

Test Series: September, 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) N Ltd. sells beer to customers; some of the customers consume the beer in the bars run by N Ltd. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting these empty bottles which are sold by the company by calling the tenders. Keeping this in view:
- (i) Decide whether the stock of empty bottles is an asset of the company;
 - (ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?
- (b) Support Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is ₹ 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of the second year and any charge to the Statement of profit and loss.
- (c) From the following details, compute according to Lev and Schwartz (1971) model, the value of human resources of the employees.

(i)	Annual average earnings of an employee till the retirement age	₹ 30,000
(ii)	Age of retirement	62 years
(iii)	Discount rate	15%
(iv)	No. of employees	50
(v)	Average age	60 years

(d) Write short notes on presentation of MAT credit in the financial statements.

(4 × 5 = 20 Marks)

2. The draft Balance Sheets of 3 Companies as at 31st March, 2013 are as below:

Liabilities	(In ₹ 000's)		
	M Ltd.	E Ltd.	N Ltd.
Share Capital – shares of ₹ 100 each	40,000	20,000	10,000
Reserves	1,800	1,000	900
P/L A/c (1.4.2012)	1,500	2,000	800
Profit for 2012-13	7,000	3,800	1,800
Loan from M Ltd.	—	5,000	—
Creditors	<u>2,500</u>	<u>1,000</u>	<u>1,400</u>
	<u>52,800</u>	<u>32,800</u>	<u>14,900</u>
Assets			
Investments:			
1,60,000 shares in E Ltd.	18,000	—	—
75,000 shares in N Ltd.	8,000	—	—
Loan to E Ltd.	5,000	—	—
Sundry assets	<u>21,800</u>	<u>32,800</u>	<u>14,900</u>
	<u>52,800</u>	<u>32,800</u>	<u>14,900</u>

Following additional information is also available:

- Dividend is proposed by each company at 10%.
- Stock transferred by N Ltd. to E Ltd. was ₹ 8 lacs on which the former made a profit of ₹ 3 lacs. On 31st March, 2013, this was in the inventory of the latter.
- Loan referred to is against 8% interest. Neither M Ltd. nor E Ltd. has considered the interest.
- Reserves as on 1.4.2012 of E Ltd. and N Ltd. were ₹ 8,00,000 and ₹ 7,50,000 respectively.
- Cash-in-transit from E Ltd. to M Ltd. was ₹ 1,00,000 as on 31.3.2013.
- The shares of the subsidiaries were all acquired by M Ltd. on 1st April, 2012.

Prepare Consolidated Balance Sheet as on 31st March, 2013. Workings should form part of the answer.

(16 Marks)

- From the following information of Worth Ltd., compute the economic value added:
 - Share capital ₹ 2,000 lakhs
 - Reserves and surplus ₹ 4,000 lakhs

(iii) Long-term debt	₹ 400 lakhs
(iv) Tax rate	30%
(v) Risk free rate	9%
(vi) Market rate of return	16%
(vii) Interest	₹ 40 lakhs
(viii) Beta factor	1.05
(ix) Profit before interest and tax	₹ 2,000 lakhs

(8 Marks)

- (b) A Mutual Fund raised ₹ 100 lakhs on April 1, 2013 by issue of 10 lakh units of ₹ 10 per unit. The fund invested in several capital market instruments to build a portfolio of ₹ 90 lakhs. The initial expenses amounted to ₹ 7 lakh. During April, 2013, the fund sold certain securities of cost ₹ 38 lakhs for ₹ 40 lakhs and purchased certain other securities for ₹ 28.20 lakhs. The fund management expenses for the month amounted to ₹ 4.50 lakhs of which ₹ 0.25 lakh was in arrears. The dividend earned was ₹ 1.20 lakhs. 75% of the realized earnings were distributed. The market value of the portfolio on 30.04.2013 was ₹ 101.90 lakh.

Determine NAV per unit. (8 Marks)

4. NRPL (Nuclear Reactors Private Limited) is engaged in the business of design and construction of nuclear reactors that are supplied exclusively to the Atomic Energy Department. The core component of such reactors is outsourced by NRPL from FIL (Fusion Industrials Ltd.) the sole manufacturer of this item. NRPL wants to gain leadership in this industry and seeks to take over FIL. NRPL estimates that its Goodwill in the industry will increase by a minimum of ₹ 300 crores consequent on the acquisition. NRPL has made the following calculation of the economic benefits presently available and that foreseen as a result of the acquisition.

- (i) Projected Cash Flows of NRPL for the next 5 years:

Year	1	2	3	4	5
Cash flow (₹ in crores)	1,000	1,500	2,000	2,500	3,000

- (ii) Projected Cash Flow of FIL for the next 5 years.

Year	1	2	3	4	5
Cash flow (₹ in crores)	400	400	600	800	1,000

- (iii) Audited net worth of FIL

	₹ in crores
Fixed assets	2,000
Investments (non-trade)	1,000
Current assets	<u>1,000</u>

Total assets	4,000
Less: Current liabilities	<u>1,000</u>
Net worth	<u>3,000</u>

(iv) Other information:

- 10% of the fixed assets of FIL will not be required in the event of the acquisition and the same has ready buyers for ₹ 100 crore.
- Current Assets include surplus stocks of ₹ 20 crore that can realize ₹ 30 crore.
- Investments have a ready market for ₹ 1,500 crore.
- The current liabilities are to be paid off immediately; ₹ 510 crores are payable on account of a compensation claim awarded against FIL, which has been treated as a contingent liability in the accounts on which 20 percent was provided for.

(v) NRPL has estimated the combined cash flows post merger as under:

Year	1	2	3	4	5
Cash flow (₹ in crores)	1,500	2,000	2,500	3,000	3,500

You are required to advise NRPL the maximum value it can pay for takeover of FIL; also show the current valuation of FIL as a 'Stand Alone' entity. The Discount rate of 15% is advised appropriate, values for which are given below:

Year	P.V
1	0.870
2	0.756
3	0.658
4	0.572
5	0.497

(16 Marks)

5. The following are the summarized Balance Sheets of Nisha Ltd. and Misha Ltd. for the year ending on 31st March, 2013:

(₹ in crores)

	Nisha Ltd.	Misha Ltd.
Equity share capital – in equity shares of ₹ 10 each	50	40
Preference share capital – in 10% preference shares of ₹ 100 each	–	60
Reserves and Surplus	<u>200</u>	<u>150</u>
	250	250
Loans – Secured	<u>100</u>	<u>100</u>
Total funds	<u>350</u>	<u>350</u>

Applied for: Fixed assets at cost less depreciation	150	150
Current assets	<u>200</u>	<u>200</u>
	<u>350</u>	<u>350</u>

The present worth of fixed assets of Nisha Ltd. is ₹ 200 crores and that of Misha Ltd. is ₹ 429 crores. Goodwill of Nisha Ltd. is ₹ 40 crores and of Misha Ltd. is ₹ 75 crores.

Misha Ltd. absorbs Nisha Ltd. on 1.4.2013, by issuing equity shares at par in such a way that intrinsic net worth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

- (a) Show the Balance Sheet after absorption.
 - (b) Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings. (16 Marks)
6. (a) At the beginning of year 1, the enterprise grants 100 stock options to each of its 500 employees, conditional upon the employees remaining in the employment of the enterprise during the vesting period. The options will vest at the end of year 1 if the earnings of the enterprise is 18 per cent; at the end of year 2 if the earnings of the enterprise is an average of 13 per cent per year over the two year period; and at the end of year 3 if the earnings of the enterprise is an average of 10 per cent per year over the three year period. The fair value of the options, calculated at the grant date using an option pricing model, is ₹ 30 per option. No dividends are expected to be paid over the three-year period.
- By the end of year 1, the earnings of the enterprise was 14 per cent, and 30 employees had left. The enterprise expected that earnings will continue at a similar rate in year 2, and, therefore, expected that the options will vest at the end of year 2. The enterprise expected on the basis of a weighted average probability, that a further 30 employees will leave during the year 2, and, therefore, assumed that options will vest in 440 employees at the end of the year 2.
- By the end of year 2, the earnings of the enterprise was only 10 per cent. 28 employees have left during the year. The enterprise expected that a further 25 employees will leave during year 3, and that the earnings of the enterprise in the 3rd year will be at least 6 per cent, thereby achieving the average of 10 per cent per year.
- By the end of the year 3, 23 employees had left and the earnings of the enterprise had been 8 per cent. You are required to determine the compensation expense to be recognised each year.
- (b) In the financial statements of the financial year 2012-13, Alpha Ltd. has mentioned in the notes to accounts that during financial year, 24,000 equity shares of ₹ 10 each were issued as fully paid bonus shares. However, the source from which these bonus shares were issued has not been disclosed. Is

such non-disclosure a violation of the Revised Schedule VI to the Companies Act? Comment. (12 + 4 = 16 Marks)

7. Answer any four of the following:

- (a) Explain the significant difference among IFRS, US GAAP and AS (applicable in India) with regard to:
 - (i) Inventories
 - (ii) Earnings per share – diluted.
- (b) Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years. You are required to advise the company.
- (c) B Ltd. entered into a sale deed for its immovable property with A Ltd. before the end of the year and that property was given for use to A Ltd. at the same time. Registration was done with the registrar subsequent to Balance Sheet date, but before finalization of accounts. Is it possible to recognize the sale and the gain at the Balance Sheet date? Give your view with reasons.
- (d) On 1st April, 2009, Delta Ltd. issued ₹ 30,00,000, 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.13 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%. Being compound financial instrument, you are required to separate equity and debt portion as on 01.04.09. The present value of Re. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

	6%	10%
End of year 1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

- (e) From the following information determine the possible value of brand under the potential earning model:

	(₹ in lakhs)
(a) Profit before tax	13.00
(b) Income tax	3.00
(c) Tangible Fixed Asset	20.00
(d) Identifiable Intangible other than brand model	10.00
(e) Expected return on tangible fixed assets	6.00

Appropriate capitalization factor for intangibles is 25%.

(4 x 4 =16 Marks)