MOCK TEST PAPER – 1

FINAL OLD COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

*Question No. **1** is compulsory.*

*Attempt any **five** questions from the remaining **six** questions.*

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidates.

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Great Ltd. was incorporated for the purpose of acquiring S Ltd. The Balance Sheet of the company as on 31st March, 2021 is as follows:

Particulars	*Rs.*
Property, plant and equipment at cost less depreciation	5,00,000
Other assets	2,00,000
10% Debentures	70,000
Sundry creditors	80,000
Average annual profits before debenture interest	90,000
Professional valuation of Property, plant and equipment on 31st March, 2021	6,20,000

1. The Directors in their negotiations agreed that (i) the other assets of the S Ltd. are worth Rs. 1,30,000; (ii) the valuation of 31st March in respect of Property, plant and equipment should be accepted.
2. The acquisition agreement provides to issue to shareholders, Rs. 10 nominal value ordinary shares for the value of the net assets of S Ltd. and to issue 12% Unsecured Debentures for the capitalized average profits of the acquired company in excess of the net assets contributed. The capitalization rate is taken at 10%.

You are required to calculate purchase consideration and show the purchase consideration as discharged.

(b) Support Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is Rs. 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by Rs. 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of the second year and any charge to the Statement of profit and loss.

(c) From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

Cost of asset	Rs. 56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	Rs. 27.30 lakhs
Useful life remaining	3 years
Recoverable amount	Rs. 12 lakhs
Upward revaluation done earlier	Rs. 14 lakhs

The company did not opt for adjustment of additional depreciation from revaluation reserve account.

(d) N Ltd. sells beer to customers; some of the customers consume the beer in the bars run by N Ltd. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting these empty bottles which are sold by the company by calling the tenders. Keeping this in view:

(i) Decide whether the stock of empty bottles is an asset of the company;

(ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'? **(4 × 5 = 20 Marks)**

2. The draft Balance Sheets of 3 Companies as at 31st March, 2021 are as below:

	(Rs. in thousand)		
Liabilities	M Ltd.	E Ltd.	N Ltd.
Share Capital – shares of Rs. 100 each	40,000	20,000	10,000
Reserves	1,800	1,000	900
P/L A/c (1.4.2020)	1,500	2,000	800
Profit for 2020-2021	7,000	3,800	1,800
Loan from M Ltd.	–	5,000	–
Creditors	2,500	1,000	1,400
	52,800	32,800	14,900
Assets			
Investments:			
1,60,000 shares in E Ltd.	18,000	–	–
75,000 shares in N Ltd.	8,000	–	–
Loan to E Ltd.	5,000	–	–
Sundry assets	21,800	32,800	14,900
	52,800	32,800	14,900

Following additional information is also available:

(a) Dividend is declared by each company at 10% on 31st March, 2021.

(b) Stock transferred by N Ltd. to E Ltd. was Rs. 8 lacs on which the former made a profit of Rs. 3 lacs. On 31st March, 2021, this was in the inventory of the latter.

(c) Loan referred to is against 8% interest. Neither M Ltd. nor E Ltd. has considered the interest.

(d) Reserves as on 1.4.2020 of E Ltd. and N Ltd. were Rs. 8,00,000 and Rs. 7,50,000 respectively.

(e) Cash-in-transit from E Ltd. to M Ltd. was Rs. 1,00,000 as on 31.3.2021.

(f) The shares of the subsidiaries were all acquired by M Ltd. on 1st April, 2020.

Prepare Consolidated Balance Sheet as on 31st March, 2021. Workings should form part of the answer. **(16 Marks)**

3. Better Ltd. and Best Ltd. are two companies. On 31st March, 2021 their summarised Balance Sheets were as under: (Rs. in crores)

	Better Ltd.		Best Ltd.	
Sources of funds:				
Share Capital:				
Authorised:		500		500
Issued: Equity shares of Rs. 10 each fully paid up		300		200
Reserves and surplus:				
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	10	750	5	450
Owners' funds		1,050		650
Loan funds		250		350
		1,300		1,000
Fund employed in:				
Property, plant and equipment				
Cost	1,000		700	
Less: Depreciation	(400)	600	(300)	400
Net current assets:				
Current assets	2,000		1,500	
Less: Current liabilities	(1,300)	700	(900)	600
		1,300		1,000

Better Ltd. has 2 divisions, very profitable division A and loss making division B. Best Ltd. similarly has 2 divisions, very profitable division C and loss making division D.

The two companies decided to reorganize. Necessary approvals from creditors and members and sanction by High Court have been obtained to the following scheme:

1. Division B of Better Ltd. which has property, plant and equipment costing Rs. 400 crores (written down value Rs. 160 crores), Current assets Rs. 900 crores, Current liabilities Rs. 750 crores and loan funds of Rs. 200 crores is to be transferred at Rs. 125 crores to Best Ltd.

2. Division D of Best Ltd. which has property, plant and equipment costing Rs. 500 crores (depreciation Rs. 200 crores), Current assets Rs. 800 crores, Current liabilities Rs. 700 crores, and loan funds Rs. 250 crores is to be transferred at Rs. 140 crores to Better Ltd.

3. The difference in the two considerations is to be treated as loan carrying interest at 15% per annum.

4. The directors of each of the companies revalued property, plant and equipment taken over as follows:

   (i) Division of D of Best Ltd. taken over: Rs. 325 crores.

   (ii) Division B of Better Ltd. taken over: Rs. 200 crores.

All the other assets and liabilities are recorded at the balance sheet values.

(a) The directors of both the companies ask you to prepare the balance sheets after reconstruction (showing the corresponding figures before reconstruction).

(b) Master Win, who owns 50,000 equity shares of Better Ltd. and 30,000 equity shares of Best Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above reorganizations. **(16 Marks)**

4. (a) Prosperous 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 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 Prosperous Ltd. stood as follows on 31st March, 2021:

Liabilities	Rs.	Assets	Rs.
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	Property, plant and equipment 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.

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 Rs. 17,20,000 and goodwill was found to be of no worth. **(12 Marks)**

(b) State the differences between AS 10 'Property, Plant and Equipment' and Ind AS 16 'Property, Plant and Equipment' **(4 Marks)**

5. (a) On the basis of the following information, prepare a note on share capital to the financial statements of 2020-2021 as per the Division I of Schedule III to the Companies Act, 2013:

S.No.	*Date*	*Particulars*
1.	31st March, 2020	Authorised share capital of 80,000 equity shares of Rs. 10 each
2.	31st March, 2020	Issued share capital of 70,000 equity shares of Rs. 10 each
3.	31st August, 2020	Issued 5,000 equity shares as right shares
4.	1st October, 2020	5,000 shares were issued to the public at an application amount of Rs. 5
5.	1st December, 2020	Allotment money of Rs. 5 was called in the last quarter of the year.
6.	1st January, 2021	Mr. Y to whom 100 shares were allotted failed to pay the allotment money
7.	February, 2021	Issued 10,000 shares to the employees against the stock options granted them three years back
8.	February, 2021	For the purpose, the company raised its authorised share capital to 1,00,000 shares of Rs. 10 each by proper resolution

(10 Marks)

(b) At the beginning of year 1, an enterprise grants 10,000 stock options to a senior executive, conditional upon the executive remaining in the employment of the enterprise until the end of year 3. The exercise price is Rs. 40. However, the exercise price drops to Rs. 30 if the earnings of the enterprise increase by at least an average of 10 per cent per year over the three-year period.

On the grant date, the enterprise estimates that the fair value of the stock options, with an exercise price of Rs. 30, is Rs. 16 per option. If the exercise price is Rs. 40, the enterprise estimates that the stock options have a fair value of Rs. 12 per option. During year 1, the earnings of the enterprise is 12 per cent, and the enterprise expects that earnings will continue to increase at this rate over the next two years. The enterprise, therefore, expects that the earnings target will be achieved, and hence the stock options will have an exercise price of Rs. 30. During year 2, the earnings of the enterprise is 13 per cent, and the enterprise continues to expect that the earnings target will be achieved.

During year 3, the earnings of the enterprise is only 3 per cent, and therefore the earnings target was not achieved. The executive completes three years' service, and therefore satisfies the service condition.

Because the earnings target was not achieved, the 10,000 vested stock options have an exercise price of Rs. 40.

Calculate the due amount to be charged to Profit and Loss Account every year on account of compensation expenses. **(6 Marks)**

6. (a) A Mutual Fund raised Rs. 100 lakhs on April 1, 2021 by issue of 10 lakh units of Rs. 10 per unit. The fund invested in several capital market instruments to build a portfolio of Rs. 90 lakhs. The initial expenses amounted to Rs. 7 lakh. During April, 2021, the fund sold certain securities of cost Rs. 38 lakhs for Rs. 40 lakhs and purchased certain other securities for Rs. 28.20 lakhs. The fund management expenses for the month amounted to Rs. 4.50 lakhs of which Rs. 0.25 lakh was in arrears. The dividend earned was Rs. 1.20 lakhs. 75% of the realized earnings were distributed. The market value of the portfolio on 30.04.2021 was Rs. 101.90 lakh. Determine NAV per unit. **(8 Marks)**

(b) On 1st April, 2021, Delta Ltd. issued Rs. 30,00,000, 6% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.2025 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%. You are required to separate equity and debt portion as on 01.04.2021. The present value of Rs. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

	6%	10%
End of year 1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

(8 Marks)

7. Answer any **four** of the following:

(a) A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

(b) Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company.

(c) B Ltd. entered into a sale deed for its immovable property with A Ltd. before the end of the year and that property was given for use to A Ltd. at the same time. Registration was done with the registrar subsequent to Balance Sheet date, but before finalization of accounts. Is it possible to recognize the sale and the gain at the Balance Sheet date? Give your view with reasons.

(d) Rich Bank has a criterion that it will give loans to companies that have an "Economic Value Added" greater than zero for the past three years on an average. The bank is considering lending money to a small company that has the economic value characteristics shown below. The data relating to the company is as follows:

(i) Average operating income after tax equals Rs. 25,00,000 per year for the last three years.

(ii) Average total assets over the last three years equals Rs. 75,00,000.

(iii) Weighted average cost of capital appropriate for the company is 10% which is applicable for all three years.

(iv) The company's average current liabilities over the last three years are Rs. 15,00,000.

Does the company meet the bank's criterion for a positive economic value added?

(e) From the following details, compute according to Lev and Schwartz (1971) model, the value of human resources of the employees.

(i)	Annual average earnings of an employee till the retirement age	Rs. 30,000
(ii)	Age of retirement	62 years
(iii)	Discount rate	15%
(iv)	No. of employees	50
(v)	Average age	60 years

(4 x 4 =16 Marks)