

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

Question No.1 is compulsory. Candidates are required to answer any four questions from the remaining five questions.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Defense Innovators Limited is a public sector undertaking and is engaged in the construction of warships and submarines. XYZ Private Limited approached Defense Innovators Limited for construction of "specially designed" ships for it, which will be used by XYZ Private Limited for transportation of specific goods. The offer was accepted by the Defense Innovators Limited and both the companies entered into an agreement for the construction and delivery of 3 specially designed ships on 'Fixed Price' basis with variable component in respect to certain items.

Base and depot (B & D) spares for all three ships shall be procured by Defense Innovators Limited and will be paid on the cost of the item with certain percentage.

The contract states that "certain equipment" out of variable cost items, will be supplied by XYZ Private Limited at 'free of cost' for installation on board of ship. It is, therefore, to be noted as under:

- (i) Some equipment are procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.
- (ii) There are certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. These equipment are known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship.

The period required for construction of one ship was approximately four years.

Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognised as revenue in its books of account? Elaborate. **(6 Marks)**

- (b) On 1 April 20X1, an 8% convertible loan with a nominal value of ₹ 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ₹ 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 48,000 has already been paid and included as a finance cost.

Present value rates are as follows:

| Year End | @ 8% | @ 10% |
|----------|------|-------|
| 1 | 0.93 | 0.91 |
| 2 | 0.86 | 0.83 |
| 3 | 0.79 | 0.75 |
| 4 | 0.73 | 0.68 |

Explain how will the Company account for the above loan notes in the financial statements for the year ended 31 March 20X2? **(8 Marks)**

- (c) An entity opens a new factory and receives a government grant of ₹ 15,000 in respect of capital equipment costing ₹ 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis. Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20. **(6 Marks)**
2. (a) KUPA Ltd. borrowed ₹ 95 lakh as loan from XYZ Bank on 1st April, 20X1 at an interest rate of 10% p.a. KUPA Ltd. spent ₹ 1,80,912 as loan processing charges. Principal amount of loan is to be repaid in 5 equal instalments and the interest to be paid annually on accrual basis. Effective interest rate on loan is 10.8%.

On 31st March, 20X3, KUPA Ltd. faced challenges in business because of sudden change in the technology. It approached XYZ Bank and renegotiated the terms of the loan. Interest rate changed to 15% p.a. Principal amount of loan is to be repaid in 8 equal instalments payable annually starting 31st March, 20X4 and the interest is to be paid annually on accrual basis. Before approaching bank, KUPA Ltd. made the interest payment on 31st March, 20X3.

You are required to record Journal entries in the books of KUPA Ltd. till 31st March, 20X4, after giving effect of the changes in the terms of the loan on 31st March, 20X3. Workings should form part of the answer.

| PV of ₹ 1 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 |
|-----------|--------|--------|--------|--------|--------|--------|--------|--------|
| 10% | 0.909 | 0.826 | 0.751 | 0.683 | 0.621 | 0.564 | 0.513 | 0.467 |
| 10.8% | 0.903 | 0.815 | 0.735 | 0.664 | 0.599 | 0.540 | 0.488 | 0.440 |
| 15% | 0.870 | 0.756 | 0.658 | 0.572 | 0.497 | 0.432 | 0.376 | 0.327 |

(13 Marks)

- (b) New Age Technology Limited has entered into following Share Based payment transactions:
- On 1st April, 20X1, New Age Technology Limited decided to grant share options to its employees. The scheme was approved by the employees on 30th June, 20X1. New Age Technology Limited determined the fair value of the share options to be the value of the equity shares on 1st April, 20X1.
 - On 1st April, 20X1, New Age Technology Limited entered into a contract to purchase IT equipment from Bombay Software Limited and agreed that the contract will be settled by issuing equity instruments of New Age Technology Limited. New Age Technology Limited received the IT equipment on 30th July, 20X1. The share-based payment transaction was measured based on the fair value of the equity instruments as on 1st April, 20X1.
 - On 1st April, 20X1, New Age Technology Limited decided to grant the share options to its employees. The scheme was approved by the employees on 30th June, 20X1. The issue of the share options was however subject to the same being approved by the shareholders in a general meeting. The scheme was approved in the general meeting held on

30th September, 20X1. The fair value of the equity instruments for measuring the share-based payment transaction was taken on 30th September, 20X1.

Identify the grant date and measurement date in all the 3 cases of Share based payment transactions entered into by New Age Technology Limited, supported by appropriate rationale for the determination? **(7 Marks)**

3. (a) Sun Limited and Moon Limited amalgamated from 1st April, 20X1. A new company Sunmoon Limited with shares of ₹ 10 each was formed to take over the businesses of the existing companies.

Summarised Balance Sheet as on 31st March, 20X1

| Particulars | Note No. | Sun Limited (₹) | Moon Limited (₹) |
|-------------------------------------|----------|---------------------------|---------------------------|
| ASSETS | | | |
| Non-current assets | | | |
| Property, plant and equipment | | 1,70,00,000 | 1,50,00,000 |
| Financial assets | | | |
| Investment | | 21,00,000 | 11,00,000 |
| Current assets | | | |
| Inventory | | 25,00,000 | 55,00,000 |
| Financial assets | | | |
| Trade receivables | | 36,00,000 | 80,00,000 |
| Cash and cash equivalent | | <u>9,00,000</u> | <u>8,00,000</u> |
| Total | | <u>2,61,00,000</u> | <u>3,04,00,000</u> |
| EQUITY AND LIABILITIES | | | |
| Equity | | | |
| Equity share capital (FV ₹ 10 each) | | 1,20,00,000 | 1,40,00,000 |
| Other equity | 1 | 61,00,000 | 54,00,000 |
| Liabilities | | | |
| Non-current liabilities | | | |
| Financial liabilities | | | |
| Borrowings (12% Debentures) | | 60,00,000 | 80,00,000 |
| Current liabilities | | | |
| Financial liabilities | | | |
| Trade payables | | <u>20,00,000</u> | <u>30,00,000</u> |
| Total | | <u>2,61,00,000</u> | <u>3,04,00,000</u> |

Notes to Accounts:

| | Sun Limited ₹ | Moon Limited ₹ |
|-----------------|---------------|----------------|
| Other equity | | |
| General reserve | 30,00,000 | 40,00,000 |
| Profit & Loss | 20,00,000 | 10,00,000 |

| | | |
|------------------------------|------------------|------------------|
| Investment allowance reserve | 10,00,000 | 2,00,000 |
| Export profit reserve | <u>1,00,000</u> | <u>2,00,000</u> |
| | <u>61,00,000</u> | <u>54,00,000</u> |

Sunmoon Limited issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also, the new debentures were issued in exchange of the old series of both the companies.

Compute purchase consideration and advice discharge thereof by preparing a note and draft the Balance Sheet of Sunmoon Limited assuming that Sun Limited and Moon Limited are not under common control and management of larger entity out of Sun Limited and Moon Limited will take over the control of the entity Sunmoon Limited.

The fair value of net assets as at 31st March, 20X1 of Sun Limited and Moon Limited are as follows:

| Assets | Sun Limited ₹ | Moon Limited ₹ |
|-------------------------------|---------------|----------------|
| Property, Plant and Equipment | 1,90,00,000 | 1,70,00,000 |
| Inventory | 26,00,000 | 58,00,000 |
| Fair value of the Business | 2,20,00,000 | 2,80,00,000 |

(14 Marks)

- (b) On 1st April, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

| Fair values of the shares are as follows: | ₹ |
|--|-----|
| Share alternative fair value (with restrictions) | 102 |
| Grant date fair value on 1 st April, 20X1 | 113 |
| Fair value on 31 st March, 20X2 | 120 |
| Fair Value on 31 st March, 20X3 | 132 |

The employees exercise their cash option at 31st March, 20X3. Pass the journal entries.

(6 Marks)

4. (a) Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

| Particulars | Property 1 | Property 2 | Property 3 |
|-------------------------|------------|-------------------|-------------------|
| | Factory | Factory | Let-Out |
| Purchase price | 15,000 | 10,000 | 12,000 |
| Market value 31.03.20X2 | 16,000 | 11,000 | 13,500 |
| Life | 10 Years | 10 Years | 10 Years |
| Subsequent Measurement | Cost Model | Revaluation Model | Revaluation Model |

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:

Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment alongwith working for the same.

(10 Marks)

(b) An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

(a) Will the inventory and the trade receivables be current in nature?

(b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different? **(4 Marks)**

(c) Nikka Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2? **(6 Marks)**

5. (a) ABC Limited supplies plastic buckets to wholesaler customers. As per the contract entered into between ABC Limited and a customer for the financial year 20X1-20X2, the price per plastic bucket will decrease retrospectively as sales volume increases within the stipulated time of one year.

The price applicable for the entire sale will be based, on sales volume bracket during the year.

| Price per unit (INR) | Sales volume |
|----------------------|-----------------------|
| 90 | 0 - 10,000 units |
| 80 | 10,001 - 35,000 units |
| 70 | 35,001 units & above |

All transactions are made in cash.

(i) Suggest how revenue is to be recognised in the books of accounts of ABC Limited as per expected value method, considering a probability of 15%, 75% and 10% for sales volumes of 9,000 units, 28,000 units and 36,000 units respectively. For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under expected value method for the financial year 20X1-20X2.

(ii) In case ABC Limited decides to measure revenue, based on most likely method instead of expected value method, how will be the revenue recognised in the books of accounts of

ABC Limited based on above available information? For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under most likely value method for the financial year 20X1-20X2. Assume that the sales volume of 28,000 units given under the expected value method, with highest probability is the sales estimated under most likely method too.

- (iii) You are required to pass Journal entries in the books of ABC Limited if the revenue is accounted for as per expected value method for financial year 20X1-20X2. **(14 Marks)**
- (b) (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ₹ 10. Entity XYZ's after-tax maintainable profits are estimated at ₹ 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.
- (ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is ₹ 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares. **(6 Marks)**
6. (a) On 1st January, 20X1 an entity purchased an item of equipment for ₹ 600,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 605,000. In addition, the entity has to pay ₹ 5,000 in loan raising fees to the Bank. The loan is secured against the equipment.

In January 20X1 the entity incurred costs of ₹ 20,000 in transporting the equipment to the entity's site and ₹ 100,000 in installing the equipment at the site. At the end of the equipment's 10-year useful life the entity is required to dismantle the equipment and restore the building housing the equipment. The present value of the cost of dismantling the equipment and restoring the building is estimated to be ₹ 100,000.

In January 20X1 the entity's engineer incurred the following costs in modifying the equipment so that it can produce the products manufactured by the entity:

- Materials – ₹ 55,000
- Labour – ₹ 65,000
- Depreciation of plant and equipment used to perform the modifications – ₹ 15,000

In January 20X1, the entity's production staff were trained in how to operate the new item of equipment. Training costs included:

- Cost of an expert external instructor – ₹ 7,000
- Labour – ₹ 3,000

In February 20X1 the entity's production team tested the equipment and the engineering team made further modifications necessary to get the equipment to function as intended by management. The following costs were incurred in the testing phase:

- Materials, net of ₹ 3,000 recovered from the sale of the scrapped output – ₹ 21,000
- Labour – ₹ 16,000

The equipment was ready for use on 1st March, 20X1. However, because of low initial order levels the entity incurred a loss of ₹ 23,000 on operating the equipment during March. Thereafter the equipment operated profitably.

What is the cost of the equipment at initial recognition? Also show the calculation or reason for underlying treatment. **(10 Marks)**

- (b) X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

- (a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?
- (b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?
- (c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?
- (d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2? **(5 Marks)**

- (c) **EITHER**

Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required? **(5 Marks)**

OR

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 20X1 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 20X1. USD 30 million is received on 1st April, 20X1 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 20X1 and 31st March, 20X1 are ₹ 72 per USD and ₹ 75 per USD respectively. **(5 Marks)**