

Test Series: May, 2020

MOCK TEST PAPER – 1
FINAL (OLD) 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) Nasha Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Nasha 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) Still 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 Rs. 200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by Rs. 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) B Ltd. on 1.1.20X2 had made an investment of Rs.600 lakh 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 31.3.20X2 became Rs. 200 lakh as G Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31.3.20X2.
 - (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, 20X3 are as below:

| Liabilities | (In Rs. 000's) | | |
|--|----------------|---------------|---------------|
| | M Ltd. | E Ltd. | N Ltd. |
| Share Capital – shares of Rs. 100 each | 40,000 | 20,000 | 10,000 |
| Reserves | 1,800 | 1,000 | 900 |
| P/L A/c (1.4.20X2) | 1,500 | 2,000 | 800 |
| Profit for 20X2-20X3 | 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 | — | — |
| Property, Plant and Equipment | <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 declared by each company on 31st March at 10% which is yet to be paid.
- Stock transferred by N Ltd. to E Ltd. was Rs. 8 lacs on which the former made a profit of Rs. 3 lacs. On 31st March, 20X3, 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 1.4.20X2 of E Ltd. and N Ltd. were Rs. 8,00,000 and Rs. 7,50,000 respectively.
- Cash-in-transit from E Ltd. to M Ltd. was Rs. 1,00,000 as on 31.3.20X3.
- The shares of the subsidiaries were all acquired by M Ltd. on 1st April, 20X2.

Prepare Consolidated Balance Sheet as on 31st March, 20X3. Workings should form part of the answer. **(16 Marks)**

3. 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 Rs. 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 (Rs. 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 (Rs. in crores) | 400 | 400 | 600 | 800 | 1,000 |

- (iii) Audited net worth of FIL

| | Rs. in crores |
|-------------------------------|----------------|
| Property, plant and equipment | 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 property, plant and equipment of FIL will not be required in the event of the acquisition and the same has ready buyers for Rs. 100 crore.
- Current Assets include surplus stocks of Rs. 20 crore that can realize Rs. 30 crore.

- (c) Investments have a ready marked for Rs. 1,500 crore.
- (d) The current liabilities are to be paid off immediately; Rs. 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 (Rs. 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 'Stands 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)

4. The following are the summarized Balance Sheets of Nisha Ltd. and Misha Ltd. for the year ending on 31st March, 20X3:

(Rs. in crores)

| | Nisha Ltd. | Misha Ltd. |
|---|------------|------------|
| Equity share capital – in equity shares of Rs. 10 each | 50 | 40 |
| Preference share capital – in 10% preference shares of Rs. 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: | | |
| Property, Plant and Equipment at cost less depreciation | 150 | 150 |
| Current assets | <u>200</u> | <u>200</u> |
| | <u>350</u> | <u>350</u> |

The present worth of property, plant and equipment of Nisha Ltd. is Rs. 200 crores and that of Misha Ltd. is Rs. 429 crores. Goodwill of Nisha Ltd. is Rs. 40 crores and of Misha Ltd. is Rs. 75 crores.

Misha Ltd. absorbs Nisha Ltd. on 1.4.20X3, 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. Property, plant and equipment 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)

5. (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 Rs. 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) A company borrowed a sum of Rs. 85 lakhs for its expansion. The terms of loan were as follows:
- (i) Tenure of the loan will be 10 years.
 - (ii) Interest is payable @ 12% p.a. and the principal is repayable at the end of 10th year.

The company defaulted in the payment of interest for the year 4, 5 and 6.

A loan reschedule agreement took place at the end of 7th year. As per the agreement the company is required to pay Rs. 150 lakhs at the end of 8th year.

You are required to calculate the additional amount to be paid on account of rescheduling and also the book value of the loan at the end of 8th year when reschedule took place assuming that interest will be compounded in case of default. **(10 + 6 = 16 Marks)**

6. (a) From the following information of Worth Ltd., compute the economic value added:

| | |
|-------------------------------------|-----------------|
| (i) Share capital | Rs. 2,000 lakhs |
| (ii) Reserves and surplus | Rs. 4,000 lakhs |
| (iii) Long-term debt | Rs. 400 lakhs |
| (iv) Tax rate | 30% |
| (v) Risk free rate | 9% |
| (vi) Market rate of return | 16% |
| (vii) Interest | Rs. 40 lakhs |
| (viii) Beta factor | 1.05 |
| (ix) Profit before interest and tax | Rs. 2,000 lakhs |

(8 Marks)

- (b) A Mutual Fund raised Rs. 100 lakhs on April 1, 20X3 by issue of 10 lakh units of Rs. 10 per unit. The fund invested in several capital market instruments to build a portfolio of Rs. 90 lakhs. The initial expenses amounted to Rs. 7 lakh. During April, 20X3, the fund sold certain securities of cost Rs. 38 lakhs for Rs. 40 lakhs and purchased certain other securities for Rs. 28.20 lakhs. The fund management expenses for the month amounted to Rs. 4.50 lakhs of which Rs. 0.25 lakh was in arrears. The dividend earned was Rs. 1.20 lakhs. 75% of the realized earnings were distributed. The market value of the portfolio on 30.04.20X3 was Rs. 101.90 lakh.

Determine NAV per unit.

(8 Marks)

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

- (a) Differentiate between Ind AS 10 and AS 4:
- (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 Rs. 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to Rs. 2 lakhs instead of Rs. 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, 20X1, Delta Ltd. issued Rs. 30,00,000, 6% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.20X5 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 01.04.20X1. 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 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 | Rs. 30,000 |
| (ii) | Age of retirement | 62 years |
| (iii) | Discount rate | 15% |
| (iv) | No. of employees | 50 |
| (v) | Average age | 60 years |

(4 x 4 = 16 Marks)