MOCK TEST PAPER

FINAL (OLD): GROUP – I

PAPER – 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/HINTS

1. (a) As per AS 13 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹13 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. ₹ 14 lakhs. Hence this long term investment will be reclassified as current investment at book value of ₹ 14 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at ₹ 20 lakhs as cost is less than its market value of ₹ 24 lakhs.

(iv) In this case, market value is ₹ 28 lakhs which is lower than the cost of ₹ 30 lakhs. The reclassification of current investment as long-term investments will be made at ₹ 28 lakhs.

(b) Mere gradual phasing is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operation'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service.

(2) Shifting of some production or marketing activities for a particular line of business from one location to another and

(3) Closing of a facility to achieve productivity improvements or other cost savings.

A Reportable business segment or geographical segment as defined in AS 17, would normally satisfy criteria (b) of the definition. However, other criterias would not be satisfied.

Hence, in view of the above the answers are:

(i) No. The companys' strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has started.

(ii) No. The resolution is salient about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing. Hence, AS 24 will not be applicable.

(iii) Yes. Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map. Hence, this action will attract AS 24 compliances.

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(c) As per para 12 of AS 9 'Revenue Recognition', 'in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished'.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is seen by public and hence revenue is recognized on that date. In this case, it is 15.03.2018, the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2018. The terms of payment are not relevant for considering the date on which revenue is to be recognized.

₹ 60,000 is treated as amount due from advertisers as on 31.03.2018 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2018 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized for the year ended 31.03.2019 after the magazine is published on 02.04.2018. The amount received from sale of advertising space on 10.03.2018 of ₹ 2,40,000 will be considered as an advance from advertisers for the year ended 31st March, 2018.

(d) (i) Present value of unguaranteed residual value = ₹ 40,000 × 0.7513 = ₹ 30,052

Present value of lease payments = ₹ 3,00,000 – ₹ 30,052 = ₹ 2,69,948.

The present value of lease payments being 89.98% $\left(\frac{2,69,948}{3,00,000} \times 100\right)$ of the fair value, i.e. being a substantial portion thereof, the lease constitutes a finance lease.

(ii) Annual lease payments = $\frac{₹\ 2,69,948}{2.4868} = ₹\ 1,08,552$ (approx.)

Calculation of unearned finance income

	₹
Gross investment in the lease [(₹ 1,08,552 × 3) + ₹ 40,000]	3,65,656
Less: Cost of the equipment	(3,00,000)
Unearned finance income	65,656

Note: - In the above solution, annual lease payment has been determined on the basis that the present value of lease payments plus residual value is equal to the fair value (cost) of the asset.

2. (a) Projected Profit and Loss Account of EF Ltd. for the period ending 31st March, 2018

Particulars	₹
Total Revenue	
Dividend Income [50,000 + 17,600]	67,600
Interest Income	11,250
	78,850
Less: Expenses	
Finance Costs (Interest on Bank Overdraft)	(1,600)
Other Expenses [Directors Fee (7,500) + Administrative Expenses (16,000) + Preliminary expenses (8,000)]	(31,500)
Profit before tax	45,750

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(b) Projected Balance Sheet of EF Ltd. as on 31st March, 2018

	Particulars	Note No.	(₹)
I.	Equity and Liabilities		
	(1) Shareholders' Funds		
	(a) Share Capital	1	15,70,000
	(b) Reserves and Surplus	2	3,49,450
	(2) Non-Current Liabilities		
	(3) Current Liabilities		
	(a) Other Current Liabilities	3	23,500
	Total		19,42,950
II.	Assets		
	(1) Non-Current Assets		
	Non-Current Investments	4	14,34,000
	(2) Current Assets		
	(a) Cash and Cash Equivalents (W.N.1)		58,950
	(b) Other Current Assets		4,50,000
	Total		19,42,950

Notes to Accounts:

	Particulars		*(₹)*
1.	**Share Capital**		
	Authorised share capital		
	4,00,000 Equity shares of ₹ 10 each		40,00,000
	Issued share capital		
	1,57,000 Equity Shares of ₹ 10 each		15,70,000
	(Of the above 1,19,500 shares were issued for consideration other than cash)		
2.	**Reserves and Surplus**		
	Securities Premium [2,39,000 + 1,12,500]		3,51,500
	Profit & Loss Account	45,750	
	Less: Interim dividend (₹ 11,95,000 x 4%)	(47,800)	(2,050)
			3,49,450
3.	**Other Current Liabilities**		
	Bank Overdraft	16,000	
	Directors Fee	7,500	23,500
4.	**Non-current investment**		
	Investment in shares of AB Ltd. @ ₹ 12	10,50,000	
	Investment in shares of CD Ltd. @ ₹ 12	3,84,000	14,34,000

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(c) Computation of Number of Shares to be issued to former shareholders

Particulars	*AB Ltd.*	*CD Ltd.*
	₹	₹
Future Maintainable EBIT	2,30,000	1,12,000
Less: Interest on Debentures	(20,000)	-
	2,10,000	1,1,2,000
Less: Income tax @ 50%	(1,05,000)	(56,000)
Profit after tax	1,05,000	56,000
Less: Preference Dividend	-	(8,000)
Profit to Equity Shareholders	1,05,000	48,000
PE Ratio	10	8
Capitalised Earning	10,50,000	3,84,000
Number of shares to be exchanged in EF Ltd. @ ₹ 12 (including Premium of ₹ 2 each)	87,500	32,000

Working Note:

Bank Account

Particulars	₹	*Particulars*	₹
To Equity Share Capital A/c	3,75,000	By Preliminary Expenses	8,000
To Securities Premium A/c	1,12,500	By Interest on Bank Overdraft	1,600
To Dividends from AB Ltd.	50,000	By Advance to AB Ltd.	2,50,000
To Dividends from CD Ltd.	17,600	By Advance to CD Ltd.	2,00,000
To Interest Income	11,250	By Interim Dividend	47,800
		By Balance c/d (Bal. fig.)	58,950
	5,66,350		5,66,350

3. Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd. as at 31st March 2018

Particulars	*Note No.*	₹
I. Equity and Liabilities		
Shareholder's funds		
a. Share capital	1	5,00,000
b. Reserves and surplus	2	3,03,103
Minority Interest (96,000+30,122)		1,26,122
Current liabilities		
(a) Trade payables	3	1,08,000
(b) Other current liabilities	4	40,000
Total		10,77,225
II. Assets		
Non-current assets		
(a) Fixed assets		

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	Tangible assets	5	4,61,225
(b)	Non-current investment		-
	Current Assets		
(a)	Inventories	6	2,18,000
(b)	Trade receivable	7	2,58,000
(c)	Cash and Cash equivalents	8	1,40,000
	Total		10,77,225

Notes to Financial Statements

S. No.	*Particulars*	*Amount (₹)*	*Amount (₹)*
1.	**Share capital**		
	Issued, subscribed and paid up 50,000 equity shares of ₹ 10 each fully paid up		5,00,000
2.	**Reserves and Surplus**		
	Capital reserves (W.N.3)	30,000	
	Other reserves (W.N.7)	1,31,300	
	Profit & Loss account (W.N.6)	1,41,803	3,03,103
3.	**Trade Payables**		
	Sundry Creditors of A Ltd.	70,000	
	B Ltd.	20,000	
	C Ltd.	30,000	
		1,20,000	
	Less: Mutual Owings	(12,000)	1,08,000
4.	**Other Current liabilities**		
	Due to B Ltd. (40,000 – 30,000)	10,000	
	Due to C Ltd. (1,20,000 – 90,000)	30,000	40,000
5.	**Tangible assets**		
	A Ltd.	2,00,000	
	B Ltd.	1,50,000	
	C Ltd.	1,20,000	
		4,70,000	
	Less: Unrealised profit on equipment	(8,775)	4,61,225
6.	**Inventories**		
	A Ltd.	1,00,000	
	B Ltd.	60,000	
	C Ltd.	60,000	
		2,20,000	
	Less: Unrealised profit	(2,000)	2,18,000
7.	**Trade Receivable**		
	A Ltd.	1,50,000	

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	B Ltd.	40,000	
	C Ltd.	80,000	
		2,70,000	
	Less: Mutual Owings	(12,000)	2,58,000
8.	**Cash and Cash Equivalents**		
	A Ltd.	90,000	
	B Ltd.	20,000	
	C Ltd.	30,000	1,40,000

Working Notes:

1. Statement of analysis of profits of C Ltd.

	Capital Profit	*Revenue reserve*	*Revenue profit*
	₹	₹	₹
General Reserve on 1.8.2017	15,000		
Profit and loss A/c on 1.8.2017	25,000		
Increase in reserve		35,000	
Increase in profit			35,000
	40,000	35,000	35,000
Less: Minority Interest (10%)	(4,000)	(3,500)	(3,500)
	36,000	31,500	31,500
Share of A Ltd. (30%)	12,000	10,500	10,500
Share of B Ltd. (60%)	24,000	21,000	21,000

2. Statement of analysis of profits of B Ltd.

	Capital Profit	*Revenue reserve*	*Revenue profit*
	₹	₹	₹
General Reserve on 1.8.2017	30,000		
Profit and loss A/c on 1.8.2017	50,000		
Increase in reserve		30,000	
Increase in profit			30,000
	80,000	30,000	30,000
Add: Share in C Ltd. (direct approach)	-	21,000	21,000
	80,000	51,000	51,000
Less: Minority interest (20%)	(16,000)	(10,200)	(10,200)
Share of A Ltd.	64,000	40,800	40,800

3. Statement of cost of control

	₹	₹	₹
Investment in B Ltd.			2,50,000
Investment in C Ltd.		(80,000 +1,60,000)	2,40,000
			4,90,000

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Less: Paid up value of investments			
In B Ltd.	2,40,000		
In C Ltd.	1,80,000	4,20,000	
Capital Profit			
In B Ltd.	64,000		
In C Ltd. (12,000+24,000)	36,000	1,00,000	(5,20,000)
Capital reserve			30,000

4. Statement of Minority Interest

	B Ltd. (20%) ₹	*C Ltd. (10%)* ₹
Share capital	60,000	20,000
Capital profit	16,000	4,000
Revenue reserve	10,200	3,500
Revenue profit	10,200	3,500
Total	96,400	31,000
Less: Unrealised profit on Stock {20% of (10,000/125 x 25)}	(400)	
Unrealised profit on Machinery (10% of 8,775)		(878)
	96,000	30,122

5. Statement showing unrealised profit on equipment sale

	₹
Cost	27,000
Profit	9,000
Selling price	36,000
Unrealized profit = Total unrealised Profit – Depreciation thereon = [9,000 - (9,000 x 10% x 3/12)]	8,775

6. Statement showing Consolidated Profit and Loss Account

	₹
A Ltd.	1,00,000
Share in B Ltd.	40,800
Share in C Ltd.	10,500
	1,51,300
Less: Unrealised profit on machinery (90% of 8,775)	(7,897)
	1,43,403
Less: Unrealised profit on stock {80% of (10,000 / 125 x 25)}	(1,600)
	1,41,803

7. Statement showing consolidated reserves

	₹
A Ltd.	80,000
Share in B Ltd.	40,800

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Share in C Ltd.	10,500
	1,31,300

4. (a) (i) Calculation of Employee Compensation Expense for the Year ended 31st March 2015, 31st March 2016 and 31st March, 2017

(Refer Working Note)

Vesting Date	Cost to be recognized in the year ending on 31st March		
as on 31st March	2015	2016	2017
Lot I	6,24,000		
Lot II	2,88,000	2,88,000	
Lot III	2,40,000	2,40,000	2,40,000
Cost for the year	11,52,000	5,28,000	2,40,000
Cumulative cost	11,52,000	16,80,000	19,20,000

(ii) Balance of ESOP Outstanding Account as on 31st March 2015, 31st March 2016 and 31st March, 2017

	Total	2015	2016	2017
ESOS outstanding A/c at the end of 1st year	11,52,000	11,52,000		
Less: Vested Options lapsed during year (200 x 240)	(48,000)			
Less: Vested Options exercised during year (2,500 x 240)	(6,00,000)			
Add: ESOP credited in the 2nd year	5,28,000			
ESOP outstanding A/c at the end of 2nd year	10,32,000		10,32,000	
Less: Vested options lapsed (600 x 240)	(1,44,000)			
Less: Vested options exercised (2,000 x 240)	(4,80,000)			
Add: ESOP credited in the 3rd year	2,40,000			
ESOP outstanding at the end of 3rd year	6,48,000			6,48,000

Working Note:

Determination of number of options expected to vest under each group

Vesting Date (Year-end) 31st March		Shares expected to vest	Value per Shares (₹) (400 – 160)	Compensation Expense (₹)
2015	(10,000 shares x 30%) - 400 shares	2,600 shares	240	6,24,000
2016	(10,000 shares x 30%) - 600 shares	2,400 shares	240	5,76,000

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2017	(10,000 shares x 40%) - 1,000 shares	3,000 shares	240	7,20,000
				19,20,000

Total compensation expense of ₹ 19,20,000, determined at the grant date, is attributed to 3 years.

Note: In the absence of estimated figures regarding lapse of unvested options, it is assumed that actual lapses were in accordance with the estimation.

(b) The above security deposit is an interest free deposit redeemable at the end of lease term for ₹ 10,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement –

Particulars	Details
Security deposit (A)	10,00,000
Total Lease Period	5 years
Discount rate	12.00%
Present value annuity factor	0.567427
Present value of deposit at beginning (B)	5,67,427
Prepaid lease payment at beginning (A-B)	4,32,573

Journal Entries

Particulars		Amount	Amount
		₹	₹
Security deposit A/c	Dr.	5,67,427	
Prepaid expenses A/c	Dr.	4,32,573	
To Bank A/c			10,00,000

Subsequently, every annual reporting year, interest income shall be accrued @ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Year 1

Particulars		Amount	Amount
		₹	₹
Security deposit A/c (5,67,427 x 12%)	Dr.	68,091	
To Interest income A/c			68,091
Rent expense A/c (4,32,573 / 5 years)	Dr.	86,515	
To Prepaid expenses A/c			86,515

At the end of 5 years, the security deposit shall accrue to ₹ 10,00,000 and prepaid expenses shall be fully amortised. Journal entry for realisation of security deposit–

Particulars		*Amount (₹)*	*Amount (₹)*
Bank A/c	Dr.	10,00,000	
To Security deposit A/c			10,00,000

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5. (a) **Calculation of NAV of a Mutual Fund Scheme**

Units as at the end of the year		*Units in Crores*
Number of units at the beginning of the year		1.00
Add: Units issued during the year		0.20
Units as at end of the year		1.20
Net Asset Value of the scheme		*₹ in crores*
Market value of Investments	(50% of ₹ 10 crores) x 80%	4.00
	10% x ₹ 10 crores - (10% below cost)	0.90
	Balance Investment at Market Price	13.60
Total Market Value		18.50
Less: Mutual fund scheme liabilities		(1.00)
Net asset value of the scheme		17.50
NAV per Unit= B/A=	₹ 17.50 crore/1.2 crore	₹ 14.58

(b) **Synergy Ltd.**

Value Added Statement for the year ended 31st March, 2018

	₹ ('000)	*₹ ('000)*	%
Turnover		29,872	
Less: Cost of bought in materials and services:			
Operating expenses (26,741 –14,761)	11,980		
GST	1,952		
Interest on Cash Credit	151	14,083	
Value added by manufacturing and trading activities		15,789	
Add: Other income		1,042	
Total value added		16,831	
Application of value added:			
To Pay to employees:			
Salaries, wages and other employee benefits		14,761	87.70
To Pay to Government:			
Corporation tax (376 – 54)		322	1.91
To Pay to providers of capital:			
Interest on 8% Debentures	987		
Dividends	125	1,112	6.61
To Provide for maintenance and expansion of the company:			
Depreciation	342		
Fixed Assets Replacement Reserve	65		

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Deferred Tax Account	54		
Retained Profit	175	636	3.78
		16,831	100

Note: Deferred tax account could alternatively be shown as an item 'To pay to government'.

Reconciliation between total value added and profit before taxation

	₹ ('000)	₹ ('000)
Profit before tax		741
Add back: Depreciation	342	
Wages, salaries and other benefits	14,761	
Debenture interest	987	16,090
Total Value Added		16,831

6. **Calculation of value per share on yield basis (Earnings Capitalisation Method)**

Particulars	
Earnings available to equity shareholders (W.N.1)	₹ 1,01,040
Normal Rate of Return (W.N.3)	14.25%
Value of business	₹ 7,09,053
Number of equity shares outstanding	50,000
Value per share	**14.18**

Working Notes:

1. **Computation of FMP available for distribution**

   a. Weighted average profits

Year	*Profit before tax*	*Weight*	*Product*
2013-14	1,80,000	1	1,80,000
2014-15	2,50,000	2	5,00,000
2016-17	3,00,000	3	9,00,000
2017-18	3,50,000	4	14,00,000
		10	**29,80,000**

Note: Profit of the year 2015-16 has not been considered, because it is a year of strike (Abnormal operation).

	₹
Weighted average profit = $\frac{29,80,000}{10}$	2,98,000
Less: Increase in managerial remuneration	(25,000)
PBT	2,73,000
Tax @ 40%	(1,09,200)
PAT	1,63,800

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Less: Provision for replacement of fixed assets (₹ 1,63,800 x 20%)	(32,760)
	1,31,040
Less: Dividend for preference shares (₹ 2,50,000 x 12%)	(30,000)
Earnings available for distribution	1,01,040

2. Ascertainment of NRR criteria as applicable to Suvarn Ltd.

(A) Asset backing:

Particulars		₹
Total assets as per balance sheet		14,20,000
Add: Increase in the value of building	1,50,000	
Increase in the value of plant & machinery	2,00,000	3,50,000
Total		17,70,000
Less: Outside liabilities and preference share capital		
i. Sundry creditors	1,50,000	
ii. 15% debentures	1,20,000	
iii. 12% Preference share capital	2,50,000	(5,20,000)
Assets backing for equity share capital (a-b)		12,50,000
Equity share capital		5,00,000
Asset backing		2.5 times

(B) Dividend Rates:

Dividend rates have been fluctuating in the industry while Suvarn Ltd. has constant dividend rates.

3. Computation of adjusted Normal Rate of Return as applicable to Suvarn Ltd.

Particulars	*Asset backing*	*Dividend rates*
Industry standard	2 times	fluctuating
Suvarn Ltd.	2.5 times	constant
Degree of Variance from standard	+25%	N.A.
Impact on risk & consequent adjustment to NRR	↓	↓
Quantum of Adjustment to NRR (assuming 100% variance=1% change)	-0.25%	-0.50% (say)

Adjusted NRR = 15%-0.25%-0.50%=14.25%.

7. (a) Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (1,00,000 x 100)	1,00,00,000
Direct Labour	10,00,000
Variable Overhead	1,00,000

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Fixed Overhead $\frac{(1,00,000-40,625)}{95,000}$	59,375
Cost of Production for normal output i.e. 95,000 MT	1,11,59,375
Cost of closing inventory per unit (1,11,59,375/95,000)	₹ 117.467 (approx)
Net Realisable Value per unit	₹ 105

Since, net realisable value is less than cost, closing inventory will be valued at ₹ 105. Therefore, closing inventory is ₹ 5,25,000 (5,000 x 105).

Note: Abnormal wastage of 10,000 MT i.e.10,000 MT x ₹ 117.467 = ₹ 11,74,670 will be separately accounted for in the books.

(b) Computation of EVA

Particulars	*₹ in crores*
Net Operating Profit after Tax (NOPAT)	252.00
Less: Cost of Operating Capital Employed (COCE) [13.25% of ₹ 1,100]	(145.75)
Economic Value Added (EVA)	106.25

Working Notes:

1. Cost of Debt = Interest Rate (1 – Tax Rate) = 15% (1 - 30) = 10.50%
2. Cost of Preference Share = 15%
3. Cost of Equity = Risk Free Rate + (Beta x Equity Market Risk Premium)

   = (15.5% - 9%) + (1.5 x 9) = 20%
4. Total Capital Employed = 800 + 100 + 300 = 1,200 crores
5. WACC $= \left(\frac{800}{1,200}\times 10.50\%\right)+\left(\frac{100}{1,200}\times 15\%\right)+\left(\frac{300}{1,200}\times 20\%\right)$

   = 7% + 1.25% + 5% = 13.25%
6. Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT -Interest}} = \frac{\text{EBIT}}{\text{EBIT}-120}$ = 1.5

   EBIT = (120 x 1.5)/0.5 = 360
7. Net Operating Profit after Tax = 360 - 30% of 360 = 252
8. Operating Capital Employed = Total Capital Employed - Non-Operating Capital Employed

   = 1,200 -100 = 1,100 crores

(c) As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss

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statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper.

(d) As per para 19 of AS 16 'Borrowing Costs', capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2018) i.e. ₹ 8 lakhs alone can be capitalized. It cannot be extended to ₹ 10 lakhs.

(e) With the introduction of AS 26 'Intangible Assets', the concept of deferred revenue expenditure no longer prevails except in respect of a very few items, such as ancillary costs on borrowings, shares issue expenses etc. AS 26 does not permit the capitalization of expenses incurred on advertising or brand promotion, etc. Thus, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crore to the P & L account of the year is correct.

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