MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/HINTS

1. (a) 1. Computation of Net Assets

Particulars	₹
Property, plant and equipment (as per valuation)	6,20,000
Other Assets (as per agreement)	1,30,000
Total Assets	7,50,000
Less: Sundry Creditors	(80,000)
10% Debentures	(70,000)
Net Assets	6,00,000

2. Settlement of Purchase Consideration

Particulars	₹
Average annual profits (before debenture interest)	90,000
Less: Debenture interest	(7,000)
Average annual profits (after debenture interest)	83,000
Capitalisation @ 10%	8,30,000
Less: Net assets as calculated above to be settled by shares	(6,00,000)
Excess to be settled by debentures	2,30,000
Issue by Great Ltd.	
- 12% Debentures	2,30,000
- Equity shares	6,00,000
Total purchase consideration	8,30,000

(b) In the case of tax free companies, no deferred tax liability or asset is recognized in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

In the first year, out of ₹ 200 lakhs, ₹ 80 lakhs will reverse in the tax holiday period. Therefore, Deferred Tax Liability will be created on remaining timing difference of ₹ 120 lakhs @ 35% (i.e.) ₹ 42 lakhs.

In the second year, the entire ₹ 400 lakhs will reverse only after the tax holiday period. Therefore, deferred tax charge in the Statement of Profit and Loss for the second year will be ₹ 400 x 35% = 140 lakhs and total deferred tax liability in the Balance Sheet will be (42+140) = ₹ 182 lakhs.

(c) According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset, to the extent, that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment

	₹
Current carrying amount (including revaluation amount of ₹ 14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to ₹ 12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹ 4,00,000.

(d) **(i)** Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. N Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

(ii) As per AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Stock of empty bottles existing on the Balance Sheet date is the inventory and N Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence stock of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

2. Consolidated Balance Sheet of M Ltd. with its subsidiaries E Ltd. and N Ltd.

As on 31st March, 2021

Particulars	*Note No.*	*(₹ in thousand)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital		40,000
(b) Reserves and Surplus	1	11,645
(2) **Minority Interest**	2	8,005
(3) **Current Liabilities**		
(a) Trade payables	3	4,900
(b) Other current liabilities	4	4,650
Total		69,200
II. **Assets**		
(1) Non-current assets		
(a) Property, plant and equipment	5	69,200
Total		69,200

Notes to Accounts

			(₹ in thousand)	*(₹ in thousand)*
1.	Reserves and surplus			
	Capital Reserve [Refer Note 5]		902.5	
	General Reserve	₹		
	M Ltd.	1,800		
	E Ltd.	160		
	N Ltd.	112.5	2,072.5	
	Profit & Loss A/c	₹		
	Balance on 1.04.2020	1,500		
	Profit during 2020-2021	7,000		
	Add: Interest on Loan	400		
		8,900		
	Less: Dividend payable	(4,000)		
		4,900		
	Add: P & L of E Ltd.	2,720		
	Add: P & L of N Ltd.	1,050	8,670	11,645

2.	Minority interest			
	E Ltd.		4,880	
	N Ltd.		3,125	8,005
3.	Trade payables			
	Creditors			
	M Ltd.		2,500	
	E Ltd.		1,000	
	N Ltd		1,400	4,900
4.	Other current liabilities			
	Dividend payable			
	M Ltd.		4,000	
	E Ltd. (Minority)		400	
	N Ltd. (Minority)		250	4,650
5.	Property, plant and equipment			
	M Ltd.		21,800	
	E Ltd.	32,800		
	Less: Unrealized profit N Ltd.	(300)	32,500	
	N Ltd.		14,900	69,200

Workings Notes:

A. M Ltd.'s holding in E Ltd. is 1,60,000 shares out of 2,00,000 shares, i.e., 4/5th or 80%; Minority holding 1/5th or 20%.

B. M Ltd.'s holding in N Ltd. is 75,000 shares out of 1,00,000 shares, i.e., 3/4th or 75%; Minority holding 1/4th or 25%.

Analysis of Reserves and Profits of Subsidiary Companies

		E Ltd. (₹'000)	*N Ltd (₹ '000)*	*Minority interest in E Ltd. (1/5) (₹ '000)*	*Minority interest in N Ltd. (1/4) (₹ '000)*
1.	**Reserve (pre-acquisition reserves and profits)**				
	Reserves on 1.04.2020	800	750		
	Profit on 1.04.2020	2,000	800		
		2,800	1,550		
	Less: Minority interest	(560)	(387.5)	560	387.5
		2,240	1,162.5		

2.	**Reserve (post-acquisition)**				
	Reserves as per Balance Sheet	1,000	900		
	Less: Reserve (pre-acquisition)	(800)	(750)		
		200	150		
	Less: Minority interest	(40)	(37.5)	40	37.5
		160	112.5		
3.	**Profit and Loss Account**				
	Profit for the year as per Balance Sheet	3,800	1,800		
	Less: Interest on Loan (5,000 x 8%)	(400)			
		3,400			
	Less: Minority Interest	(680)	(450)	680	450
		2,720	1,350		
	Less: Unrealised profit on stock transfer	-	(300*)		
		2,720	1,050		
4.	**Share Capital**				
	As per Balance sheet	20,000	10,000		
	Less: Minority interest	(4,000)	(2,500)	4,000	2,500
	Transferred for computation of Goodwill/Capital Reserve	16,000	7,500		
				5,280	3,375
	Less: Dividend payable shown separately			(400)	(250)
	Transferred to Consolidated Balance Sheet			4,880	3,125
	Total			8,005	

5. **Computation of Cost of Control i.e. Goodwill / Capital Reserve on consolidation**

(₹ in thousand)

	E Ltd.	*N Ltd.*
Cost of Investments	18,000	8,000
Less: Paid up value of shares [Refer Note 4]	(16,000)	7,500

* As per para 17 of AS 21, 'Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full.

	2,000	500
Less: Pre-acquisition Reserve [Refer Note 1]	(2,240)	(1,162.5)
Capital reserve	(240)	(662.5)
Total Capital Reserve (₹ 240 + ₹662.5)	902.5	

3. **Balance Sheet of Better Ltd. as on 31st March, 2021**

Particulars	*Note No.*	*After reconstruction*	*Before reconstruction*
		(₹ in crores)	*(₹ in crores)*
I. **Equity and Liabilities**			
(1) **Shareholder's Funds**			
(a) Share Capital	1	300	300
(b) Reserve and Surplus	2	800	750
(2) **Non-Current Liabilities**			
Long-term borrowings	3	315	250
(3) **Current Liabilities**		1,250	1,300
Total		2,665	2,600
II. **Assets**			
(1) **Non-current assets**			
(a) Property, plant and equipment	4	765	600
(2) **Current assets**		1,900	2,000
Total		2,665	2,600

Notes to Accounts

Particulars		*After reconstruction*		*Before reconstruction*	
		(₹ in crores)		*(₹ in crores)*	
1.	**Share Capital**				
	Authorised:				
	50 crores equity shares of ₹10 each		500		500
	Issued and subscribed:				
	30 crores equity shares of ₹ 10 each fully paid up		300		300

2.	**Reserves and surplus**				
	Capital reserves	40		40	
	Add: Capital profit on reconstruction [WN 1(ii & iii)]	50		-	
	Revenue reserves	700		700	
	Surplus	10	800	10	750
3.	**Long term Borrowings**				
	Best Ltd. (Interest @ 15% p.a.) [WN 1(i)]	15			
	Others	300	315		250
4.	**Property, plant and equipment**				
	Gross block	925		1,000	
	Less: Depreciation	(160)		(400)	
	Net block		765		600

Best Ltd.

Balance Sheet as at 31st March, 2021

Particulars	Note No.	*After reconstruction*	*Before reconstruction*
		(₹ in crores)	*(₹ in crores)*
I. **Equity and Liabilities**			
(1) **Shareholder's Funds**			
(a) Share Capital	1	200	200
(b) Reserves and Surplus	2	465	450
(2) **Non-Current Liabilities**			
Long-term borrowings		300	350
(3) **Current Liabilities**		950	900
Total		1,915	1,900
II. **Assets**			
(1) **Non-current assets**			
Property, plant and equipment	3	300	400
(2) **Current assets**			
(a) Short term loans and advances	4	15	-
(b) Other current assets		1,600	1,500
Total		1,915	1,900

Notes to Accounts

	Particulars	After reconstruction		Before reconstruction	
		(₹ in Crores)		*(₹ in Crores)*	
1.	**Share Capital**				
	Authorized:				
	50 crores equity shares of ₹ 10 each		500		500
	Issued and subscribed:				
	30 crores equity shares of ₹ 10 each fully paid up		200		200
2.	**Reserves and surplus**				
	Capital reserves	20		20	
	Add: Capital profit on reconstruction [WN 1(ii)]	15	35	-	20
	Revenue reserves		425		425
	Surplus		5		5
			465		450
3.	**Property, plant and equipment**				
	Gross block	400		700	
	Less: Depreciation	(100)		(300)	
	Net block		300		400
4.	**Short term loans and advances**				
	Loan to Better Ltd.[WN 1(i)]		15		----

(b) Net asset value of Master Win's holdings

	Pre-reorganisation (₹)	*Post-reorganisation (₹)*	*Change (Gain) (₹)*
Net asset value of one equity share:			
(Refer to working notes)			
Better Ltd.	35.00	36.67	1.67
Best Ltd.	32.50	33.25	0.75
Net asset value of equity shares owned by Master Win			

Better Ltd. (50,000 shares)	17,50,000	18,33,500	83,500
Best Ltd. (30,000 shares)	9,75,000	9,97,500	22,500
	27,25,000	28,31,000	1,06,000

Master Win has gained in terms of net asset value of his holdings as indicated in the last column.

Working Notes:

(1) Better Ltd.

(₹ in crores)

		Pre-re-organisation figures *(a)*	*Sale of division B* *(b)*	*Purchase of division D of Best Ltd.* *(c)*	*Post-re-organisation figures* *(d) = (a) – (b) + (c)*
(i)	Property, plant and equipment				
	Cost	1,000	400	325	925
	Depreciation	(400)	(240)	–	(160)
	Written down value (I)	600	160	325	765
	Current assets	2,000	900	800	1,900
	Current liabilities	(1,300)	(750)	(700)	(1,250)
	Net current assets (II)	700	150	100	650
	Funds employed [(I) + (II)]	1,300	310	425	1,415
	Loan funds:				
	Others (III)	(250)	(200)	(250)	(300)
	Best Ltd. (balance payable on transfer of divisions i.e. ₹ 140 – ₹ 125) (IV)	_____	____	___	(15)
	Net worth (I + II – III – IV)	1,050	110	175	1,100

Calculation of Profit / (Loss) on Division sale and purchase

		(₹ in crores)
(ii)	Sale of division B	
	Transfer price	125
	Cost of the division (₹160 + ₹ 150 – ₹ 200)	(110)
	Capital Profit	15
(iii)	Purchase of division D of Best Ltd.	
	Agreed value of assets less liabilities taken over ₹ (325 + 800-700 – 250)	175
	Less: Transfer price	(140)
	Capital Profit	35
(iv)	Pre-reorganisation net worth	1,050
	Add: Capital profit on	
	Sale 15	
	Acquisition 35	50
	Post-reorganisation net worth	1,100

No. of equity shares 30 crores

Net asset value of equity share: ₹

Pre-reorganisation 1,050/30 = 35.00

Post-reorganisation 1,100/30 = 36.67 (rounded off)

(2) Best Ltd.

(i) (₹ in crores)

	Pre-re-organisation figures (a)	*Sale of division D* (b)	*Purchase of division B of Better Ltd.* (c)	*Post-re-organisation figures* (d) = (a) – (b) + (c)
Property, plant and equipment				
Cost	700	500	200	400

Depreciation	(300)	(200)	–	(100)
Written down value (I)	400	300	200	300
Current assets	1,500	800	900	1,600
Current liabilities	(900)	(700)	(750)	(950)
Net current assets (II)	600	100	150	650
Funds employed [(I) + (II)]	1,000	400	350	950
Loan funds–others (III)	(350)	(250)	(200)	(300)
	650	150	150	650
Better Ltd. (balance on account of transfers of divisions) (IV)	—	—	—	15
Net worth (I + II – III + IV)	650	150	150	665

(ii) *(₹ in crores)*

		Purchase of division B of Better Ltd.		*Sale of division D*
Value of assets less liabilities				
(Value to Best Ltd.)	(200 + 900 – 750 – 200)	150	(300 + 800 – 700 – 250)	150
Less: Transfer Price		(125)		(140)
Capital Profit/(Capital Loss)		25		(10)

(iii) *(₹ in crores)*

Pre-reorganisation net worth		650
Add: Capital profit on - acquisition	25	
- Sale	(10)	15
Post-reorganisation net worth		665

No. of equity shares	20 crores
Net asset value of equity share:	₹
Pre-reorganisation	650/20 = 32.50
Post-reorganisation	665/20 = 33.25

4. (a) **Computation of probable market price based on actual dividend**

Actual dividend per share	₹ 25
Adjusted yield (W.N.3)	17.98%

Market price for shares of ₹100 paid up	₹139.04
Market price for shares of ₹80 paid up	₹111.23

Working Notes:

1. Asset backing position of Prosperous Ltd

Particulars	₹
Property, plant and equipment	17,20,000
Government securities	1,50,000
Current assets	11,30,000
Total assets	30,00,000
Less: Liabilities	
12% Debentures	(4,00,000)
Current liabilities and provisions	(8,00,000)
Net assets	18,00,000
Less: Preference share capital	(6,00,000)
Net assets available to equity share holders	12,00,000

Ratio of net asset to equity share capital = $\left[\frac{12,00,000}{8,00,000} \times 100\right]$ = 150%

2. Payout ratio

Particulars	₹
Profit available for distribution	
Profit before tax	8,00,000
Less: Tax @ 50%	(4,00,000)
Profit after tax	4,00,000
Total dividend paid	
Preference shareholders (14% of ₹ 6,00,000)	84,000
Equity shareholders (25% of ₹ 8,00,000)	2,00,000
Total dividend paid	2,84,000
Pay-out ratio $\left[\frac{2,84,000}{4,00,000} \times 100\right]$	71%

3. **Computation of adjusted yield**

	Asset backing ratio	*Pay-out ratio*
Representative Company	250%	50%
Prosperous Ltd. (W.N.1 and 2)	150%	71%
Variation	100%	(21%)
Degree of variation	$\left[\frac{100}{250}\times 100\right]$=40%	$\left[\frac{(21)}{50}\times 100\right]$=(42%)
Nature of adjustment to yield	May increase	May decrease
Quantum of adjustment (Assuming 100% variance = 1% risk)	0.40	(0.42)

Adjusted yield = 18% + 0.40% - 0.42% = 17.98%

(b) Difference between AS 10 'Property, Plant and Equipment' and Ind AS 16 'Property, Plant and Equipment'

(i) ***Fixed Assets retired from Active Use and Held for Sale:*** Ind AS 16 does not deal with the assets 'held for sale' because the treatment of such assets is covered in Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. AS 10 deals with accounting for items of fixed assets retired from active use and held for sale.

(ii) ***Stripping Costs in the Production Phase of a Surface Mine:*** Ind AS 16 provides guidance on measuring 'Stripping Costs in the Production Phase of a Surface Mine'. AS does not contain this guidance.

5. **(a) Notes on Share Capital to the financial statements for the year ended 31st March, 2021**

	Current year ended on 31st March, 2021
Authorised Share Capital	
1,00,000 Equity shares (previous year 80,000) of ₹ 10 each	10,00,000
Issued, Subscribed and Paid-up Share Capital	
90,000 Equity shares (previous year 70,000) of ₹ 10 each	9,00,000
Less: Calls unpaid on 100 equity shares of ₹ 10 each	(500)
	8,99,500

Reconciliation of shares outstanding at the beginning and at the end of the reporting period

	Current year ended on 31st March, 2021	
	Number of shares	*₹*
Equity shares at the commencement of the period	70,000	7,00,000
Shares issued under the right issue	5,000	50,000
Shares issued to the public during the year	5,000	50,000
Shares issued on exercise of Employee Stock Option	10,000	1,00,000
Equity shares at the end of the period	90,000	9,00,000

Rights, preferences and restrictions attached to equity shares

The company has a single class of equity shares. Accordingly, all equity shares rank equally with regard to dividends and share in the company's residual assets. The equity shares are entitled to receive dividend as declared from time to time. Failure to pay any amount called up on shares may lead to forfeiture of the shares. On winding up of the company, the holders of equity shares will be entitled to receive the residual assets of the company.

(b) Since the exercise price varies depending on the outcome of a performance condition that is not a market condition, the effect of that performance condition (i.e. the possibility that the exercise price might be ₹ 40 and the possibility that the exercise price might be ₹ 30) is not taken into account when estimating the fair value of the stock options at the grant date. Instead, the enterprise estimates the fair value of the stock options at the grant date under each scenario and revises the transaction amount to reflect the outcome of that performance condition at the end of every year based on the information available at that point of time.

Calculation of compensation expenses to be charged every year

Year	*Calculation*	*Compensation expenses for the period (₹)*	*Cumulative compensation expense (₹)*
1	10,000 options x ₹ 16 x 1/3	53,333	53,333
2	(10,000 options x ₹ 16 x 2/3) – ₹ 53,333	53,334	1,06,667
3	(10,000 options x ₹ 12 x 3/3) – ₹ 1,06,667	13,333	1,20,000

6. (a) Calculation of net assets as on 30.04.2021

	₹ in lakhs	*₹ in lakhs*
Opening bank balance [₹ (100 – 90 - 7) lakhs]	3.00	
Add: Proceeds from sale of securities	40.00	
Dividend received	1.20	44.20
Less:		
Cost of securities	(28.20)	
Fund management expenses		
[₹ (4.50 – 0.25) lakhs]	(4.25)	
Capital gains distributed		
[75% of ₹ (40.00 – 38.00) lakhs]	(1.50)	
Dividends distributed (75% of ₹ 1.20 lakhs)	(0.90)	(34.85)
Closing bank balance		9.35
Add: Closing market value of portfolio		101.90
		111.25
Less: Arrears of expenses		(0.25)
Closing net assets as on 30.4.2021		111.00

Calculation of NAV per unit as on 30.4.2021

Closing net assets as on 30.4.2021	₹ 111.00 lakhs
Number of units	10 lakhs
Closing Net Assets Value (NAV) per unit	₹ 11.10

(b) Separation of Equity and Debt Portion

	₹
Present value of the principal repayable in 4 years	
₹ 30,00,000 × 1.10 × 0.68 (10% Discount factor)	22,44,000
Present value of Interest 1,80,000 x 3.17	
(4 years cumulative 10% discount factor)	5,70,600
Total liability component (Debt Portion)	28,14,600
Equity Portion (Balance)	1,85,400
Proceeds of the issue	30,00,000

7. (a) AS 17 'Segment Reporting' requires that in measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers. Further, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

(b) According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Kumar Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

(c) Yes, both sales and gain of B Ltd. should be recognized. In accordance with AS 9, at the Balance Sheet date what was pending was merely a formality to register the deed. It is clear that significant risk and rewards of ownership had passed before the balance sheet date i.e. assets is in use by A Ltd. Further the registration of the property in the name of A Ltd. post the balance sheet date confirms the condition of sale which existed at the balance sheet date. Therefore, as per AS 4, it is an adjusting event and the sale will be recognised in the previous year.

(d) **Calculation of Economic Value Added**

	₹
Net Operating Profit After Tax	25,00,000
Less: Cost of capital employed (Refer W.N.)	(6,00,000)
Economic Value Added	19,00,000

Economic value added is greater than zero. Therefore, the company qualifies for the loan.

Working Note:

Calculation of Cost of Capital employed	₹
Average total assets	75,00,000
Less: Average current liabilities	(15,00,000)
Capital employed	60,00,000
Cost of capital = Capital employed x Weighted average cost of capital	
$= ₹\ 60,00,000 \times \frac{10}{100} = ₹\ 6,00,000$	

(e) According to Lev and Schwartz, the value of human capital embodied in a person of age τ is the present value of his remaining future earnings from employment. Their valuation model for a discrete income stream is given by the following formula:

$$V\tau = \sum_{t=\tau}^{t} \frac{I(t)}{(1+r)^{t-\tau}}$$

Where,

V_τ = the human capital value of a person τ years old.

I(t) = the person's annual earnings up to retirement.

r = a discount rate specific to the person.

t = retirement age.

Value of employees

$$= \frac{30,000}{(1+0.15)^{(62-60)}} + \frac{30,000}{(1+0.15)^{(62-61)}}$$

$$= \frac{30,000}{(1+0.15)^{2}} + \frac{30,000}{(1+0.15)}$$

= 22,684.31 + 26,086.96 = 48,771.27

Value of the employees = ₹ 48,771.27× 50 = ₹ 24,38,564