

MOCK TEST PAPER 1
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING

Question No.1 is compulsory. Candidates are required to answer any four questions from the remaining five questions.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ₹ 30,000 for the incorporation of company and to do other necessary statutory registrations. ₹ 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 20X1.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared following draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 20X2 on the basis of Accounting Standards (IGAAP):

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	<u>1,00,000</u>
Total Revenue (a)	<u>11,00,000</u>
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expenses	1,75,000
Depreciation	30,000
Other expenses	<u>90,000</u>
Total Expenses (b)	<u>7,45,000</u>
Profit before tax (c) = (a)-(b)	<u>3,55,000</u>
Current tax	1,06,500
Deferred tax	<u>6,000</u>
Total tax expense (d)	<u>1,12,500</u>
Profit for the year (e) = (c) – (d)	<u>2,42,500</u>

Balance Sheet

Particulars	Amount (₹)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	

(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long-term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short-term Provisions	<u>1,06,500</u>
TOTAL	<u>5,21,000</u>
ASSETS	
(1) Non-current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non-current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	<u>51,000</u>
TOTAL	<u>5,21,000</u>

Additional information of Softbharti Pvt. Ltd.:

- i. Deferred tax liability of ₹ 6,000 is created due to following temporary difference:
Difference in depreciation amount as per Income-tax and Accounting profit
- ii. There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 20X2 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	₹ 1,00,000	₹ 80,000

- iii. Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.
- iv. Current tax is calculated at 30% on PBT - ₹ 3,55,000 without doing any adjustments related to Income-tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income-tax comes to ₹ 1,25,700.
- v. After the reporting period, the directors have recommended dividend of ₹ 15,000 for the year ending 31st March, 20X2 which has been deducted from reserves and surplus. Dividend payable of ₹ 15,000 has been grouped under 'other current liabilities' alongwith other financial liabilities.
- vi. There are 'Government statutory dues' amounting to ₹ 15,000 which are grouped under 'other current liabilities'.
- vii. The capital advances amounting to ₹ 50,000 are grouped under 'Other non-current assets'.

- viii. Other current assets of ₹ 51,000 comprise Interest receivable from trade receivables.
- ix. Current investment of ₹ 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ₹ 50,000 as at 31st March, 20X2.
- x. Actuarial gain on employee benefit measurements of ₹ 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 20X2.

The financial statements for financial year 20X1-20X2 have not been yet approved.

You are required to analyse that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information. **(15 Marks)**

- (b) ABC Ltd. requires assistance on whether the following revenue can be anticipated or cost can be deferred as of 30th June, 20X1 while preparing the interim financial statements:
 - (i) Dividend income from its investment which is declared in September of every year.
 - (ii) 60% of the advertising cost for the whole year is incurred by ABC Ltd. in the first quarter and the remaining 40% in the second quarter. **(5 Marks)**
- 2. (a) On 1st April, 20X1, Johansen Ltd. acquired a new subsidiary, Bosman Ltd., purchasing all 150 million shares of Bosman Ltd. The terms of the sale agreement included the exchange of four shares in Johansen Ltd. for every three shares acquired in Bosman Ltd. On 1st April, 20X1, the market value of a share in Johansen Ltd. was ₹ 10 and the market value of a share in Bosman Ltd. ₹ 12.

The terms of the share purchase included the issue of one additional share in Johansen Ltd. for every five acquired in Bosman Ltd., if the profits of Bosman Ltd. for the two years ending 31st March, 20X3 exceeded a target figure. Current estimates are that it is 80% probable that the management of Bosman Ltd. will achieve this target.

Legal and professional fees associated with the acquisition of Bosman Ltd. shares were ₹ 12,00,000, including ₹ 2,00,000 relating to the cost of issuing shares. The senior management of Johansen Ltd. estimates that the cost of their time that can be fairly allocated to the acquisition is ₹ 2,00,000. This figure of ₹ 2,00,000 is not included in the legal and professional fees of ₹ 12,00,000 mentioned above.

The individual Balance Sheet of Bosman Ltd. at 1st April, 20X1 comprised net assets that had a fair value at that date of ₹ 1,200 million. Additionally, Johansen Ltd. considered Bosman Ltd. possessed certain intangible assets that were not recognized in its individual Balance Sheet:

- Customer relationships – reliable estimate of value ₹ 100 million. This value has been derived from the sale of customer databases in the past.
- An in-process research and development project that had not been recognised by Bosman Ltd. since the necessary conditions laid down in Indian Accounting Standards for capitalisation were only just satisfied at 31st March, 20X2. However, the fair value of the whole project (including the research phase) is estimated at ₹ 50 million.
- Employee expertise – estimated value of Director employees of Bosman Ltd. is ₹ 80 million.
- The market value of a share in Johansen Ltd. on 31st March, 20X2 was ₹ 11.

Compute the goodwill on consolidation of Bosman Ltd. that will appear in the consolidated Balance Sheet of Johansen Ltd. at 31st March, 20X2 with necessary explanation of adjustments therein. Also state the treatment of contingent consideration as on 31st March, 20X2 **(12 Marks)**

- (b) Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31st March, 20X3. The transition date is 1st April, 20X1.

The following adjustments were made upon transition to Ind AS:

- (a) The Company opted to fair value its land as on the date on transition.
The fair value of the land as on 1st April, 20X1 was ₹ 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was ₹ 4.5 crores.
- (b) The Company has recognised a provision for proposed dividend of ₹ 60 lacs and related dividend distribution tax of ₹ 18 lacs during the year ended 31st March, 20X1. It was written back as on opening balance sheet date.
- (c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is ₹ 75 lacs.
- (d) The Company has an Equity Share Capital of ₹ 80 crores and Redeemable Preference Share Capital of ₹ 25 crores.
- (e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was ₹ 95 crores representing ₹ 40 crores of general reserve and ₹ 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.
- (f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards) and as per Ind AS to be presented in the opening balance sheet as on 1st April, 20X1.

Ignore deferred tax impact.

(8 Marks)

3. (a) An entity can borrow funds in its functional currency (₹) @ 12%. It borrows \$ 1,000 @ 4% on 1st April, 20X1 when \$ 1 = ₹ 40. The equivalent amount in functional currency is ₹ 40,000. Interest is payable on 31st March, 20X2. On 31st March, 20X2, exchange rate is \$ 1 = ₹ 50. The loan is not due for repayment.

Compute exchange loss and borrowing cost to be capitalized as on 31st March, 20X2. What will be exchange loss and borrowing cost to be capitalized as on 31st March, 20X2 if the exchange rate on 31st March, 20X2, is \$ 1 = ₹ 41?

(6 Marks)

- (b) G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January, 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April, 20X2. They made a public announcement of their decision on 15th February, 20X2.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May, 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May, 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay ₹ 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May, 20X2. As per latest estimates made on 15th May, 20X2, the total relocation cost is ₹ 63 lakhs.

- G Ltd. had taken a property on lease, which was expiring on 31st March, 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ₹ 430 lakhs. On 15th May, 20X2, G Ltd. made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March, 20X2 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 60 lakhs till 30th April, 20X2.

What are the provisions that the Company is required to make as per Ind AS 37 as on 31st March, 20X2? **(8 Marks)**

(c) **Either**

Determine the lease term in the following scenarios:

Scenario A: Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception. There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

Scenario B: Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity XYZ pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property. What is the lease term?

Scenario C: Entity PQR enters into a lease for an identified retail space in a shopping centre. The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years. The lessor agrees to provide the same retail space for each of the seven years. What is the lease term? **(6 Marks)**

(c) **Or**

On 1st April, 20X1, Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 20X1 and utilisation of the property started on 1st January 20X2 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was ₹ 40 crores. Besides internal accruals, the cost was partly funded by way of loan of ₹ 10 crores taken on 1st January, 20X1. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent ₹ 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as per applicable Ind AS. **(6 Marks)**

4. (a) Company Z is engaged in the business of importing oil seeds for further processing as well as trading purposes. It enters into the following types of contracts as on 1st October, 20X1:

Particulars	Contract 1	Contract 2	Contract 3
Nature of Contract	Import of oil seeds from a foreign supplier	Purchase of oil seeds from a domestic producer / supplier	Contract to sell oil seeds on the commodity exchange

Quantity and rate	100 MT at USD 400 per MT to be delivered as on 31 st March, 20X2	50 MT at ₹ 30,000 per MT to be delivered as on 31 st January, 20X2	50 MT at USD 450 per MT, maturing as on 15 th January, 20X2
Net settlement clause included in the contract	Yes	Yes	Yes
Net settlement in practice for similar contracts	There have also been several instances of the oil seeds being sold prior to or shortly after taking delivery. These instances of net settlement constitute approximately 30% of the value of total import contracts.	Yes – company Z has net settled some of the domestic purchase contracts. However, these instances constitute only 1 per cent of the total domestic purchase contracts in value. The remaining contracts are settled by taking delivery of oil seeds which are used for further processing.	Yes – these contracts are required to be net settled with the exchange on the maturity date. Company Z enters into these types of derivative contracts to hedge the risks on its domestic oil seeds purchase contracts

Company Z is required to determine if the contracts entered into for purchase and sale of oil seeds are derivatives within the scope of Ind AS 109 or are executory contracts outside the scope of Ind AS 109. **(8 Marks)**

- (b) A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 2.5 per unit. How should revenue be measured in this case? **(6 Marks)**

- (c) 1st January Shares in issue 10,00,000
 5% Convertible bonds ₹ 1,00,000

(terms of conversion 120 ordinary shares for ₹ 100)

- 31st March Holders of ₹ 25,000 bonds converted to ordinary shares.
 Profit for the year ended 31st December ₹ 2,00,000

Tax rate 30%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements. **(6 Marks)**

5. (a) An entity enters into a contract with a customer on 1st April, 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31st March, 20X3, the customer pays for the machine and spare parts, but only

takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods? **(8 Marks)**

- (b) Company A, an Indian company whose functional currency is ₹, enters into a contract to purchase machinery from an unrelated local supplier, company B. The functional currency of company B is also ₹. However, the contract is denominated in USD, since the machinery is sourced by company B from a US based supplier. Payment is due to company B on delivery of the machinery.

Key terms of the contract:

Contractual features	Details
Contract / order date	9 th September 20X1
Delivery / payment date	31 st December 20X1
Purchase price	USD 1,000,000
USD / ₹ Forward rate on 9 th September, 20X1 for 31 st December, 20X1 maturity	67.8
USD / ₹ Spot rate on 9 th September, 20X1	66.4
USD / ₹ Forward rates for 31 st December, on:	
30 th September	67.5
31 st December (spot rate)	67.0

Company A is required to analyse if the contract for purchase of machinery (a capital asset) from company B contains an embedded derivative and whether this should be separately accounted for on the basis of the guidance in Ind AS 109. Also give necessary journal entries for accounting the same. **(8 Marks)**

- (c) On 31st March, 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was ₹ 10 million and based on retail prices at 31st March, 20X1, the expected selling price of the spare parts is ₹ 12 million. On 15th April, 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to ₹ 8 million. The estimated selling expense required to make the sales would ₹ 0.5 million. Financial statements were approved by the Board of Directors on 20th April, 20X1.

As at 31st March, 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is ₹ 11 million and estimated selling expenses are same ₹ 0.5 million.

What will be the value inventory at the following dates:

- (a) 31st March, 20X1
(b) 31st March, 20X2

(4 Marks)

6. (a) A Ltd. prepares financial statements to 31st March each year. The rate of income tax applicable to A Ltd. is 20%. The following information relates to transactions, assets and liabilities of A Ltd. during the year ended 31st March, 20X2:
- A Ltd. has a 40% shareholding in L Ltd. A Ltd. purchased this shareholding for ₹ 45 Cr. The shareholding gives A Ltd. significant influence over L Ltd. but not control and therefore A Ltd. accounts for its interest in L Ltd. using the equity method. The equity method carrying value of A Ltd.'s investment in L Ltd. was ₹ 70 Cr on 31st March, 20X1 and ₹ 75 Cr on 31st March 20X2. In the tax jurisdiction in which A Ltd. operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend, or the relevant investment is disposed of.
 - A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31st March. On 31st March, 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31st March, 20X2, A Ltd. charged depreciation in its statement of profit or loss of ₹ 2 Cr and claimed a tax deduction for tax depreciation of ₹ 1.25 Cr. On 31st March, 20X2, the building was revalued to ₹ 45 Cr. In the tax jurisdiction in which A Ltd. operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Basis the above information, you are required to compute:

- The deferred tax liability of A Ltd. at 31st March, 20X2
 - The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31st March, 20X2 **(10 Marks)**
- (b) An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January, 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December, 20X6 and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is ₹ 11 and it estimates that overall, 10% of the employees will leave during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31 st December, 20X5	12
31 st December, 20X6	8
31 st December, 20X7	13
31 st December, 20X8	12

10% of employees left before the end of 20X6. On 31st December, 20X7 (when the intrinsic value of each SAR was ₹ 10), six employees exercised their options and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of ₹ 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries. **(10 Marks)**