

Test Series: August, 2017

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 assumption(s) may be made by the candidates.

1. (a) A Ltd. leased a machinery to B Ltd. on the following terms:

	(₹ in Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income.

- (b) ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with AS 10 (Revised).

- (c) Prakash Ltd. purchased assets costing Rs. 5,000 lakh on 01.04.2016 payable in foreign currency (US\$) on 05.04.2017. Exchange rate of 1 US \$ = Rs. 50.00 and Rs. 54.98 as on 01.04.2016 and 31.03.2017 respectively.

The company also obtained a soft loan of US \$ 1 lakh on 01.04.2016 payable in three annual equal instalments. First instalment was due on 01.05.2017.

You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2017 assuming that the company has availed the option under para 46A of AS 11.

- (d) V Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 150 lakhs during 2013-2014 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2016-2017, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was Rs. 21 lakhs and written down value of plant was Rs. 105 lakhs.

- (i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2016-2017 in profit and loss account?

- (ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2013-2014 assuming plant account showed the balance of Rs. 84 lakhs as on 1.4.2016? (4 x 5 = 20 Marks)

2. S Ltd. carried on manufacturing business. Its products were sold to wholesalers and the company had its own retail shop. B Pvt. Ltd. carried on similar manufacturing business, but all goods produced were sold through the company's own retail shops.

The summarised balance sheets of the two companies as at 31st March, 2017 were as follows:

	<i>S Ltd.</i> Rs.	<i>B Pvt. Ltd.</i> Rs.		<i>S Ltd.</i> Rs.	<i>B Pvt. Ltd.</i> Rs.
<i>Share Capital</i>			<i>Fixed Assets :</i>		
<i>Authorised Equity</i>			<i>Freehold</i>		
<i>Shares of Rs. 10</i>	<u>40,00,000</u>	<u>6,00,000</u>	<i>Properties at cost</i>	10,00,000	2,50,000
<i>Issued & fully paid up</i>	25,00,000	6,00,000	<i>Plant & Machinery at cost less depreciation</i>	<u>13,00,000</u>	<u>1,00,000</u>
<i>P & L A/c</i>	3,40,000	90,000		23,00,000	3,50,000
<i>Trade payables</i>	4,20,000	70,000	<i>Current Assets :</i>		
			<i>Inventory</i>	4,80,000	1,20,000

			Trade receivables	2,30,000	80,000
			Bank	<u>2,50,000</u>	<u>2,10,000</u>
	<u>32,60,000</u>	<u>7,60,000</u>		<u>32,60,000</u>	<u>7,60,000</u>

The original cost of Plant and Machinery was:

S Ltd. Rs. 26,00,000

B Pvt. Ltd. Rs. 2,00,000

The following arrangements were made and carried out on April 1, 2017:

- (1) S Ltd. purchased from the shareholders of B Pvt. Ltd. all the issued shares @ Rs. 14 per share.
- (2) The shareholders of B Pvt. Ltd. took over one of the freehold properties of B Pvt. Ltd. for Rs. 60,000, at the book value of the same. It was agreed that the amount should be set off against the amount due to them under (1) above and the balance due to them to be satisfied by the issue of an appropriate number of equity shares in S Ltd. at Rs. 19.50 per share.

The necessary transfer in regard to the setting off the price of the property taken over by the shareholders against the amount due to them from S Ltd. were made in the books of the two companies.

- (3) All manufacturing was to be carried on by S Ltd. and all retail business is to be carried on by B Pvt. Ltd. in this connection.
 - (i) S Ltd. purchased the whole of B Pvt. Ltd.'s plant and machinery for Rs. 1,50,000 and certain of their free-hold property (cost Rs. 1,00,000) at Rs. 1,20,000.
 - (ii) B Pvt. Ltd. purchased S Ltd.'s. freehold retail shop buildings (cost to S Ltd. Rs. 75,000) at Rs. 60,000 and took over the retail inventory at Rs. 80,000 at the book value.
- (4) S Ltd. drew a cheque in favour of B Pvt. Ltd. for the net amount due, taking into account all the matters mentioned above.
- (5) Immediately after the transfer of shares in (1) above, B Pvt. Ltd. declared and paid a dividend of Rs. 60,000 (ignore Dividend Distribution Tax).

You are required to prepare the Balance Sheets of S Ltd. and B Pvt. Ltd. immediately after the completion of the above transaction. (16 Marks)

3. A Limited purchased 48,000 shares in S Limited on 31st March 2015, at 50% premium over face value by issue of 8% Debentures at 20% premium. The Balance Sheets of A Limited and S Limited as on 31-03-2015, i.e., on the date of purchase were as under:

(in Rs.)

Liabilities	A Ltd.	S Ltd.	Assets	A Ltd.	S Ltd.
Share capital of Rs. 10 each	10,50,000	6,00,000	Fixed Assets	6,50,000	2,00,000
General Reserve	1,20,000	40,000	Inventory in Trade	3,00,000	1,80,000
Profit and Loss A/c	80,000	-	Trade receivables	3,40,000	2,10,000
Trade payables	1,00,000	60,000	Cash in hand	60,000	30,000
			Profit and Loss A/c	-	80,000
	13,50,000	7,00,000		13,50,000	7,00,000

(a) Particulars of A Limited:

- | | | | |
|-------|--|-----------|--------------|
| (i) | Profits made: | 2015-2016 | Rs. 1,60,000 |
| | | 2016-2017 | Rs. 2,00,000 |
| (ii) | The above profit was made after charging depreciation of Rs. 60,000 and Rs. 40,000 respectively. | | |
| (iii) | Out of profit shown above, every year Rs. 20,000 had been transferred to General Reserve. | | |
| (iv) | 10% Dividend had been paid in both the years. | | |
| (v) | It has been decided to write down investment to face value of shares in 10 years and to provide for share of loss to subsidiary. | | |

(b) Particulars of S Limited:

The company incurred losses of Rs. 40,000 and Rs. 60,000 in 2015-2016 and 2016-2017 after charging depreciation of 10% p.a. on the book value of Fixed Assets as on 01-04-2015.

Prepare Consolidated Balance Sheet of A Limited and its subsidiary as at 31st March, 2017 as per requirement of Schedule III. (16 Marks)

4. (a) Given below is the summarised Profit and Loss Account of L Ltd.:

Summarised Profit and Loss Account for the year ended 31st March, 2017

	Notes	Amount (Rs. '000)
Income		
Sales	1	28,525
Other Income		<u>756</u>
		<u>29,281</u>
Expenditure		
Operating cost	2	25,658

Excise duty		1,718
Interest on Bank overdraft	3	93
Interest on 10% Debentures		<u>1,157</u>
		<u>28,626</u>
Profit before Depreciation		655
Less: Depreciation		<u>(255)</u>
Profit before tax		400
Provision for tax	4	<u>(275)</u>
Profit after tax		125
Less: Transfer to Fixed Asset Replacement Reserve		<u>(25)</u>
		100
Less: Dividend paid		<u>(45)</u>
Retained profit		<u>55</u>

Notes:

1. This represents the invoice value of goods supplied after deducting discounts, returns and sales tax.
2. Operating cost includes Rs. ('000) 10,247 as wages, salaries and other benefits to employees.
3. The bank overdraft is treated as a temporary source of finance.
4. The charge for taxation includes a transfer of Rs. ('000) 45 to the credit of deferred tax account.

You are required to:

- (i) Prepare a value added statement for the year ended 31st March, 2017.
 - (ii) Reconcile total value added with profit before taxation.
- (b) J Ltd. furnishes the following information from which you are required to calculate the prevailing Economic Value Added of the company and also explain the reason for the difference, if any, between the EVA as calculated by you and the MVA (Market Value Added) amounting to Rs. 14005 crores.

Common shares of Rs. 1,000 face value	1,58,200 units
12% Debentures Rs. 10 face value	50,00,000 units
Current tax rate	30%
Financial Leverage	1.1 times
Securities Premium Account (Rupees in lakhs)	155
Free Reserves (Rupees in lakhs)	154
Capital Reserve (Rupees in lakhs)	109

It is a prevailing practice for companies in the industry to which Jindal Ltd. belongs to pay at least a dividend of 15% p.a. to its common shareholders. (8 + 8 = 16 Marks)

5. (a) On 1st April, 2016, a company offered 100 shares to each of its 500 employees at Rs. 50 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under the plan (ESPP) shall be subject to lock-in on transfers for three years from grant date. The market price of shares of the company on the grant date is Rs. 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at Rs. 56 per share.

On 30th April, 2016, 400 employees accepted the offer and paid Rs. 50 per share purchased. Nominal value of each share is Rs. 10.

Record the issue of shares in the books of the company under the aforesaid plan.

- (b) Let us say on 30th March 2017 an entity enters into an agreement to purchase a Financial Asset for Rs. 200 which is the Fair Value on that date.

On Balance Sheet date i.e. 31/3/2017 the Fair Value is Rs. 204 and on Settlement date i.e. 2/4/2017 Fair Value is Rs. 206.

Pass necessary Journal entries on trade date and settlement date when the asset acquired is measured at FVTOCI. (6 + 10 = 16 Marks)

6. The summarised Balance Sheet of D Ltd. as on 31st March, 2017 is as under:

Liabilities	(Rs. in lakhs)	Assets	(Rs. in lakhs)
Equity shares of Rs. 10 each	6,000	Goodwill	1,540
Reserves (including provision for taxation of Rs. 600 lakhs)	2,000	Premises and Land at cost	800
5% Debentures	4,000	Plant and Machinery	6,000
Secured loans	400	Motor vehicles	
Trade Payables	600	(purchased on 1.10.2016)	80
Profit & Loss A/c:		Raw materials at cost	1,840
Balance from previous year	64	Work-in-progress at cost	260
Profit for the year		Finished goods at cost	360
(after taxation)	<u>2,200</u>	Trade Receivables Investment	800
	2,264	(meant for replacement of plant and machinery)	3,200
		Cash at bank and cash in hand	384
	15,264		15,264

1. The resale value of premises and land is Rs. 2,400 lakhs and that of plant and machinery is Rs. 4,800 lakhs.
2. Depreciation @ 20% is applicable to motor vehicles.
3. Applicable depreciation on premises and land is 2% and that on plant and machinery is 10%.
4. Market value of the investments is Rs. 3,000 lakhs.
5. 10% of trade receivables is bad.
6. The company also revealed that the depreciation was not charged to Profit and Loss account and the provision for taxation already made is sufficient.
7. In a similar company the market value of equity shares of the same denomination is Rs. 25 per share and in such company dividend is consistently paid during last 5 years @ 25%. Contrary to this, D Ltd. is having a marked upward or downward trend in the case of dividend payment.
8. In 2011-2012 and in 2012-2013, the normal business was hampered. The profit earned during 2011-2012 is Rs. 134 lakhs, but during 2012-2013 the company incurred a loss of Rs. 2,610 lakhs.

Past 3 years' profits of the company were as under:

2013-2014	Rs. 938 lakhs
2014-2015	Rs. 1092 lakhs
2015-2016	Rs. 810 lakhs

The unusual negative profitability of the company during 2012-13 was due to the lock out in the major manufacturing unit of the company which happened in the beginning of the second quarter of the year 2011-2012 and continued till the last quarter of 2012-2013.

Value the goodwill of the company on the basis of 4 years' purchase of the super profit. Ignore purchase goodwill given in the question at the time of valuation of new goodwill.

(16 Marks)

7. Answer any **four** of the following:
 - (a) B Ltd. on 1-1-2017 had made an investment of Rs.600 lakhs in the equity shares of G Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2017 became Rs. 200 lakhs as G Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2017.
 - (b) A Ltd. entered into agreement with B Ltd. for sale of goods of Rs. 8 lakhs at a profit of 20% on cost. The sale transaction took place on 1st February, 2017. On the same day B Ltd. entered into another agreement with A Ltd. to resell the same goods at

Rs. 10.80 lakhs on 1st August, 2017. State the treatment of this transaction in the financial statements of A Ltd. as on 31.03.2017. The pre-determined re-selling price covers the holding cost of B Ltd. Give the Journal Entries as on 31.03.2017 in the books of A Ltd.

- (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) X Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.
- (e) On 30-6-2017, L Limited incurred Rs. 6,00,000 net loss from disposal of a business segment. Also on 31-7-2017, the company paid Rs. 1,60,000 for property taxes assessed for the calendar year 2017. How should the above transactions be included in determination of net income of L Limited for the six months interim period ended on 30-9-2017?
(4 x 4 = 16 Marks)