

Test Series: October, 2013

MOCK TEST PAPER – 2

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) From the following details of an asset
- (i) Find out impairment loss
 - (ii) Treatment of impairment loss
 - (iii) 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

- (b) During the financial year 2012-2013, Ms. Advanced Computers, incurred costs to develop and produce 'Excellent', which is low risk high-tech software. Following details are made available:

	₹
Completion of detailed program design	26,000
Costs incurred for coding and testing to establish technological feasibility	20,000
Other coding costs after establishment of technological feasibility	48,000
Other testing costs after establishment of technological feasibility	40,000

Costs of producing product masters for training manuals	30,000
Duplication of computer software and training materials from product masters (1000 units)	50,000
Packaging Product (500 units)	18,000

Required:

- (i) Determine the amount to be capitalised as software cost subject to amortisation as on 31st March 2013.
 - (ii) What expenditure should be booked as expenses during the financial year 2012-2013? Reply with reference to the AS 26?
- (c) 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.

- (d) A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –
- (a) Sale price of ₹50 lakhs is equal to fair value.
 - (b) Fair value is ₹ 60 lakhs.
 - (c) Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.

(d) Fair value is ₹ 40 lakhs and sale price is ₹50 lakhs.

(e) Fair value is ₹46 lakhs and sale price is ₹ 50 lakhs (4 × 5 = 20 Marks)

2. Evil Ltd. purchased control of Devil Ltd. on 01.10.2012. Following are the summarized Balance Sheets of Evil Ltd. and Devil Ltd. as at 31st March, 2013:

Liabilities	Evil Ltd.	Devil Ltd.	Assets	Evil Ltd.	Devil Ltd.
	₹	₹		₹	₹
Equity Capital (₹ 10)	6,00,000	3,00,000	Goodwill	10,000	40,000
General Reserves	60,000	50,000	Land & Buildings	1,00,000	1,00,000
Profit & Loss Account	1,00,000	1,00,000	Plant & Machinery	2,00,000	1,80,000
Bills Payable to Evil Ltd.	-	10,000	Investment: 22,500 Shares of Devil Ltd.	3,37,500	-
Sundry Creditors	1,00,000	70,000	Stock in Trade	1,17,500	1,00,000
			Trade Debtors	50,000	90,000
			Cash at Bank	45,000	20,000
	<u>8,60,000</u>	<u>5,30,000</u>		<u>8,60,000</u>	<u>5,30,000</u>

Note: Contingent Liability: Evil Ltd. has bills discounted of ₹ 15,000.

On 01.04.2012, Devil Ltd. had ₹ 50,000 in General Reserve and ₹ 60,000 in Profit and Loss A/c. On 30th September 2012, 10% dividend was declared by Devil Ltd. in respect of financial year 2011-12 from its profit and loss account. Evil Ltd. credited its share of dividend, on receipt, to the Profit and Loss Account.

Debtors of Devil Ltd. include ₹ 10,000 due from Evil Ltd. Machinery of Devil Ltd. standing in books at ₹ 2,00,000 as on 1.4.2012, was revalued at ₹ 2,40,000. Stock of Evil Ltd. includes goods valued at ₹ 16,000 purchased from Devil Ltd., on which the latter made a profit of 1/3rd on cost price.

Prepare the Consolidated Balance Sheet of Evil Ltd. and its subsidiary Devil Ltd. as on 31.03.2013. (16 Marks)

3. 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) 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>

(8 Marks)

- (b) Jayadev Ltd. had earned a PAT of ₹ 48 lakhs for the year just ended. It wants you to ascertain the value of its business, based on the following information.

1. Tax rate for the year just ended was 36%. Future tax rate is estimated at 34%.
2. The company's equity shares are quoted at ₹ 120 at the Balance Sheet date. The company had an equity capital of ₹ 100 lakhs, divided into shares of ₹ 50 each.
3. Profits for the year have been calculated after considering the following in the Profit and Loss Account:
 - (i) Subsidy ₹ 2 lakhs received from the Government towards fulfilment of certain social obligations. The Government has withdrawn this subsidy and hence, this amount will not be received in future.
 - (ii) Interest ₹ 8 lakhs is on term loan. The final instalment of this term loan was fully settled in this year.
 - (iii) Managerial remuneration ₹ 15 lakhs. The shareholders have approved an increase of ₹ 6 lakhs in the overall managerial remuneration, from the next year onwards.
 - (iv) Loss on sale of fixed assets and Investments amounting to ₹ 8 lakhs.

(8 Marks)

5. (a) 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)

- (b) On 1st April, 2013, Fair Return Mutual Fund has the following assets and prices at 3.00 p.m.

Shares of	No. of shares	Market price per share (₹)
P Ltd.	5000	19.70
Q Ltd.	25000	482.60
R Ltd.	5000	264.40
S Ltd.	50000	674.90
T Ltd.	15000	25.90

No. of units of fund

4,00,000 units

Calculate:

- (a) NAV of the Fund.
- (b) Assuming Mr. Mohan, send a cheque of ₹ 25,00,000 to the Fund on 1st April, 2013 and Fund Manager purchases 9,000 shares of R Ltd. and balance is held in bank. What will be the new position of the fund?
- (c) Now suppose on 2nd April 2013, at 3.00 p.m. the market price of shares is as follows:

Shares	₹
P Ltd.	20.30

Q Ltd.	513.70
R Ltd.	290.80
S Ltd.	671.90
T Ltd.	44.20

Calculate the new NAV?

(10 Marks)

6. (a) 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. A Ltd. makes a tender offer to debenture holders to repurchase the debentures for ₹ 1,700, which the holders accepted. At the date of repurchase, A Ltd. could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 per cent. Show how an entity accounts for (i) equity and liability at the inception and (ii) at the repurchase of the convertible instrument. (10 Marks)

- (b) LH Ltd. provides you with the following summarized balance sheet as at 31st March 2013. (₹ in lakhs)

Liabilities		Amount	Assets		Amount
Share Capital	981.46		Fixed Assets (Net)		2,409.90
Reserves and			Current Asset		50.00
Surplus	1,313.62	2,295.08			
Long term Debt		144.44			
Sundry Creditors		20.38			
		2,459.90			2,459.90

Additional information provided is as follows:

- (i) Profit before interest and tax is ₹ 2,202.84 lakhs
- (ii) Interest paid is ₹ 13.48 lakhs.
- (iii) Tax rate is 40%
- (iv) Risk Free Rate = 11.32%
- (v) Long term Market Rate = 12%
- (vi) Beta = 1.62 (highest during the period)
- (vii) Cost of equity = 12.42% and cost of debt = 5.6%.

You are required to calculate Economic Value Added of LH Ltd. (6 Marks)

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

(a) 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.

(b) DS Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. Normal operating cycle of the business is 20 months. First instalment is due on 1.4.2013 of ₹ 1,00,000. Determine how the loan will be classified for the purpose of the Financial Statements of DS Ltd. for the year ended 31.3.2013.

(c) Bright Finance Ltd. is a non-banking financial company. It provides you with the following information regarding its outstanding hire purchase instalments, ₹ 200 lakhs of which instalments are overdue on 200 accounts for last three months (amount overdue ₹ 40 lakhs) on 24 accounts for eight months (amount overdue ₹ 24 lakhs). On 10 accounts for more than 30 months (amount overdue ₹ 20 lakhs) and 4 accounts for more than three years (amount over due ₹ 20 lakhs-already identified as sub-standard assets) and one account of ₹ 10 lakhs which has been identified as non-recoverable by the management. Out of 10 accounts overdue for more than 30 months, 6 accounts are already identified as sub-standard (amount ₹ 6 lakhs) for more than two years and other are identified as sub-standard asset for a period of less than two years.

Classify the assets of the company in line with Non-Banking Financial (Deposit, Accepting or Holding) Companies, Prudential Norms (Reserve Bank) Directions, 2007.

(d) 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.

(e) 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?
(4 x 4 =16 Marks)