MOCK TEST PAPER – 1
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING
SUGGESTED ANSWERS

1. (a) (i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Nasha 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 Nasha 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.

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

In the second year, the entire Rs. 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 Rs. 400 x 35% = Rs. 140 lakhs and total deferred tax liability in the Balance Sheet will be (42+140) = Rs. 182 lakhs.

(c) B limited invested Rs. 600 lakh in the equity shares of G Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakh and remaining as temporary (current) investment i.e. Rs. 300 lakh. Irrespective of the fact that investment has been held by B Limited only for 3 months (from 1.1.20X2 to 31.3.20X2), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.20X2 became Rs. 200 lakh i.e. Rs. 100 lakh in respect of current investment and Rs. 100 lakh in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at Rs. 100 lakh. The reduction of Rs. 200 lakh in the carrying value of current investment will be charged to the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, G Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by Rs. 200 lakh and show the investments at Rs. 100 lakh, considering the downfall in the value of shares as decline other than temporary. The reduction of Rs. 200 lakh in the carrying value of long term investment will be charged to the profit and loss account.

Alternatively, for treatment of long term investment.

If one assumes that the decline in the value of long term investment is temporary and G Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost ie Rs. 300 lakh.

(d) Presentation of MAT credit in the financial statements:

Balance Sheet : Where a company recognizes MAT credit as an asset on the basis of the considerations specified in the Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961, the same should be presented under the head 'Long-term or Short term Loans and Advances' under non-current or current item as the case may be if there is a convincing evidence of realization of the asset then it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Short-term Provision for Taxation' under current liabilities of the balance sheet. The unavailed amount of MAT credit entitlement, if any, would continue to be presented under the head 'Long-term or Short term Loans and Advances' as the case may be if it continues to meet the considerations stated in paragraph 11 of the Guidance Note.

Statement of Profit and Loss: According to explanation given in para 21 of AS 22, "Accounting for Taxes on Income" in the context of Section 115JB of the Income-tax Act, 1961, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the Statement of profit and loss in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the statement of profit and loss and presented as a separate line item therein.

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

As on 31st March, 20X3

Particulars	*Note No.*	*(Rs. 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**			
Non-current assets			
Property, Plant and Equipment	5		69,200
Total			69,200

Notes to Accounts

				(Rs. in thousand)	(Rs. in thousand)
1.	Reserves and surplus				
	Capital Reserve [Refer Note 5]			902.5	
	General Reserve	Rs.			
	M Ltd.	1,800			
	E Ltd.	160			
	N Ltd.	112.5		2,072.5	
	Profit & Loss A/c	Rs.			
	Balance on 1.04.20X2	1,500			
	Profit during 20X2-20X3	7,000			
	Add: Interest on Loan	400			
		8,900			
	Less: Dividend	(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				
	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. (Rs.'000)	*N Ltd (Rs. '000)*	*Minority interest in E Ltd. (1/5) (Rs. '000)*	*Minority interest in N Ltd. (1/4) (Rs. '000)*
1.	**Reserve (pre-acquisition reserves and profits)**				
	Reserves on 1.04.20X2	800	750		
	Profit on 1.04.20X2	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 (5,000x8%)	(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 shown separately			(400)	(250)
	Transferred to Consolidated Balance Sheet			4,880	3,125
	Total			8,005	

* 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 property, plant and equipment, are eliminated in full.

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

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

3. **(1) Calculation of operational synergy expected to arise out of merger**

(Rs. in crores)

Year	1	2	3	4	5
Projected cash flows of NRPL after merger with FIL	1,500	2,000	2,500	3,000	3,500
Less: Projected cash flows of NRPL Ltd. without merger	(1,000)	(1,500)	(2,000)	(2,500)	(3,000)
	500	500	500	500	500

(2) Valuation of FIL in case of merger

Year	Additional Cash Flows to NRPL from operations (Rs. in crores)	Discount Factor	Discounted Cash Flow (Rs. in crores)
1	500	0.870	435.00
2	500	0.756	378.00
3	500	0.658	329.00
4	500	0.572	286.00
5	500	0.497	248.50
			1,676.50

(3) Maximum value to be quoted

	Rs. in crores	Rs. in crores
Value as per discounted cash flows from operations		1,676.50
Add: Increase in goodwill of NRPL on acquisition of FIL		300
		1,976.50
Add: Cash to be collected immediately by disposal of assets:		
Property, plant and equipment	100	
Investments	1,500	
Stock	30	1,630.00
		3,606.50
Less: Current liabilities	1,000	
Compensations claim (510 – 102)	408	(1,408.00)
		2,198.50

So, NRPL can quote as high as Rs. 2,198.50 crores for taking over the business of FIL.

(4) Valuation of FIL ignoring merger (as a 'Stand Alone' entity)

Year	Cash Flows	Discount Factor	Discounted Cash Flow
	(Rs. in crores)		(Rs. in crores)
1	400	0.870	348.00
2	400	0.756	302.40
3	600	0.658	394.80
4	800	0.572	457.60
5	1,000	0.497	497.00
			1,999.80

4. (a) Misha Ltd.

Balance Sheet as at 1st April, 20X3

Particulars	Note No.	*(Rs. in crores)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	125
(b) Reserves and Surplus	2	375
(2) **Non-Current Liabilities**		
Long-term borrowings	3	200
Total		700
II. **Assets**		
(1) **Non-current assets**		
(a) Property, Plant and Equipment	4	300
(2) **Current assets**	5	400
Total		700

Notes to Accounts

		(Rs. in Crores)	*(Rs. in Crores)*
1.	Share Capital		
	6.5 crores equity shares of Rs. 10 each	65	
	(of the above shares, 2.5 crores equity shares are allotted as fully paid-up for consideration other than cash)		
	60 lakhs 10% Preference shares of Rs. 100 each	60	125
2.	Reserves and Surplus		
	As per last Balance Sheet	150	
	Capital Reserve (Refer W.N.)	225	375
3.	Long Term Borrowings		
	Secured Loans:		

	As per last Balance Sheet	100	
	Taken over on absorption of Nisha Ltd.	100	200
4.	Property, plant and equipment		
	As per last Balance Sheet	150	
	Taken over on absorption of Nisha Ltd.	150	300
5.	Current assets		
	As per last Balance Sheet	200	
	Taken over on absorption of Nisha Ltd.	200	400

(b) Valuation of shares on intrinsic value basis

(i)	Nisha Ltd.	Misha Ltd.
	(Rs. in crores)	
Equity share capital	50	40
Reserves and Surplus	200	150
	250	190
Goodwill agreed upon	40	75
Increase in the value of property, plant and equipment (Present worth less book value)	50	279
	340	544
(ii)	**Nisha Ltd.**	**Misha Ltd.**
Number of Equity shares	5 crores	4 crores
Intrinsic value per equity share	Rs. 68	Rs. 136
(iii) Ratio of intrinsic value of shares in the two companies	1 : 2	

Since the shares are to be issued at par, the number of equity shares of Rs. 10 each to be issued to maintain the intrinsic net worth = 5 crores /2 = 2.5 crores

(iv) Statement to prove the accuracy of workings

		(Rs. in crores)	
(1)	Equity share capital (after absorption)		65
	Reserves and Surplus (after absorption) (150 + 225)		375
			440
	Add: Unrecorded value of goodwill Rs. (40 + 75)		115
	Add: Unrecorded incremental value of property, plant and equipment Rs. (50+279)		329
			884
(2)	Number of equity shares	6.5 crores	
(3)	Intrinsic value of an equity share (884/6.5)	Rs. 136	

Working Note:

Calculation of Capital Reserve on Absorption

	(Rs. in crores)
Property, plant and equipment taken over	150
Net current assets taken over	200
	350
Less: Secured loans taken over	(100)
Net Assets taken over	250
Less: Purchase consideration	(25)
Capital Reserve	225

5. (a) In the given case, the length of the vesting period varies, depending on when the performance condition is satisfied. In such a situation, as per paragraph 14 of the text of the Guidance Note on 'Accounting for Employee Share-based Payments' the enterprise estimates the length of the expected vesting period, based on the most likely outcome of the performance condition, and revises that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates.

Statement showing determination of the compensation expense to be recognised each year

Particulars	Year 1	Year 2	Year 3
Vesting condition (earnings)	18%	13% (avg.)	10% (avg.)
Actual earnings	14%	12% (avg.)	10.67% (avg.)
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
No. of employees expected to meet vesting conditions	440 employees	417 employees	419 employees
No. of options expected to vest	44,000	41,700	41,900
Fair value of options expected to vest @ Rs. 30 per option (Rs.)	13,20,000	12,51,000	12,57,000
Compensation expense accrued at the end of year (Rs.)	6,60,000 [13,20,000/2]	8,34,000 (12,51,000 × 2/3)	12,57,000
Compensation expense recognised till the end of previous year (Rs.)	Nil	6,60,000	8,34,000
Compensation expense to be recognized for the year (Rs.)	6,60,000	1,74,000	4,23,000

(b) Outstanding Amount at the end of 8th year

= Rs. 85,00,000 x 1.12 x 1.12 x 1.12 x 1.12 x 1.12

= Rs. 1,49,79,904 (i.e. adding interest for 4th to 8th year)

Rescheduled amount to be paid at the end of the 8th year = Rs. 1,50,00,000

Additional amount to be paid on rescheduling = Rs. 1,50,00,000 - Rs. 1,49,79,904

= Rs. 20,096.

At the end of the 8th year, book value of loan will become Nil.

Note: In the above solution it is assumed that interest due for the 7th and 8th year have also not been paid.

6. (a) **Worth Limited**

Computation of Economic Value Added

	Rs. in lakhs
Profit after Tax (Refer W.N. 5)	1,372.00
Add: Interest on Long-term Fund – net of tax (Refer W.N. 2)	28.00
Net Operating Profit after Tax	1,400.00
Less: Cost of Capital (Rs. 6,400 lakhs × 15.77%) (Refer W.N. 3 and 4)	(1,009)
Economic Value Added	391.00

Working Notes:

(1) **Cost of Equity** = Risk free rate + Beta factor (Market rate – Risk free rate)

= 9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%

(2) **Cost of Debt**

	Rs. in lakhs
Interest	40
Less: Tax @ 30%	(12)
Interest after Tax	28

Cost of debt = $\frac{28}{400} \times 100 = 7\%$

(3) **Weighted Average Cost of Capital**

		Rs. in lakhs
Cost of Equity	Rs. 6,000 lakhs × 16.35% (W.N.1)	981
Cost of Debt	Rs. 400 lakhs × 7% (W.N.2)	28
	Rs. 6,400 lakhs	1,009

WACC = $\frac{1,009}{6,400} \times 100 = 15.77\%$ (approx.)

(4) **Capital Employed**

	Rs. *in lakhs*
Share Capital	2,000
Reserves and Surplus	4,000
Long-term debts	400
	6,400

(5) **Profit after Tax**

	Rs. *in lakhs*
Profit before Interest and Tax	2,000
Less: Interest	(40)
	1,960
Less: Tax (30% on Rs. 1,960 lakhs)	(588)
Profit after Tax	1,372

(b) Calculation of net assets as on 30.04.20X3

	Rs. in lakhs	*Rs. in lakhs*
Opening bank balance [Rs. (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		
[Rs. (4.50–0.25) lakhs]	(4.25)	
Capital gains distributed		
[75% of Rs. (40.00 – 38.00) lakhs]	(1.50)	
Dividends distributed (75% of Rs. 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 30.04.20X3		111.00

Calculation of NAV per unit as on 30.04.20X3

Closing net assets as on 30.04.20X3	Rs. 111.00 lakhs
Number of units	10 lakhs
Closing Net Assets Value (NAV) per unit	Rs. 11.10

7. (a) Differences between Ind AS 10 and AS 4

(i) In Ind AS 10, material non-adjusting events are required to be disclosed in the financial statements, whereas AS 4 requires the same to be disclosed in the report of approving authority.

(ii) If, after the reporting date, it is determined that the fundamental accounting assumption of going concern is no longer appropriate, Ind AS 10 requires a fundamental change in the basis of accounting. Whereas AS 4 requires assets and liabilities to be adjusted for events occurring after the balance sheet date that indicate that the fundamental accounting assumption of going concern is not appropriate. In this regard, Ind AS 10 refers to Ind AS 1, which requires an entity to make the following disclosures:

- disclose the fact that the financial statements are not prepared on a going concern basis together with the basis on which the financial statements are prepared
- state the reason why the entity is not regarded as a going concern. AS 4 does not require any such disclosure. However, AS 1 requires the disclosure of the fact in case going concern assumption is not followed.

(iii) Consequent to changes made in Ind AS 1, it has been provided in the definition of 'Events after the reporting period' that in case of 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, if the lender, before the approval of the financial statements for issue, agrees to waive the breach, it shall be considered as an adjusting event.

(iv) Ind AS 10 includes an Appendix Distribution of Non-cash Assets to Owners which deals, inter alia, with when to recognise dividend payable to its owners.

(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 Rs. 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 Rs. 6 lakhs over the next 2 years by reducing the annual contributions to Rs. 2 lakhs instead of Rs. 5 lakhs. It has to contribute Rs. 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) Separation of Equity and Debt Portion

	Rs.
Present value of the principal repayable in 4 years	
Rs. 30,00,000 × 1.10 × 0.68 (10% discounting 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 (balancing figure)	1,85,400
Proceeds of the issue	30,00,000

(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 = Rs. 48,771.27× 50 = Rs. 24,38,564