

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

1. (a) Computation of average accumulated expenses

	₹
1 st April, 2010 ₹ 5,00,000 × $\frac{12}{12}$	5,00,000
1 st August, 2010 ₹ 12,00,000 × $\frac{8}{12}$	8,00,000
1 st January, 2011 ₹ 2,00,000 × $\frac{3}{12}$	<u>50,000</u>
	<u>13,50,000</u>
Interest on average accumulated expenses	
On specific borrowing (4,00,000 × 10%)	40,000
On Non-specific borrowings (13,50,000 – 4,00,000) × 12%	<u>1,14,000</u>
Amount of interest to be capitalized	<u>1,54,000</u>
Total expenses to be capitalized for borrowings:	
Cost of Plant (5,00,000 + 12,00,000 + 2,00,000)	19,00,000
Add: Amount of interest to be capitalized	<u>1,54,000</u>
	<u>20,54,000</u>

- (b)** As per para 21 of AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”, the preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate does not bring the resulting amount within the definition either of prior period item or of an extraordinary item .

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2011-2012. Subsequently in 2012 they revised the estimates based on the changed circumstances and wants to create 8% provision. AS per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS – 5 (Revised), a change in accounting estimate which has material effect in the current period should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

- (c) The accounting treatment of the Foreign Branches depend on whether they are Integral Operations (IFO) or Non-Integral Foreign Operations (NFO).
- (1) In respect of IFO, the difference of ₹ 20 lakhs shall be taken to the Profit and Loss Account, since they constitute exchange differences on monetary items, when translated using the closing rate.
 - (2) In respect of NFO, the difference shall be accumulated in the Foreign Currency Translation Reserve Account, until the disposal of the Net Investment. At the time of disposal of net investment in a NFO, they should be charged/credited to the Profit and Loss Account.
- (d) Paragraph 7 of AS 18, reads as under: “No disclosure is required in consolidated financial statements, in respect of intra-group transactions” in as much as the transactions themselves would get eliminated in the consolidation process. It is also unnecessary because Consolidated Financial Statement presents information about the holding and its subsidiary as a single reporting enterprise.

**2. Consolidated Balance Sheet of P Ltd. and its subsidiary Q Ltd.
as at 30th September, 2011**

<i>Liabilities</i>	₹	<i>Assets</i>	₹
<i>Share Capital:</i>		<i>Fixed Assets:</i>	
Equity Shares of ₹ 100 each	5,00,000	Goodwill	2,56,000
12% Preference Shares	1,00,000	Machinery	1,60,000
<i>Reserve and Surplus:</i>		Vehicle	2,50,000
General Reserve (Note 6)	1,48,000	Furniture	80,000
Profit & Loss A/c (Note 5)	1,94,000	<i>Investments</i>	Nil
Minority Interest	80,000	<i>Current Assets, Loans and Advances:</i>	
<i>Secured Loans</i>	Nil	Stock	2,06,000
<i>Unsecured Loans</i>	Nil	Sundry Debtors	2,45,000
<i>Current Liabilities and Provisions:</i>		Cash at Bank	65,000
Sundry creditors	1,10,000		
Income Tax	<u>1,30,000</u>		
	<u>12,62,000</u>		<u>12,62,000</u>

Working Notes:

(1) Degree of Control = $\frac{1,200 \text{ Shares} + 400 \text{ Bonus Shares}}{2,000 \text{ shares}} = 4/5\text{th}$; Minority = $1/5\text{th}$

(2) **Reserves and surplus of Q Ltd.**

<i>Proprietary Balances</i>		<i>Total (₹)</i>	<i>P Ltd.'s Share (4/5)</i>	<i>Minority Interest (1/5)</i>
(a)	Capital Profit			
	1. Pre-acquisition Profit	30,000		
	Less: Equity Dividend paid	18,000		
	Less: Preference Dividend	<u>6,000</u>		
		24,000		
		6,000		
	2. Pre-acquisition General Reserve	50,000		
	Less: Bonus Shares	<u>50,000</u>		
		Nil		
		<u>6,000</u>	4,800	1,200
(b)	Post-acquisition Profit			
	Profit as per Balance Sheet	90,000		
	Less: Pre-acquisition Profit	<u>6,000</u>		
		<u>84,000</u>	67,200	16,800
(c)	Post-acquisition General Reserve			
	General Reserve as per Balance Sheet	60,000		
	Less: Pre-acquisition General Reserve	<u>Nil</u>		
		<u>60,000</u>	48,000	12,000
(d)	Share Capital (Equity + Preference)	2,50,000		
	Less: Minority Interest (₹ 40,000 + ₹ 10,000)	<u>50,000</u>		50,000
	Adjusted in W.N. 3	<u>2,00,000</u>		
				<u>80,000</u>

(3) **Calculation of Goodwill/Capital Reserve**

	₹	₹
Cost of Investments (2,80,000 + 1,00,000)		3,80,000
Less: Capital Profit	4,800	
Less: Dividend out of pre-acquisition profit (80% of ₹ 24,000)	19,200	
Less: Face Value of Shares held (W.N. 2)	<u>2,00,000</u>	<u>2,24,000</u>
Goodwill		<u>1,56,000</u>

(4) **Other Assets and Liabilities (Consolidated)**

Particulars	Goodwill	Machinery	Vehicle	Furniture	Stock	Debtors	Bank	Creditors	Income Tax
P Ltd.	60,000	1,00,000	1,80,000	50,000	70,000	1,00,000	40,000	60,000	70,000
Q Ltd.	<u>40,000</u>	60,000	70,000	30,000	<u>1,40,000</u>	<u>1,65,000</u>	25,000	<u>70,000</u>	60,000
	1,00,000	-			2,10,000	2,65,000		1,30,000	
From W.N. 3	1,56,000	-							
Less: Unrealised Profit on Stock (W.N. 7)	-	-	-	-	4,000	-	-	-	-
Mutual Indebtedness	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,000</u>	<u>-</u>	<u>20,000</u>	<u>-</u>
	<u>2,56,000</u>	<u>1,60,000</u>	<u>2,50,000</u>	<u>80,000</u>	<u>2,06,000</u>	<u>2,45,000</u>	<u>65,000</u>	<u>1,10,000</u>	<u>1,30,000</u>

(5) **Consolidated Profit and Loss Account**

	₹
P Ltd.	1,50,000
Less: Dividend from pre-acquisition profit	<u>19,200</u>
	1,30,800
Add: Share of post-acquisition profit from Q Ltd. (W.N. 2)	<u>67,200</u>
	1,98,000
Less: Unrealised Profit on stock (W.N. 7)	<u>4,000</u>
	<u>1,94,000</u>

(6) **Consolidated General Reserve**

	₹
P Ltd.	1,00,000
Post-acquisition share from Q Ltd. (W.N. 2)	<u>48,000</u>
	<u>1,48,000</u>

(7) **Unrealised Profit on stock**

	₹
Total Profit $\frac{₹25}{₹125} \times ₹20,000 = ₹4,000$	4,000
As per AS -21 entire unrealized profit on stock is to be eliminated.	

- (8) After issue of one bonus share for every 3 shares held, the share capital is ₹ 2,00,000. It means share capital before bonus issue was $\frac{₹2,00,000}{4} \times 3 = ₹1,50,000$ i.e., 1,500 shares of ₹ 100 each. So 12% dividend which was declared on 1st December, 2010 will be calculated on the share capital of ₹ 1,50,000. Total equity dividend will be 12% of ₹ 1,50,000 = ₹ 18,000

3. (i) **Intrinsic value on the basis of book values**

	₹ in lakhs	₹ in lakhs
Goodwill		420
Other Fixed Assets		11,166
Current Assets		2,910
Loans and Advances		<u>933</u>
		15,429
Less: Secured loans	4,500	
Current liabilities	1,242	
Provisions	<u>960</u>	<u>6,702</u>
		8,727
Add: Notional call on 90 lakhs equity shares @ ₹ 2 per share		<u>180</u>
		<u>8,907</u>

Equivalent number of equity shares of ₹ 10 each.

	₹ in lakhs
Fully paid shares of ₹ 10 each	180
Partly-paid shares after notional call	90
Fully paid shares of ₹ 5 each, $\frac{₹ 150 \text{ lakhs}}{₹ 10} \times ₹ 5$	<u>75</u>
	<u>345</u>

$$\text{Value per equivalent share of ₹ 10 each} = ₹ \frac{8,907 \text{ lakhs}}{345 \text{ lakhs}} = ₹ 25.82$$

Hence, intrinsic values of each equity share are as follows:

Value of fully paid share of ₹ 10 = ₹ 25.82 per equity share.

Value of share of ₹ 10, ₹ 8 paid-up = ₹ 25.82 – ₹ 2 = ₹ 23.82 per equity share.

$$\text{Value of fully paid share of ₹ 5} = \frac{₹ 25.82}{2} = ₹ 12.91 \text{ per equity share.}$$

(ii) Valuation on dividend yield basis:

$$\text{Value of fully paid share of ₹ 10} = \frac{20}{15} \times ₹ 10 = ₹ 13.33$$

$$\text{Value of share of ₹ 10, ₹ 8 paid-up} = \frac{20}{15} \times ₹ 8 = ₹ 10.67$$

$$\text{Value of fully paid share of ₹ 5} = \frac{20}{15} \times 5 = ₹ 6.67$$

(iii) Valuation on the basis of EPS:

Profit after tax = ₹ 1,371 lakhs

Total share capital = ₹ (1,800 + 720 + 750) lakhs = ₹ 3,270 lakhs

$$\text{Earning per rupee of share capital} = ₹ \frac{1,371 \text{ lakhs}}{3,270 \text{ lakhs}} = ₹ 0.419$$

Earning per fully paid share of ₹ 10 = ₹ 0.419 × 10 = ₹ 4.19

Earning per share of ₹ 10 each, ₹ 8 paid-up = ₹ 0.419 × 8 = ₹ 3.35

Earning per share of ₹ 5, fully paid-up = ₹ 0.419 × 5 = ₹ 2.10

$$\text{Value of fully paid share of ₹ 10} = ₹ \frac{4.19}{2} \times 10 = ₹ 20.95$$

$$\text{Value of share of ₹ 10, ₹ 8 paid-up} = ₹ \frac{3.35}{2} \times 10 = ₹ 16.75$$

$$\text{Value of fully paid share of ₹ 5} = ₹ \frac{2.10}{2} \times 10 = ₹ 10.50$$

4. Journal Entries in the Books of H Ltd.

		<i>Dr.</i>	<i>Cr.</i>
		₹	₹
Business Purchase Account	Dr.	12,42,500	
To Liquidator of S Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of S Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (₹ 100)			9,03,600
To Securities Premium Account (₹ 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of H Ltd. as on 31st December, 2011

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
	₹		₹
Equity Share Capital: 17,036 shares of ₹ 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	Fixed Assets (5,00,000 + 8,50,000)	13,50,000
General Reserve	4,00,000	Goodwill (6,00,000 + 1,00,000 + 16,000)	7,16,000
Securities Premium	3,38,850	Investments (2,00,000+1,92,500)	3,92,500
Investment Allowance Reserve	2,00,000	Current Assets	
Sundry Creditors	<u>7,00,000</u>	(7,00,000 – 50 – 16,000)	6,83,950
	<u>33,42,450</u>	Amalgamation Adjustment Account	<u>2,00,000</u>
			<u>33,42,450</u>

Working Notes:

1. Calculation of net asset value of shares

	<i>H Ltd.</i>	<i>S Ltd.</i>
	₹	₹
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	<u>4,00,000</u>	<u>3,00,000</u>
	16,00,000	15,80,000
Less: Sundry Creditors	<u>5,00,000</u>	<u>2,00,000</u>
Net assets	<u>11,00,000</u>	<u>13,80,000</u>
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investment of S Ltd. are calculated as follows:	₹
Shares in H Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	<u>1,92,500</u>
	<u>3,30,000</u>

2. Calculation of Purchase Consideration

	₹
Net assets of S Ltd.	<u>13,80,000</u>
Value of Shares of H Ltd.	<u>137.50</u>
Number of shares to be issued in H Ltd. to S Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by S Ltd.	<u>1,000</u>
Additional shares to be issued	<u>9,036.36</u>
Total value of shares to be issued (9,036.36 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	<u>50</u>
	<u>12,42,500</u>

5. (a) Computation of Economic Value Added

E.V.A. (Economic Value Added) = NOPAT – COCE

NOPAT = Net Operating Profit after Tax

COCE = Cost of Capital Employed

Particulars	₹
a. Net operating profit after taxes	25,00,000
b. Less: Cost of Capital (WN 2)	<u>6,00,000</u>
c. Economic Value Added	<u>19,00,000</u>

Decision:

The company qualifies for the loan because the economic value added is greater than zero.

Working Notes:

1. Capital Employed

Particulars	₹
Average total assets	75,00,000
Less: Average current liabilities	<u>15,00,000</u>
Total capital employed	<u>60,00,000</u>

2. **Cost of capital** = Capital employed x Weighted average cost of capital
= ₹ 60,00,000 x 10% = ₹ 6,00,000

(b)

	(₹'000)
Net Assets at commencement of Accounting period	12,00,000
Add: Par Value of Units Issued $8,50,200 \times 100$	85,020
Less: Par Value of units Redeemed $7,52,300 \times 100$	75,230
Add: Balance in Reserve/Equalization Fund Transferred	7,570
Net Income for the year	<u>85,000</u>
Net Assets at close of Accounting period	<u>13,02,360</u>

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
Par Value thereof (₹ '000)	85,020	75,230
Sale Proceeds/Redemption Value (₹ '000)	96,500	71,320
Profit/(Loss) transferred to Reserve/Equalization A/c (₹ '000)	11,480	(3,910)
Net Balance in Reserve/Equalization Fund (₹ '000)	7,570	

6. (a) The interest rate swap is used to hedge fair value of fixed-rate debt. This is a case of fair value hedge.

In the books of Om Ltd.

Journal Entries

	Dr.(₹ in lakh)	Cr.(₹ in lakh)	
Interest A/c Dr. To Cash A/c (Being interest on fund borrowed for first half-year 2011-12)	0.35	0.35	10 % 7% 6/12
Loss on valuation of debt A/c Dr. To Loan A/c (Being increase in value of debt recognised)	0.20	0.20	10.2 – 10
Swap Hedge A/c Dr.	0.20		

To Gain on Swap Hedge A/c (Being increase in value of swap recognised)			0.20	
Cash A/c	Dr.	0.05		10 (7% – 6%) × 6/12
To Interest A/c (Being swap settlement received for first half-year 2011-12)			0.05	
Interest A/c	Dr.	0.35		10 × 7% × 6/12
To Cash A/c Being interest on fund borrowed for second half-year 2011-12)			0.35	
Loan A/c	Dr.	0.30		10.2 – 9.9
To Gain on valuation of debt (Being decrease in value of debt recognised)			0.30	
Loss on Swap Hedge A/c	Dr.	0.30		0.2 – (– 0.1)
To Swap Hedge A/c Being cumulative loss on swap recognised)			0.30	
Interest A/c	Dr.	0.05		10 (8% – 7%) × 6/12
To Cash A/c (Being swap settlement paid for second half-year 2011-12)			0.05	

(b) Journal Entries in the Books of ABC Ltd.

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.2009	Employees compensation expenses account Dr. 48,000 To Employees stock option outstanding account 48,000 (Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)		
	Profit and loss account Dr. 48,000		

	To Employees compensation expenses account (Being expenses transferred to profit and loss account at the end of the year)			48,000
31.3.2010	Employees compensation expenses account Dr. To Employees stock option outstanding account (Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)	48,000		48,000
	Profit and loss account Dr. To Employees compensation expenses account (Being expenses transferred to profit and loss account at the end of the year)	48,000		48,000
31.3.2011	Employees stock option outstanding account Dr. (W.N.) To General Reserve account (W.N.) (Being excess of employees compensation expenses transferred to general reserve account)	12,000		12,000
30.6.2011	Bank A/c (600 x ₹ 40) Dr. Employee stock option outstanding account (600 x ₹ 120) Dr.	24,000 72,000		
	To Equity share capital account (600 x ₹ 10)			6,000
	To Securities premium account (600 x ₹ 150) (Being 600 employees stock option exercised at an exercise price of ₹ 40 each)			90,000
01.10.2011	Employee stock option outstanding account Dr. To General reserve account (Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)	12,000		12,000

Working Note:

On 31.3.2011, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options, that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

	₹
No. of options actually vested (700 x ₹ 120)	84,000
Less: Expenses recognized ₹ (48,000 + 48,000)	<u>96,000</u>
Excess expenses transferred to general reserve	<u>12,000</u>

7. (a) Capitalised value of ₹ 30,000 at 12% rate of return = $30,000 \times 100/12 = ₹ 2,50,000$

Limit upto which the company may bid for an Engineer	=	₹ 2,50,000
New Capital base	= 5,00,000 + 2,50,000 =	<u>₹ 7,50,000</u>
Required rate of return on new capital base	= $7,50,000 \times 12/100 =$	₹ 90,000
Profit generated at old capital base	=	<u>₹ 50,000</u>
Additional profit generated by the Engineer	= 90,000 – 50,000 =	<u>₹ 40,000</u>

Therefore, the maximum bid can go upto the capitalized value of additional profit of ₹ 3,33,333 (i.e., $40,000 \times 100/12$).

(b) Statement Showing Computation of Tier- I Capital

		(₹ in lakhs)
Paid up Equity Capital		100
Free Reserve		<u>500</u>
	(A)	600
Deduct deferred expenditure	(B)	<u>200</u>
	(C)	<u>400</u>
Investments		
In shares of subsidiaries and Group Companies		100
In Debenture of subsidiaries and Group Companies		<u>100</u>
		200
10% (C)	(D)	<u>40</u>
Excess of Investment over 10% of (C) = (E)		<u>160</u>
Tier- I Capital [(C - E)]		<u>240</u>

- (c) Paragraph 8.4 and 13 of Accounting Standard 9 on 'Revenue Recognition' states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th April, 2011, while it is declared on 15th June, 2011. Hence, the right to receive payment is established on 15th June, 2011. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by P Ltd. in the financial year ended 31st March, 2012.

The recognition of ₹ 10 lakhs on accrual basis in the financial year 2010-2011 is not as per AS 9 'Revenue Recognition'.

(d)

(i)	Indian AS	IFRS	US GAAPs
Impairment of assets	Assets are impaired at higher of fair value less costs to sell and value in use based on discounted cash flows. Impairment test is to be conducted every year and if there is upward increase in the value of asset than reversal of impairment losses is required in certain circumstances. Assets are not separately classified or disclosed as held for sale on the face of the balance sheet.	Similar to Indian Accounting Standard. However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.	Impairment is assessed on undiscounted cash flows for assets to be held and used. If less than carrying amount, impairment loss is measured using market value or discounted cash flows. Reversal of losses is prohibited.
(ii)	Indian AS	IFRS	US GAAPs
Earnings per share – diluted	Weighted average potential dilutive shares are used as denominator for diluted EPS, except in certain circumstances where advance share application money received is treated as dilutive potential equity shares.	Weighted average potential dilutive shares are used as denominator for diluted EPS.	Similar to IFRS.

(e) Computation of earnings per share

	<i>Earnings</i>	<i>Shares</i>	<i>Earnings per share</i>
Net profit for the year 2010-11	₹ 15,00,000		
Weighted average number of shares outstanding during year 2010-11		6,00,000	
Basic earnings per share			₹ 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00		<u>(60,000)</u>	
Diluted earnings per share	<u>₹ 15,00,000</u>	<u>6,40,000</u>	₹ 2.34 (approx.)