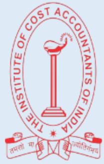

FINAL EXAMINATION — SET 1

MODEL ANSWERS — TERM – JUNE 2023

PAPER - 18

CORPORATE FINANCIAL REPORTING

Time Allowed: 3 Hours | **Full Marks: 100**

The figures in the margin on the right side indicate full marks.

Where considered necessary, suitable assumptions may be made and clearly indicated in the answer.

Answer Question No. 1 and 8 are compulsory; Answer any four from Question No. 2, 3, 4, 5, 6 & 7.

SECTION - A

1. (a) Choose the correct alternative. Provide justification in each case. 1 mark is allotted for correct selection and 1 mark for the justification.: [10 × 2 = 20]

<table>
<tr><th>Sl. No.</th><th>Answer</th><th>Justification</th></tr>
<tr><td>(i)</td><td>(b)</td><td>Bad debts of ₹40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹20,000 to the next quarter. Therefore, ₹20,000 should be deducted from ₹7,20,000. Hence the correct quarterly income = ₹ (7,20,000 – 20,000) = ₹7,00,000.
So, the correct answer is (b)</td></tr>
<tr><td>(ii)</td><td>(b)</td><td>Conglomerate merger involves coming together of two or more companies engaged in the different industry and/or services. Their businesses or services are neither horizontally not vertically related to each other. They lack any commonality either in their product, or in the rendering of any specific type of service to the society.
So, the correct answer is (b)</td></tr>
<tr><td>(iii)</td><td>(c)</td><td>
<table>
<tr><th>Particulars</th><th>₹ in lakhs</th></tr>
<tr><td>Carrying Amount in the beginning of 7th year [60 – (60 – 4) × 6/10]</td><td>26.40</td></tr>
<tr><td>Add: Upward Revaluation (26.4 × 50%)</td><td>13.20</td></tr>
<tr><td>Carrying Amount at the end of 7th year before Dep.</td><td>39.60</td></tr>
<tr><td>Less: Depreciation [(39.6 – 4)/4)</td><td>(8.90)</td></tr>
<tr><td>Carrying Amount in the beg. of the 8th year (including revaluation amount of 13.2 lakhs)</td><td>30.70</td></tr>
<tr><td>Less: Current Recoverable Amount (being Net Selling Price or Value in use whichever is higher)</td><td>(12.00)</td></tr>
</table>
</td></tr>
</table>

<table>
<tr><td></td><td></td><td>
<table>
<tr><td>Impairment Loss</td><td>18.70</td></tr>
<tr><td>Less: Impairment Loss Charged to Revaluation Reserve</td><td>(13.20)</td></tr>
<tr><td>Impairment Loss charged to Profit and Loss Account</td><td>5.50</td></tr>
</table>
So, the correct answer is (c)</td></tr>
<tr><td>(iv)</td><td>(c)</td><td>The features of Government Accounting inter alia include Reporting of Utilisation of Funds, Double Entry System and Fund-based Accounting.
Hence, the correct answer is (c).</td></tr>
<tr><td>(v)</td><td>(a)</td><td>₹ 360 Lakhs is correct option as detailed below:
NCI = 40% of ₹ (1,800 - 900) Lakhs = ₹ 360 Lakhs
Hence, the correct answer is (a).</td></tr>
<tr><td>(vi)</td><td>(b)</td><td>As per Ind AS 21, exchange difference of monitory items should be transferred to Profit & Loss A/c. Here loss to be debited to Profit & Loss A/c in 2018-19 is ₹ (1,00,000 x 79.00) - (1,00,000 x 78.60) = ₹40,000.
Hence, the correct answer is (b).</td></tr>
<tr><td>(vii)</td><td>(d)</td><td>As per Ind AS, financial assets are:
a. cash;
b. an equity instrument of another entity;
c. a contractual right:
Hence, the correct answer is (d).</td></tr>
<tr><td>(viii)</td><td>(d)</td><td>The ESG criteria largely used are (i) Environmental Test Criterion, (ii) Social Test Criterion and (iii) Governance Test Criterion.
Hence, the correct answer is (d).</td></tr>
<tr><td>(ix)</td><td>(a)</td><td>According to Ind AS 103, Business Combination, an entity shall account for each business combination by applying the Acquisition Method.
Hence, the correct answer is (a).</td></tr>
<tr><td>(x)</td><td>(a)</td><td>Average net profit = (20 + 15 + 10)/3 = ₹15.00 Cr.
Minimum CSR expenditure = ₹ 15.00 cr. x 2% = ₹30,00,000
Eligible CSR expenditure incurred = ₹7,00,000
Shortfall = ₹23,00,000
Hence, the correct answer is (a).</td></tr>
</table>

SECTION – B

2. (a) (i) Computation of average accumulated expenses

Particulars	₹
5,00,000 x 12/12	5,00,000
12,00,000 x 8/12	8,00,000
2,00,000 x 3/12	50,000
	13,50,000

Non-specific borrowings
= Average accumulated capital expenses – specific borrowings
= 13,50,000 – 8,00,000 = 5,50,000

Interest on average accumulated expenses

Particulars	₹
Specific borrowings (8,00,000 x 10%)	80,000
Non-specific borrowings (5,50,000 x 12%)	66,000
Amount of interest to be capitalised	1,46,000

Total expenses to be capitalised for plant

Particulars	₹
Cost of the plant (500000 + 1200000+200000)	19,00,000
Add: Amount of interest to be capitalised	1,46,000
Total cost of plant	20,46,000

So, the management should capitalised ₹1,46,000 amount of interest and as a result the cost of the plant will be ₹20,46,000.

(ii) Depreciation method helps accountants in aligning the recognition of cost with the benefits rendered by asset as per the requirement of Ind AS 16 that requires rate of depreciation to match the rate at which benefits are extracted from the asset. Thus, depreciation method in itself is an estimation of consumption of utility in the asset.
On the same footings, change in depreciation method is not a change in accounting policy rather it is a change in accounting estimate. Change in accounting policy only occurs if rules of either recognition, measurement or presentation of line item are changed. Change in depreciation method changes neither of these. Therefore, it is a change in accounting estimate.

This is further confirmed by IAS 8's definition of change in accounting estimate.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Depreciation is an adjustment of carrying amount of asset over its useful life to correctly project the state of affairs of business. Hence, it is a change in accounting estimate and not in policy.

(b) Business Combination under Common Control

Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. Accordingly, common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.

Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interests method.

Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.

For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

3. (a) Immediate cash payment = ₹ 15.00 lakh

Fair value of contingent consideration [$3.63/1.1 + 3.63/(1.1)^2$] = ₹6.30 lakh

Total purchase consideration = 15.00 + 6.30 = ₹ 21.30 Lakh

(b) N Ltd. having the control over MN Ltd., it is considered a reverse acquisition and in the merged balance sheet, assets and liabilities of N Ltd. would be shown at carrying amount.

(₹ in lakhs)

	M Ltd.	N Ltd.
Fair Value of Business	15,000	30,000
Share of each company in the merged company	1/3	2/3

Fair value per share of N Ltd. = ₹30,000/2,000 = ₹15

Consideration payable by N Ltd. to M Ltd. is ₹15,000/15 = 1,000 lakh shares

Or, No. of shares held by N Ltd. for 2/3 share in MN Ltd. = 2000 lakh shares; no. of shares to be issued to M for 1/3 share = 1,000 lakh.

Thus, total consideration = 1,000 lakh shares of ₹ 10 each at ₹ 5 premium = ₹15,000 lakh.

Particulars	Note	(₹ in lakh)
Assets		
Non-Current Assets		
PPE (16000 + 16000)		32,000
Financial Assets		2,600
Current Assets (10000 + 13000)		23,000
Total		57,600
Equity and Liabilities		
Equity		
Equity Share Capital 3000 (2000 + 1000) lakh shares of ₹ 10		30,000
Other Equity	Note 1	11,600
Borrowings (4,000 + 6,000)		10,000
Current Liabilities (4,000 + 2,000)		6,000
Total		57,600

Note 1: Calculation for Gain on Bargain Purchase and Other Equity

Particulars	₹ in lakh
PPE	16,000
Financial Assets	1600
Current Assets	10,000
	27,600

Particulars	
Borrowings	4,000
Current Liabilities	4,000
	8,000
Net Assets	19,600
Consideration	15,000
Gain on Bargain Purchase	4,600

Other Equity = Other Equity of N + Gain on Bargain Purchase + security premium
= ₹ (2,000+4,600+5,000) = ₹11,600

4. (a) (i) Calculation of reportable segments (amount '₹000)

	A	B	C	D	E	F	G	H	Total (segment)
1. Segment Revenue									
(a) External Sales	-	1326	74	50	26	250	100	174	2000
(b) Inter Segment Sales	500	300	150	26	-	-	24	-	1000
Total	500	1626	224	76	26	250	124	174	3000
2. Segment Results Total Profit (Total Loss)	30	(540)	90	(30)	48	(30)	30	42	
3. Segment Assets	60	20	20	240	12	20	20	8	400

10% of total revenue of all segments = 300
Reportable segments under revenue criterion = A and B
10% of segment result (higher of total profit or loss in absolute figure) = 60
Reportable segments under result criterion = B and C
10% of total segment assets = 20
Reportable segments under asset criterion = A and D
Thus, the reportable segments are A, B, C and D.
Total external revenue of segments selected as above = Nil + 1326+ 74 + 50 = 1450
75% of aggregate external revenue = 75% of 2000 = 1500
To meet the threshold, segment F may be identified.
So, the reportable segments are A, B, C, D and F.
Alternatively, Segment G or H can also be selected instead of F.

(ii) As per Ind As 36, the revised carrying amount of the asset would be ₹3,90,000

The tax base of the asset = ₹4,80,000

Carrying base of the asset = ₹3,90,000

Since tax base is higher than carrying base of the asset, so deferred tax asset would be created on the temporary difference of ₹ (4,80,000 – 3,90,000) = ₹90,000 at the given tax rate of 30%.

Hence, deferred tax asset = 90,000 x 30% = ₹27,000

(b) Fair value of net assets = ₹14,40,000. Purchase Consideration = ₹12,60,000

NCI (at fair value) = ₹12,60,000 x $\frac{30\%}{70\%}$ = ₹5,40,000 (considering PC as base)

Goodwill = Purchase consideration + NCI – Fair value of net assets

= ₹12,60,000 + ₹5,40,000 – ₹14,40,000 = ₹3,60,000

Number of equity shares issued = ₹12,60,000 ÷ ₹12 = 1,05,000

The treatment will be as under:

A Ltd. (in Consolidated Accounts)

Journal

Particulars	Dr. (₹)	Cr. (₹)
Net Assets A/c................................ Dr.	14,40,000	
Goodwill A/c..................................Dr.	3,60,000	
To Consideration A/c		12,60,000
To NCI A/c		5,40,000
Consideration A/c............................. Dr.	12,60,000	
To Equity Share Capital A/c (105,000 x ₹10)		10,50,000
To Securities Premium A/c (105,000 x ₹2)		2,10,000

5. (a) 1. Calculation for capital employed ₹ In Lakhs

Assets: Land and Buildings		3,200
Plant and Machinery		1,800
Stock		1,450
Debtors		360
Cash and Bank		220
		7,030
Less: Liabilities:		
Debentures	1,000	
Creditors	800	1,800
		5,230

2. Calculation of Actual Profit

	₹ in Lakhs
Average Profit before Tax (given) Less: Income from Investment (₹ 500 lakh × 10%)	2,400 50
	2,350
Less: Income Tax @ 30%	705
Average Actual Profit	1,645

3. Normal Profit = 12% of Capital Employed = ₹ 5,230 Lakhs ×12% = ₹ 627.60 Lakhs

4. Super Profit = Average Actual Profit - Normal Profit

= ₹ 1,645 Lakhs – ₹ 627.60 Lakhs = ₹ 1,017.40 Lakhs

5. Goodwill = Super Profit × 2 = ₹ 1,017.40 Lakhs × 2 = ₹ 2,034.80 Lakhs

(b) RBI has prescribed that, for an NBFC, income recognition should be based on recognised accounting principles. However, Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India shall be followed in so far as they are not inconsistent with any of these Directions.

Following are the guidelines to be followed.

a. The income recognition of NBFCs, irrespective of their categorisation, shall be based on recognised accounting principles.

b. Income including interest/ discount/ hire charges/ lease rentals or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non- performing and remaining unrealised shall be reversed.

c. Income like interest /discount /any other charges on NPAs shall be recognised only when actually realised, RBI also requires that income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA.

d. The NBFCs are required to recognise income from dividends on shares of corporate bodies and units of mutual funds on cash basis, unless the company has declared the dividend in AGM and right of the company to receive the same has been established, in such cases, it can be recognized on accrual basis.

e. Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on accrual basis provided it is paid regularly and is not in arrears.

f. Income on securities of corporate bodies or public sector undertakings may be taken into account on accrual basis provided the payment of interest and repayment of the security has been guaranteed by Central Government.

6. Working Notes:

1. Analysis of profits of S:

   Opening P/L = Other Equity at the end + Dividend – Profits for the year

   = ₹ (15,000 + 9,000 - 20,000) = ₹ 4,000

2. Net Assets identified on acquisition in the mid of the year, represented by Value of Equity of S

   = ₹25,000 + Pre acquisition profits (Opening P/L + 50% of yearly profit)

   = ₹ (25,000 + 4,000 + 10,000) = ₹ 39,000 (A)

3. Goodwill = B + C - A = ₹ (15,600 + 30,000 – 39,000) = ₹6,600

   Where: A = ₹ 39,000

   B = NCI = 40% × ₹ 39,000 = ₹15,600

   C = Consideration = Investment in shares of S = ₹ 30,000.

4. NCI at the reporting date

   = NCI at acquisition + Share of NCI in post-acquisition profits of S – Dividend payable to NCI

   = ₹15,600 + 40% × ₹10,000 (50% of yearly profit) - 40% × 9000 (dividend payable to be shown separately)

   = ₹15,600 + ₹4,000 – ₹3,600 = ₹16,000.

5. Consolidated Other Equity = R's Other Equity + Share from Post acquisition profits of S

   = ₹25,000 + 60% × ₹10,000 = ₹31,000

6. Separate Other Equity = ₹ 25,000 + ₹ 2,700 (post-acquisition profits) = ₹ 27,700

	In R's Book	
	Separate ₹ Lakhs	**Consolidated ₹ Lakhs**
Goodwill (3)		6,600
PPE = ₹ (50,000 + 30,000)	50,000	80,000
Investment in shares of S ₹ (30,000 – 2,700 Pre-acquisition Dividend)	27,300	
Current Assets ₹ (20,000 + 5,400 Dividend Receivable)	25,400	48,000#
	1,02,700	1,34,600
Equity Shares	60,000	60,000
Other Equity (5)	27,700	31,000
NCI (4)		16,000
Current Liabilities		
Trade Payables	15,000	24,000
Dividend Payable (to NCI)		3,600
	1,02,700	1,34,600

(20000 + 28000 = 48000); In Consolidated balance sheet Inter-company dividend is set off and does not appear.

7. (a) In today's competitive world, corporate organizations with a transparent and fair image receive added attention from various stakeholders. Especially, investors are increasingly applying various nonfinancial factors as part of their analysis process to identify material risks and growth opportunities. In this process, corporates are being judged on three important aspects namely, economic, environmental and social aspects. Thus, ESG reporting has become immensely important. Each and every corporate house needs to disclose all the facts and figures relating to its contributions made towards the protection of environment and society as well as it should disclose all the essential economic information in front of the stakeholders.

Importance of ESG Reporting

The importance of ESG Reporting can be assessed based on the following five broad aspects:

a. ESG risks and opportunities have potential impact on shareholder's value.

b. Today, most of the investors wish to integrate the business with environment and society to generate sustainable profits in responsible manner.

c. ESG Reporting analyses how the business operations of the company impact the environment both directly as well as indirectly.

d. ESG Reporting analyses how a company manages relationships with its stakeholders, regardless of where it operates.

e. ESG reporting highlights on various dimensions of corporate governance.

Annual report, in spite of incorporating many mandatory reporting tools, often fails to identify the corporates' ESG performance. A separate ESG reporting can do a lot to meet this gap.

(b) Although the basic principles of financial accounting that are applicable in regular commercial activities apply to the government accounts, there are certain features of governmental accounting which make it quite different from that of regular commercial accounting. The differences between commercial and government accounting have been presented hereunder:

a. Meaning: The accounting system applied in the government departments, offices and institutions is referred to as government accounting. While, the system of accounting applied by non-government organizations (whether profit-oriented or non-profit oriented) is known as commercial accounting.

b. Objective: Government accounting is maintained by the government offices for recording and reporting the utilisation and position of public funds. Commercial accounting is maintained by business organizations to know the

profit or loss for an accounting period and disclose the financial position of the entity.

c. Scope: The government accounting happens to be more elaborate that that followed in commercial accounts.

d. Budget: Government accounting is directly influenced by the government budgeting system, while commercial accounting does not follow the government budgeting system.

e. Basis: Government accounting is prepared on cash basis. On the other hand, commercial accounting may be done on cash basis or accrual basis, or sometimes even on hybrid basis.

f. Level of Accounting: Government accounting has the system of central level and operating level accounting. Commercial accounting has no provision of central level and operating level accounting.

g. Rules and Provisions: Government accounting is strictly maintained by following the financial rules and provisions as set by the concerned government. Commercial accounting is maintained by following the applicable rules and the 'Generally Accepted Accounting Principles' (GAAP).

h. Information: Government accounting provides information to the government about the receipts, deposit, transfer and utilisation of public funds. Commercial accounting provides information to the various stake-holders about the operating result and financial position of the business.

i. Auditing: The audit the books of accounts maintained by government departments, offices or institutions are to be audited by a recognised department of the government (namely, the Auditor General Office); while the books of accounts maintained under commercial accounting is audited by any professional auditor.

SECTION – C

8. **Calculation of Closing Trading Capital Employed**

Particulars	Amount (₹)	Amount (₹)	Amount (₹)
Plant and Machinery		12,30,000	
Add. New Machinery	40,000		
Less. Depreciation (40000x15%x3)	18,000		
		22,000	
		12,52,000	
Add. Appreciation @ 25%		3,13,000	
Current market value of P/M			15,65,000
Add. Trade investment (200000x30%x120%)			72,000
Add. Stock			4,20,000
Add. Sundry Debtors			1,00,000
Add. Cash at bank			7,00,000
			28,57,000
Less. S. Creditors and STL			7,40,000
Closing trading capital employed			21,17,000

Calculation of Annual Maintainable Trading Profit After Tax

	2018-19 (₹)	2019-20 (₹)	2020-21 (₹)
Profit after tax	1,00,000	95,000	1,05,000
Add. Machinery wrongly treated as revenue (after tax) [40,000 x 60%]	24,000		
Less. Depreciation on the above after tax	3,600	3,600	3,600
Less. Income from non-trading investment 2,00,000x70%x20% x 60%	16,800	16,800	16,800
	1,03,600	74,600	84,600

Average Annual Maintainable Trading Profit After Tax

= (1,03,600+74,600+84,600)/ 3 = 87,600

Calculation of Average Trading Capital Employed

Closing trading capital employed	₹21,17,000
Less. ½ of current year's trading profit after tax (84,600 x 1/2)	₹42,300
	₹20,74,700

Calculation of Super Profit

Average Annual Maintainable Trading Profit After Tax	₹87,600
Less. Normal return on average trading capital employed (20,74,700 x 15%)	₹3,11,205
	(-)₹ 2,23,605

Value of goodwill = Nil (Since super profit is negative)

Calculation of Net Assets available to ESH

Particulars	₹
Trading capital employed	21,17,000
Add. Goodwill	Nil
Add. Non-trading investment (200000 x 70%) x120%	1,68,000
	22,85,000
Less. Preference shareholders' claim	4,00,000
Net Assets available to ESH	18,85,000

Value of each fully paid equity share = 18,85,000/100000 = ₹18.85