150,000 + 150,000}{400,000} = 75\%$$

(ii) Unrealised profit on stock transfers from Q Ltd to P Ltd (Upstream)

$$30 * \frac{25}{100} * \frac{1}{2} = 3.75$$

(iii) Unrealised profit on Fixed asset transfers from R to Q (Upstream)

$$\text{Total Profits} = 20 * \frac{20}{100} = 4$$

Depreciation charged for 3 months $(5 * 10\% * \frac{3}{12}) = 1.25$

Net unrealised profit 4.875

Analysis of Profits

Reserves	20
Current year (20+30)*20%	10
Opening	10
P&L	30
Current year 12.4	
+ insurance loss of previous year	
(0.75-0.55)	0.2
	12.6
Opening	30-12.6
	17.4

Working note for consolidation

Particulars	Amount	Cap Res/GW	Con PL	MI
<i>R Ltd</i>				
Share capital	100	80(80%)		20(20%)
Reserves				
Opening(Pre)	10(Pre)	6.75(67.5%)		3.25(32.5%)
Current year	10(Post)		6.75(67.5%)	3.25(32.5%)
P&L	30			
Op	17.4 (Pre)	11.745(67.5%)		5.655(32.5%)
Current year	12.6(Post)		8.505(67.5%)	4.095(32.5%)
URP on asset	4.875 (post)		Rs-3.291(67.5%)	-1.584(32.5%)



Q Ltd				
		75%	75%	25%
Share capital	400	300		100
Reserves	10			
Opening	5(Pre)		3.75	1.25
Current	5(Post)		3.75	1.25
P&L	40			
Opening	15(Pre)	11.25		3.75
Current year	25 (Post)		18.75	6.25
URP On				
Stock(Upward)				
(30*25/125*1/3)	2(Post)		-1.5	-0.5

Consolidated Balance sheet

Particulars	Note	Rs
Equity and liabilities		
I Shareholders funds		
Share capital		600.00
Reserves and surplus		132.96
II Minority Interest		
		146.67
III Non-Current liabilities		
Long term borrowings		
IV Current liabilities		
Trade payables		75.00
Other liabilities		
		954.63



Consolidated Balance sheet

Particulars	Note	Rs
Assets		
I Non-Current assets		
Fixed assets		
Tangible	230+150+100-4.875	475.13
Intangible		46.51
Non-Current investments		
II Current Assets		
Inventories	50+30+40-2	118.00
Trade receivables		130.00
Cash and cash equivalent		185.00
		954.63

Question 4

Purchase Consideration

To equity shareholders

30,000 shares x8/6	= 40,000
Less: 1/5 already held by X Ltd.	-8,000
Less: Held by y ltd	-5000
No of shares	27,000
Value of shares 27000*10	2,70,000

To preference shareholders

<u>100,000*90%</u>	90,000
Total PC	3,60,000



Discharge of PC

Equity share capital	2,70,000
Preference share capital	90,000

Net Assets taken over from Y Ltd.

Fixed Assets	(2,50,000 × 115%)	2,87,500
Stock	(3,20,000 × 95%)	3,04,000
Debtors	(1,90,000 × 95%)	1,80,500
Bills Receivable		20,000
Cash at Bank	40000+5000-30000	15,000
Debentures	(1,50,000 × 108%)	-1,62,000
Sundry Creditors		-1,25,000
Bills Payable		<u>-25,000</u>
Net Asset taken over		4,95,000

Goodwill/cap reserve

N.A.T.O. 4,95,000

-Purchase consideration	3,60,000	
-Investments in Y Ltd	80,000	4,40,000
		55,000
-Liquidation expenses		<u>30,000</u>
Capital reserve		25,000

Note 1 Share capital

Equity shares	600000+270000	8,70,000	
Preference share capital	200,000+90000	2,90,000	11,60,000

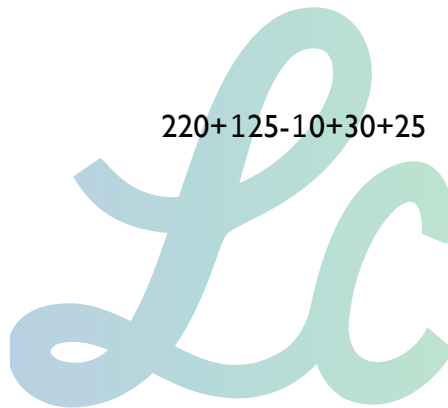
Note 2 Reserves and surplus

Capital Reserve		25,000	
Revaluation Reserve	700,000*15%	1,05,000	
Other Reserves	300,000+6000-60000	2,46,000	
-Discount on issue of debentures			
	150,000*108%*10/90	-18,000	3,58,000



Balance sheet

Particulars	Note	Rs
Equity and liabilities		
I Shareholders funds		
share capital	1	11,60,000
Reserves and surplus	2	3,58,000
II Non-Current liabilities		
Long tem borrowings	(200,000+162,000/90%)	3,80,000
III Current liabilities		
Trade payables	220+125-10+30+25	3,90,000
		22,88,000
Assets		
I Non-Current assets		
Fixed assets		
Tangible		10,92,500
II Current Assets		
Inventories	240+304	5,44,000
Trade receivables	360+180.5-10+60+20	6,10,500
Cash and cash equivalent	110-60-30+6+15	41,000
		22,88,000



Question 5(a)

Assume that total proceeds of the issue is = Rs M

Hence, interest payable every year = 6% of Rs M = 0.06M

Present value of interest (10% discount factor) = $0.06M \times \text{cumulative discount factor of 4 years}$
 $= 0.06M \times 3.17 = 0.1902M$.

Present value of the principal repayable after four years [$1.10M \times 0.68$ (10% discount factor)] = 0.748 M

Total present value of debentures (value of debt component)
 $= 0.1902M + 0.748M = 0.9382M$

Hence, amount of equity = $M - 0.9382M = \text{Rs } 1,85,400$
 $0.0618M = \text{Rs } 1,85,400$

$M = 1,85,400 / 0.0618 = \text{Rs } 30,00,000$

Therefore, total proceeds of the issue is Rs 30,00,000

Debt portion (Debenture amount) = $30,00,000 - 1,85,400 = 28,14,600$.

OR

For one debenture

FV = 100

Debt component = $\text{Coupon} \times \text{AF}[10\%, 4] + \text{Redemption Price} \times \text{DF}(10\%, 4\text{th})$
 $= 6 \times 3.17 + 110 \times 0.68$
 $= 93.82$

Equity component = $100 - 93.82 = 6.18$

	Debt	Equity
One debn	93.82	6.18
Total	?	185400
	<u>93.82×185400</u>	
	6.18	
	28,14,600	



Question 5(b)

Cost to Company in employing to Mr. X

Salary before tax $4,00,000 \times 12 = 48,00,000/0.75$	64,00,000
Add: Employee's PF contribution $(50,000 \times 12)$	6,00,000
Add: Employer's PF contribution $(50,000 \times 12)$	6,00,000
	76,00,000

Capital base

Equity Share Capital paid up (5,00,000 shares of 75 each)	3,75,00,000
Less: Calls in arrears	(1,00,000)
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	8,00,000
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 $54,65,000 + 10\% (54,65,000) + 180,000 = 61,91,500$

Maximum emoluments that can be paid to Mr. X = 61,91,500

Thus, the company is advised not to hire him as his CTC Rs 76,00,000 is more than 61,91,500

Question 6

(i) FMP

	1996	1997	1998	1999
PAT	3	3.5	4	4.1
-Bonus			(1)	
	3	3.5	4	3.1
Average profits = $(3+3.5+4+3.1)/4$				3.4



(ii) Average capital employed

Fixed assets		24
Other tangibles		3
Intangibles		3
Goodwill*		0
-Liabilities	(10+1)	(11)
Closing capital employed		19
-1/2 * (3.1)		(1.55)
Average capital employed		17.45

(iii) NRR

10%

(iv) Normal profits

17.45*10%

1.745

(v) Super profits

1.655

(vi) Goodwill

1.655*3

4.965

Average of book value and revalued = $(5+4.965)/2 = 4.9825$

Goodwill book value 5

Goodwill for purpose of valuation of shares 9.9825

Valuation of shares

Rs lakhs

Closing capital employed (As computed)	19
+Goodwill	9.98
+ Non trade Investment	0
- Preference share capital	0
Net assets available to equity shareholders	28.98
Equity share capital(total)	16
Value per rupee of share capital	$28.98/16 = 1.81$

Break up value

10 paid $1.81*10 = 18.1$

6 paid $1.81*6 = 10.86$



Market value of shares

Market values company on its earnings potential

In market , only small lot of shares are bought

relevant method of share valuation is dividend yield method

Average dividend yield(Simple*) = $(11\%+12\%+13\%+14\%)/4 = 12.5\%$

Value per share = Paid up * Actual return/normal return

For 10 paid up = $10 * 12.5\% / 10\% = 12.5$

For 6 paid up = $6 * 12.5\% / 10\% = 7.5$

Market value

10 paid 12.5

6 paid 7.5

If controlling interest is Sold

Break up value remains same as 18.1 and 10.86

Market value

Average earnings = 3.4, Paid up capital=16 Lakhs

Actual return = $3.4/16 = 21.25\%$

For 10 paid up = $10 * 21.25\% / 10\% = 21.25$

For 6 paid up = $6 * 21.25\% / 10\% = 12.75$

Market value

10 paid 21.25

6 paid 12.75

Fair value

10 paid = $(18.1+21.25)/2 = 19.68$

6 paid = $(10.86+12.75)/2 = 11.81$



Question 7(a)

Calculation of cost for closing inventory

Particulars	Rs
Cost of Purchase (1,00,000 × 100)	1,00,00,000
Direct Labour	10,00,000
Variable Overhead	1,00,000
Fixed Overhead 1,00,000 - 40,625/95,000	59,375
Cost of Production for normal output i.e. 95,000 MT	1,11,59,375
Cost of closing inventory per unit (1,11,59,375/95,000)	Rs 117.467 (approx)
Net Realisable Value per unit	Rs 105

Since, net realisable value is less than cost, closing inventory will be valued at Rs 105. Therefore, closing inventory is Rs 5,25,000 (5,000 × 105).

Note:

Abnormal wastage of 10,000 MT i.e. 10,000 MT × Rs 117.467 = Rs 11,74,670 will be separately accounted for in the books

Question 7(b)

With the introduction of AS 26 'Intangible Assets', the concept of deferred revenue expenditure no longer prevails except in respect of a very few items, such as ancillary costs on borrowings, shares issue expenses etc. AS 26 does not permit the capitalization of expenses incurred on advertising or brand promotion, etc. Thus, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crore to the P & L account of the year is correct

Question 7(c)

As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss

Question 7(d)

IAS 1 requires that in case of a loan liability, if any condition of the loan agreement which was classified as non-current is breached on the reporting date, such loan liability should be classified as current, even if the breach is rectified after the balance sheet date.

Carve Out: Ind AS 1 clarifies that where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

Reason: Under Indian banking system, a long-term loan agreement generally contains a large number of conditions. Some of these conditions are substantive, such as, recalling the loan in case interest is not paid, and some conditions are procedural and not substantive, such as, submission of insurance details where the entity has taken the insurance but not submitted the details to the lender at the end of the reporting period. Generally, customer-banker relationships are developed whereby in case of any procedural breach, a loan is generally not recalled. Also, in many cases, a breach is rectified after the balance sheet date and before the approval of financial statements. Carve out has been made as it is felt that if the breach is rectified after the balance sheet date and before the approval of the financial

statements, it would be appropriate that the users are informed about the true nature of liabilities being non-current liabilities and not current liabilities.

Question 7(e)

As per AS 11 (revised), monetary items denominated in a foreign currency should be reported using the closing rate. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item hence should be valued at the closing rate i.e. Rs. 68 at 31st March, 2018 irrespective of the payment for the same subsequently at lower rate. The difference of Rs. 5 (68 - 63) per US dollar should be shown as an exchange loss in the profit and loss account and is not to be adjusted against the cost of raw materials. In the subsequent year, the company would record an exchange gain of Re. 1 per US dollar, i.e., the difference between Rs. 68 and Rs. 67 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

