FINANCIAL REPORTING – MAY 2017 - QUESTION PAPER

Q1. **[4 × 5 = 20 Marks]**

(a) Desire Limited acquired a patent at a cost of Rs.288 lakh for a period of six years and the product life cycle is also six years. The company capitalized the cost and started amortising at Rs. 48 lakh per annum. After three years, it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these five years are expected to be ₹ 96 lakh, ₹ 144 lakh, ₹ 120 lakh, ₹ 112 lakh and ₹ 104 lakh respectively.
You are required to find out amortization cost of the patent for each of the years, as per Ind As 38.

(b) Zee Ltd. purchased raw material of 20,000 units at ₹ 10 per kilogram during the year 2016-17. They provide you with the following other information for the year ended 31st March, 2017:

Particulars	**Units**	**₹**
Opening inventory :		
Finished Goods	2,000	50,000
Raw Materials	2,200	22,000
Labour		1,53,000
Fixed overhead		1,50,000
Sales	20,000	5,60,000
Closing Inventory :		
Finished Goods	2,400	
Raw Materials	1,800	

The expected production of the finished product for the year was 30,000 units. Due to a fall in the market demand, the price of the finished goods in which the raw material is incorporated is, expected to be sold at ₹ 20 per unit. The replacement cost of raw material was ₹ 9.50 per unit on the closing day of the accounting period.
You are required to value the closing inventory as on 31st March, 2017 with reference to Ind AS 2.

(c) A contract to build a bridge across a river is under execution by a firm of contractors. From the following details, indicate the relevant disclosure that has to be made by the firm in its accounts for the year ended 31st March, 2017 under the relevant Ind A.S.

	₹ in Lakhs
Contract price	2,000
Work certified upto 31-03-2017	1,200
Work pending certification	480
Estimated further costs to complete the contract	520
Amounts received from the contractee so far	1,000
Amounts still to be received	500

(d) Mac Ltd purchased good, on credit from Toy Ltd, for ₹ 580 lakh, export. The export order was cancelled. Mac Ltd. decided to sell the same goods in the local market with a price discount. Toy Ltd. was requested to offer a price discount of 10%. Toy Ltd. wants to adjust the sales figure to the extent of the discount requested by Mac Ltd. Discuss whether such a treatment in the books of Toy Ltd. is justified as per the provisions of the relevant Ind A.S.
Also, Toy Ltd. entered into a sale deed for its Land on 15th March, 2016. But registration was done with the registrar on 20th April, 2016. But before registration, is it possible to recognize the sale and the gain at the Balance Sheet date? Give reasons in support of your answer.

Q.2 On 1st April, 2015, Vinyl Limited decided to purchase from Minal Limited its investments in two Ltd. companies i.e. Sind Ltd. and Hind Ltd. The purchase was of the entire shares of Sind Ltd. and 50% of the shares of Hind Ltd.

After acquisition by Vinyl Ltd., Hind Ltd. was to be run by Vinyl Ltd. and Minal Ltd. as a jointly controlled entity.

The terms of acquisition were as follows:

Sind Ltd.: The total consideration was based on Price Earnings Ratio of 10 applied to the reported profit of ₹ 1,80,000 of Sind Ltd. for the year 31st March, 2015. The consideration was settled by Vinyl Ltd. issuing 10% Debentures for ₹ 9,00,000 (at par) and the balance consideration was met by a new issue of ₹ 10 equity shares, based on its market value of Rs.18 each.

Hind Ltd.: The market value of Hind Ltd. on 1st April, 2015 was mutually agreed as ₹ 90,00,000. Vinyl Ltd. settled the purchase price by issuing to Minal Ltd. ₹ 10 equity shares based on its market value of Rs.18 each.

Vinyl Ltd. has not recorded in its books, the acquisition of the above investments or the payment of the consideration.

The summarized statements of financial position of the three entities at 31st March, 2016 are :

Particulars	**Vinyl Ltd. (Amount ₹)**	**Sind Ltd. (Amount ₹)**	**Hind Ltd. (Amount ₹)**
Liabilities:			
Equity Share Capital (₹ 10 each)	20,00,000	15,00,000	17,00,000
General Reserve	48,60,000	23,58,150	15,23,760
10% Debentures	12,00,000	-	-
Trade Payables	4,26,860	3,48,620	6,45,390
Provision for taxes	5,98,300	8,36,210	5,23,200
Total	**90,85,160**	**50,42,980**	**43,92,350**
Assets :			
Fixed Assets	47,22,400	27,63,000	22,90,600
Plant & Machinery	29,39,860	13,61,200	13,72,880
Inventories	8,16,400	4,28,350	3,18,610
Trade Receivables	4,29,550	3,15,720	3,00,030
Cash & Bank Balance	2,76,950	1,74,710	1,10,230
Total:	**90,85,160**	**50,42,980**	**43,92,350**

Following information is also provided to you:

(i) The current profits of Sind Ltd. and Hind Ltd. for the year ended 31st March, 2016 were ₹ 9,20,000 and ₹ 5,60,000 respectively. No dividends were paid by any of the companies during the year.

(ii) Hind Ltd., the jointly controlled entity, is to be accounted for using proportional consolidation, in accordance with Ind AS 28 “Interests in Joint Venture”.

(iii) Goodwill in respect of the acquisition of Hind Ltd. has been impaired by ₹ 2,40,000 at 31st March, 2016. Gain on acquisition, if any, will be separately accounted.

(iv) The book values of the net assets of Sind Ltd. and Hind Ltd. on the date of acquisition were considered to be a reasonable approximation to their fair values.

You are asked to prepare the Consolidated Balance Sheet of Vinyl Ltd. and its subsidiary and joint ownership as at 31st March, 2016.

[16 Marks]

Q.3 (a) Sea Ltd. has lent a sum of ₹ 10 lakhs lit 18% per annum for 10 years. The loan had a Fair Value of ₹ 12,23,960 at the effective interest rate of 13%. To mitigate prepayment risks but at the same time retaining control over the loan, Sea Ltd. transferred its right to receive the principal amount of the loan on its maturity with interest, after retaining rights over 10% of principal and 4% interest that carries Fair Value of ₹ 29,000 and ₹ 1,84,620 respectively. The consideration for the transaction was ₹ 9,90,000. The interest component retained included a 2% fee towards collection of principal and interest that has a Fair Value of ₹ 65,160. Defaults, if any, are deductible to a maximum extent of the company's claim on principal portion. You are required to show the Journal Entries to record derecognition of the Loan.

[8 Marks]

(b) Sona Ltd. is considering to takeover Hira Ltd. They provided you the following information:

Particulars	**Sona Ltd.**	**Hira Ltd.**
Earning after tax	720 lacs	86.4 lacs
Number of Equity shares	36 lacs	14.4 lacs
P.E. Ratio (Times)	10	6

You are required:

(i) To calculate market price of shares of Sona Ltd. and Hira Ltd.

(ii) To find out the swap ratio based on market price.

(iii) To compute the EPS of Sona Ltd. after takeover of Hira Ltd.

(iv) To find out the market value of merged company.

[8 Marks]

Q.4(a) Abhiram Limited is a non-banking finance company. It accepts public deposits and also deals in hire purchase business of trucks. As on 31st March, 2014, few trucks were sold on hire purchase basis. The hire purchase price was set as ₹ 400 lakhs as against the cash price of ₹ 350 lakhs. The amount was payable as ₹ 50 lakhs down payment and the balance in 5 equal installments. The hire vendor collected the first installment as on 31-03-2015, but could not collect the second installment which was due on 31-03-2016. Till15-05-2016, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 5.4%. Depreciation is to be charged at 20% per annum.

You are required to answer the following:

(i) What should be the principal outstanding as on 01-04-2015? Should the company recognize finance charges for the year 2015-2016 as income?

(ii) What should be the net book value of assets as on 31-03-2016 so far Abhiram Ltd. is concerned 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 RBI?

[8 Marks]

(b) Raghunath Ltd. belongs to an industry in which equity shares are sold at par on the basis of 18% yield provided the net assets of the company are 250% of the paid up equity capital and the total distribution of profits does not exceed 50% of the profits. The dividend rate fluctuates from year to year in the industry. The Balance Sheet of Raghunath Ltd. stood as follows on 31st March, 2017:

Liabilities	**Amount**	**Assets**	**Amount**
6,000, 14% Preference shares of Rs,100 each, fully paid up ,	6,00,000	Goodwill	1,00,000
10,000, Equity shares of Rs.100 each. Rs.80 paid up	8,00,000	Tangible fixed assets less depreciation	16,00,000
General Reserve	3,80,000	Government Securities	1,50,000
12% Debentures	4,00,000	Current Assets	11,30,000
Current Liabilities and Provisions	8,00,000		
	29,80,000		**29,80,000**

The company has been earning on an average Rs. 8,00,000 as profit after interest but before taxation which is. 50%. The rate of dividend on equity shares has been maintained at 25% in the past years and is expected to be maintained in the future also. Determine. the probable market value of the equity shares of the company based on actual dividend. The tangible assets may be taken to be worth ₹ 17,20,000 and goodwill was found to be of no worth.

[8 Marks]

Q.5 (a) S Ltd., a mobile phone manufacturing company, has hired a Marketing Consultancy Firm for doing research. The market consultancy firm provided data relating to Mobile phone industry for the next 6 years. It gave the following observations and projections:

(i) The market size in terms of basic sales of mobiles was estimated at ₹ 10,000 Crores in the last year. This includes roughly 15% of locally manufactured mobiles. Market share of this segment is expected to increase by 0.4% every year over a period of 6 years. Chinese imports accounted for 30% of the business last year. This is expected to. increase by 0.3% every year over a period of 6 years. The other large companies accounted for roughly 40% of the business value last year, which is expected to go down by 0.5% every year over a period of 6 years; due to expansion of S Ltd.' s product portfolio.

(ii) The mobile industry in the target area is expected to grow at 8% p.a. for the next three years and thereafter at 10% p.a. over the subsequent three years.

(iii) The company is in the process of developing a new technology, which will start yielding results in one year's time and increase its profitability by 2% from its existing 10%.

You are asked to calculate the Brand Value of S Ltd. under Market Oriented Approach, at the discount rate of 10%.

Discount Factor

Year	1	2	3	4	5	6
Discount Factor	0.909	0.826	0.751	0.683	0.621	0.564

[8 Marks]

(b) Ram Garments Ltd. is a company which produces and sells to retailers a certain range of fashion clothing's. They have made the following estimates of potential cash flows for the next 10 years:

Year	1	2	3	4	5	6	7	8	9	10
Cash Flows ₹ in Lakhs	1500	1700	2000	2500	3000	3400	3800	4500	5000	6000

Children Wear Ltd. is a company which owns a series of boutiques in a certain locality. The boutiques buy clothes from various suppliers and retail them. Each boutique has a manager and an assistant but all purchasing and policy decisions are taken centrally. Independent cash flow estimates of Children Wear Ltd. was as follows.

Year	1	2	3	4	5	6	7	8	9	10
Cash Flows ₹ in Lakhs	120	160	200	280	340	460	520	600	660	800

Ram Garments Ltd. is interested in acquiring Children Wear Ltd. in order to get some additional retail outlets. They make. the following cost-benefit calculations:

(i) Net value of assets of Children Wear Ltd.

	₹ in lacs
fixed Assets	800
Investment	200
Inventory	400

Less: Trade Payables	1400 400
	1000

(ii) Fixed Assets amounting to ₹ 50 lacs cannot be used and their immediate net realizable value is ₹ 45 lacs.

(iii) Inventory can be realized immediately at ₹ 470 lacs.

(iv) Investment can be disposed off for ₹ 212 lacs.

(v) Some workers of Children Wear Ltd. are to be retrenched for which estimated compensation is ₹ 130 lacs.

(vi) Trade payables are to be discharged immediately.

(vii) Liabilities on account of retirement benefits not accounted for in the Balance Sheet by Children Wear Ltd. are ₹ 48 lacs.

(viii) Expected cash flows of the combined business will be as follows:

Year	1	2	3	4	5	6	7	8	9	10
Cash Flows ₹ in Lakhs	1800	1900	2300	2950	3500	4000	4500	5300	5800	6900

Find out the maximum values of Children Wear Ltd., which Ram Garments Ltd., can quote. Also show the difference in. valuation had there been no merger. Use 20% as discount factor.
Note: For purposes of calculation, candidates can adopt the present value of one rupee discounted at 20% at .8333, .6944, .5787, .4823, .4019, .3349, .2791, .2326, .1938 and .1615 for years 1 to 10 respectively.

[8 Marks]

Q.6 The following are the extracts from the Balance Sheets of X Co. Ltd.

	As at 31st March, 2015 ₹ in Lakhs	**As at 31st March, 2016 ₹ in lakhs**		**As at 31st March, 2015 ₹ in Lakhs**	**As at 31st March, 2016 ₹ in Lakhs**
Share Capital divided into equity shares of ₹ 100 each	600	600	Fixed Assets	480	540
Reserves	100	200	Trade Investment	50	50
Surplus	75	150	Inventories	300	60
13% Debentures	225	200	Trade Receivables	90	100
Trade Payables	60	75	Cash and Cash equivalents	220	270
Provision for taxation	80	95			
	1,140	1,320		1,140	1,320

The following additional information is made available to you:

(i) The company, on the basis of an external expert valuation, estimates the replacement value of its fixed assets at ₹ 700 lakhs and ₹ 900 lakhs respectively on 31st March, 2015 and 31st March, 2016.

(ii) Fixed assets are depreciated at 10% per annum.

(iii) 20% of the inventories is slow-moving and is expected to realized only 50% of the book value for both the years.

(iv) Receivables include on 31st March, 2016, ₹ 1,00,000 taken in the books at Rs.78 per £ sterling. The applicable rate on that date was ₹ 80 per £ sterling.

(v) Profits for the year 31st March, 2016 included Rs.6 lakhs of gains on sale of capital asset a non-recurring event.

(vi) Profits for the year 31st March, 2016 were after writing off ₹ 80 lakhs of one-time development expenses.

(vii) Income Tax rate for both the years can be taken at 40% which is likely to come down to 30% the next year.

(viii) Future maintainable profits are anticipated to increase by 10% over those of the two-year period.

(ix) Normal rate of return for this line of business is 15%. The average return for units in the line of industry was 12% per annum on long term funds and 15% on equity funds.

On the basis of your calculations, kindly ascertain whether X Co. Ltd., enjoys any goodwill and if you determine that it does, show the leverage effect that it has' on the company's result.

[16 Marks]

Q.7 Answer any FOUR of the following

(a) PQR Ltd., sells agriculture products to dealers. One of the conditions of sale is that interest is payable at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2016-17 the company wants to recognize the entire interest receivable. Do you agree?

[4 Marks]

(b) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for the class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump-sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employees. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it should account for liability on an actual "on claim" basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support Of your answer.

[4 Marks]

(c) A company borrowed ₹ 50 lakhs @ 12% p.a. Tenure of the loan is 10 years. Interest is payable every year and the principal is repayable at the end of the tenth year. The company defaulted in payment of interest for the years 4, 5 and 6.

A loan reschedule agreement took place at the end of the seventh year. As per the agreement, the company is required to pay ₹ 90 lakhs at the end of the eighth year. Calculate the additional amount to be paid on account of rescheduling and also the book value of loan at the end of the eighth year when the rescheduled agreement took place.

[4 Marks]

(d) Explain the carve outs in Ind AS 103 from IFRS 3 along with reasons. **[4 Marks]**

(e) Sky Limited are Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract.

As per the terms of the contract, Dee Limited will receive an additional ₹ 50 Lakhs if the construction of the flyover were to be finished within a period two years of the commencement of the contract. The Accountant of the Dee Limited wants to recognise this revenue since in the past the company has been able to meet similar targets very easily.

With reference to relevant Accounting Standard, discuss whether the accountant's proposal to recognize incentive receipt as contract revenue is correct or not.

[4 Marks]