

Test Series: February, 2013

MOCK TEST PAPER – 1

FINAL 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) Star Ltd. purchased a conveyor system and the total amount capitalized on 1.4.2009 was for a value of ₹ 48.00 crores. The break-up of the capital cost was as follows:

	₹ in crore
Civil and mechanical structure	15.60
Driving units and planning	5.40
Rope	3.45
Belt	12.20
Safety and electrical equipments	7.25
Other accessories	<u>4.10</u>
	<u>48.00</u>

During the financial year 2012-2013 due to wear and tear, the rope used in the conveyor system was replaced by a new one at cost of ₹ 8.60 crores. As new rope did not increase the capacity and is a component of the total assets, the company charged the full cost of the new rope to repairs and maintenance. Old rope continues to appear in the books of account and is charged with depreciation every year.

Discuss the correctness of the accounting treatment.

- (b) From the following details of an asset
- Find out impairment loss
 - Treatment of impairment loss
 - Current year depreciation

Particulars of asset:

Cost of asset	₹56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹12 lakhs
Upward revaluation done in last year	₹14 lakhs

- (c) 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?
- (d) Great Ltd. was incorporated for the purpose of acquiring Support Ltd. The Balance Sheet of the company as on 31st March, 2013 is as follows:

Particulars	₹
Tangible fixed assets at cost less depreciation	5,00,000
Goodwill	60,000
Other assets	2,00,000
10% Debentures	70,000
Sundry creditors	80,000
Average annual profits before debenture interest	90,000
Professional valuation of tangible assets on 31 st March, 2013	6,20,000

- The Directors in their negotiations agreed that (i) the recorded Goodwill of Support Ltd. is valueless; (ii) the other assets of the Support Ltd. are worth ₹ 1,30,000; (iii) the valuation of 31st March in respect of tangible fixed assets should be accepted.
- The acquisition agreement provides to issue ₹ 10 nominal value ordinary shares for the value of the net assets of Support 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. (4 × 5 = 20 Marks)

2. The summarised Balance Sheets of Plus Ltd. and Minus Ltd. as on 31st March, 2013, are given below:

Liabilities	Plus Ltd.	Minus Ltd.	Assets	Plus Ltd.	Minus Ltd.
	₹	₹		₹	₹
Equity Share Capital	25,00,000	6,00,000	Tangibles Assets	40,00,000	5,00,000
General Reserves	16,00,000		Investment (60% holding in Minus Ltd.)	5,00,000	
Profit & Loss A/c	14,00,000		Stock in Trade	25,00,000	2,00,000
8% Debentures	5,00,000	4,00,000	Sundry Debtors	20,00,000	3,00,000
Bank Overdraft	20,00,000	7,00,000	Profit and Loss A/c		<u>10,00,000</u>
Sundry Creditors	<u>10,00,000</u>	<u>3,00,000</u>			
	<u>90,00,000</u>	<u>20,00,000</u>		<u>90,00,000</u>	<u>20,00,000</u>

When Plus Ltd. acquired the shares in Minus Ltd., the Profit and Loss A/c of Minus Ltd. reflected a balance of ₹ 2,00,000 (Dr.). Prepare Consolidated Balance Sheet of the Group as on 31st March, 2013 under the following situations:

- Minority shareholders are not under any express obligation to make good the losses.
- Minority shareholders are required to make good their share of losses subject to a maximum of (a) ₹ 1,00,000; (b) ₹ 2,00,000. (16 Marks)
- Better Ltd. and Best Ltd. are two companies. On 31st March, 2012 their summarised Balance Sheets were as under:

(₹ in crores)

	Better Ltd.		Best Ltd.	
Sources of funds:				
Share Capital:				
Authorised:		<u>500</u>		<u>500</u>
Issued: Equity shares of ₹10 each fully paid up		300		200
Reserves and surplus:				
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	<u>10</u>	<u>750</u>	<u>5</u>	<u>450</u>
Owners' funds		1,050		650

Loan funds		<u>250</u>		<u>350</u>
		<u>1,300</u>		<u>1,000</u>
Fund employed in:				
Fixed assets:				
Cost	1,000		700	
Less: Depreciation	<u>(400)</u>	600	<u>(300)</u>	400
Net current assets:				
Current assets	2,000		1,500	
Less: Current liabilities	<u>(1,300)</u>	<u>700</u>	<u>(900)</u>	<u>600</u>
		<u>1,300</u>		<u>1,000</u>

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 fixed assets costing ₹400 crores (written down value ₹160 crores), Current assets ₹900 crores, Current liabilities ₹750 crores and loan funds of ₹200 crores is to be transferred at ₹125 crores to Best Ltd.
2. Division D of Best Ltd. which has fixed assets costing ₹500 crores (depreciation ₹200 crores), Current assets ₹800 crores, Current liabilities ₹700 crores, and loan funds ₹250 crores is to be transferred at ₹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 the fixed assets taken over as follows:
 - (i) Division of D of Best Ltd. taken over: ₹325 crores.
 - (ii) Division B of Better Ltd. taken over: ₹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, 2013:

Liabilities	₹	Assets	₹
6,000, 14% Preference shares of ₹ 100 each, fully paid up	6,00,000	Goodwill	1,00,000
10,000 Equity shares of ₹ 100 each, ₹ 80 paid up	8,00,000	Tangible fixed assets 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	<u>8,00,000</u>		<u> </u>
	<u>29,80,000</u>		<u>29,80,000</u>

The company has been earning on an average ₹ 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 ₹17,20,000 and goodwill was found to be of no worth.
(10 Marks)

- (b) On the basis of the following Profit and Loss Account of Addition Limited and the supplementary information provided thereafter, prepare Gross Value Added Statement of the company for the year ended 31st March, 2013.

Profit and Loss Account of Addition Limited for the year ended 31st March, 2013

	Amount	Amount
	(₹ in lakhs)	(₹ in lakhs)
Income		
Sales		5,010
Other Income		<u>130</u>
		5,140
Expenditure		
Production and Operational Expenses	3,550	
Administrative Expenses	185	
Interest	235	
Depreciation	<u>370</u>	<u>(4,340)</u>
Profit before Taxation		800
Provision for Taxation		<u>(280)</u>

Profit after Taxation	520
Credit Balance as per last Balance Sheet	<u>40</u>
	<u>560</u>
Appropriations	
Transfer to General Reserve	100
Preference Dividend (Interim) paid	50
Proposed Preference Dividend (Final)	50
Proposed Equity Dividend	300
Balance carried to Balance Sheet	<u>60</u>
	<u>560</u>
Supplementary Information	
Production and Operational Expenses consist of:	
Raw Materials and Stores consumed	1,900
Wages, Salaries and Bonus	610
Local Taxes including Cess	220
Other Manufacturing Expenses	<u>820</u>
	<u>3,550</u>
Administrative Expenses consist of:	
Salaries and Commission to Directors	60
Audit Fee	24
Provision for Bad and Doubtful Debts	20
Other Administrative Expenses	<u>81</u>
	<u>185</u>
Interest is on:	
Loan from Bank for Working Capital	35
Debentures	<u>200</u>
	<u>235</u>

(6 Marks)

5. Huge Ltd. had acquired 51% in Tiny Ltd. for ₹ 75.80 lakhs on April 1st, 2011. On the date of the acquisition Tiny's assets stood at ₹ 196 lakhs and liabilities at ₹ 16 lakhs. The net asset position of Tiny Ltd. as on 31st March, 2012 and 30th September 2012 were ₹ 280 lakhs and ₹ 395 lakhs respectively, the increase resulting from profits earned during the period.

On 1st October, 2012, 25.5% holdings were sold for ₹ 125 lakhs. You are required to explain the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship. The profit arising on part sale of investment, carrying value of the portion

unsold and goodwill/capital reserve that arises on change in classification of the investment may also be worked out by you. (16 Marks)

6. (a) On the basis of the following information, prepare a note on share capital to the financial statements of 2012-13 as per the Revised Schedule VI:

S.No.	Date	Particulars
1.	31 st March, 2012	Authorised share capital of 80,000 equity shares of ₹ 10 each
2.	31 st March, 2012	Issued share capital of 70,000 equity shares of ₹ 10 each
3.	31 st August, 2012	Issued 5,000 equity shares as right shares
4.	1 st October, 2012	5,000 shares were issued to the public at an application amount of ₹ 5
5.	1 st December, 2012	Allotment money of ₹ 5 was called in the last quarter of the year.
6.	1 st January, 2013	Mr. Y to whom 100 shares were allotted failed to pay the allotment money
7.	February, 2013	Issued 10,000 shares to the employees against the stock options granted them three years back
8.	February, 2013	For the purpose, the company raised its authorised share capital to 1,00,000 shares of ₹ 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 ₹ 40. However, the exercise price drops to ₹ 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 ₹ 30, is ₹ 16 per option. If the exercise price is ₹ 40, the enterprise estimates that the stock options have a fair value of ₹ 12 per option. During year 1, the earnings of the enterprise increased by 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 ₹ 30. During year 2, the earnings of the enterprise increased by 13 per cent, and the enterprise continues to expect that the earnings target will be achieved.

During year 3, the earnings of the enterprise increased by 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 ₹ 40.

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

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

- (a) Style Limited borrowed an amount of ₹150 crores on 1.4.2011 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Style Ltd. capitalized ₹19.50 crores for the accounting period ending on 31.3.2012. Due to surplus fund out of ₹150 crores an income of ₹3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.
- (b) State the treatment of the following items with reference to Accounting Standards (as applicable in India), IFRS and US GAAP:
 - (i) Investment Property; and
 - (ii) Property, Plant and Equipment.
- (c) 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 ₹ 25,00,000 per year for the last three years.
 - (ii) Average total assets over the last three years equals ₹ 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 ₹ 15,00,000.

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

- (d) On 1st April 2009, A Ltd. issued a 10 per cent convertible debentures with a face value of ₹1,000 maturing on 31st March 2018. The debentures are convertible into equity shares of A Ltd. at a conversion price of ₹ 25 per share. Interest is payable half-yearly in cash. At the date of issue, A Ltd. could have issued non-convertible debt with a ten year term bearing a coupon interest rate of 11 per cent. On 1st April 2014, the convertible debenture has a fair value of ₹ 1,700. Show how an entity accounts for equity and liability at the inception.
- (e) Write a short note on Human Resource Accounting. (4 x 4 =16 Marks)