Mock Test Paper - 1

Final (New Course): Group I

Paper 1: Financial Reporting

ANSWERS

1. (a) On evaluation of the financial statements, following was observed:

1. Reserve for foreseeable loss for INR 500 million, due within 6 months, should be a part of provisions. Hence it needs to be regrouped, and if it was a part of previous year's comparatives, a Note should be added in the notes to account on the regrouping done this year.

2. Interest accrued and due of INR 555 million on term loan will be a part of current liabilities since it is supposed to be paid within 12 months from the reporting date. Hence, it should be shown under the heading "Other Current Liabilities".

3. It can be inferred from Note 3, that the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, hence these shall be set off, in accordance with AS 22. The net DTA of INR 300 million shall be shown in the balance sheet.

4. The notes to trade receivables is incorrectly presented. The recommended notes would be as below:

Trade receivables (Unsecured) consist of the following:	INR in million
a) Over six months from the date they were due for payment	
i. Considered good	0
ii. Considered doubtful	40
Less: Provision for doubtful debts	(5)
(A)	35
(b) Others	
i. Considered good	1,065
ii. Considered doubtful	0
Less: Provision for doubtful debts	0
(B)	1,065
Total	1,100

5. It is common to have a termination clause in service contracts and having a termination clause *per se* will not create a liability on the company. Para 14 to AS 29 states that a provision will be recognized when:

   (a) An enterprise has a present obligation as a result of a past event;

   (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

   (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the above case, there is nothing to show that there is a present obligation, and hence there is no provision to be made.

As per para 27 of AS 29, a contingent liability is recognized only where the possibility of an outflow of resources embodying economic benefits is not remote. Since there is no onerous liability as of date, the possibility of an outflow being remote, no contingent liability arises. In fact, the management has wrongly worded 'onerous liability' in its notes to accounts. Onerous liability arises only if the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it, which doesn't seem to be the case as far as Arish Ltd. is concerned. Hence, this note shall be eliminated.

6. The demand notice from the tax department that is under litigation is a clear instance of a 'contingent liability'. Accordingly, the note should be revised as –

   'Contingent Liability- Demand notice from income tax department pertaining to INR 6 Million, under contest with CIT (Appeals) as on the reporting date.

7. The Statement to Profit and Loss needs to represent earnings per share, to be compliant with AS 20.

Revised extracts of the financial statements

Balance Sheet **(INR in Million)**

	Note No.	*As at 31st March, 2018*
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital		1,000
Reserves and surplus	1	1,500
Non-current liabilities		
Long-term borrowings	2	5,000
Current liabilities		
Trade payables		300
Short-term provisions		750
Other current liabilities	4	705
TOTAL		9,255
ASSETS		
Non - current assets		
Fixed Assets		5,655
Deferred Tax Assets	3	300
Current assets		
Inventories		1,000
Trade receivables	5	1,100
Cash and Cash Equivalents		1,200
TOTAL		9,255

Statement of Profit and Loss

(INR in Million)

	Note No.	Year ended 31st March, 2018
Revenue from operations		5,500
Expenses		
Operating Costs		2,200
Employee Benefit Expense		1,200
Depreciation		999
Total Expenses		4,399
Profit Before Tax		1,101
Tax Expense		150
Profit for the period		951
Earnings Per Equity Share		
Basic		9.51
Diluted		9.51
Number of equity shares (face value of Rs. 10 each)		100 million

Revised Notes (wherever applicable):

Note on Reserves and Surplus **(INR in Million)**

Capital Reserve		500
Surplus from P & L		
Opening Balance	49	
Additions	951	1,000
Total		1,500

Note on Long Term Borrowings

Term Loan from Bank	5,000
Total	5,000

Note on Other Current Liabilities

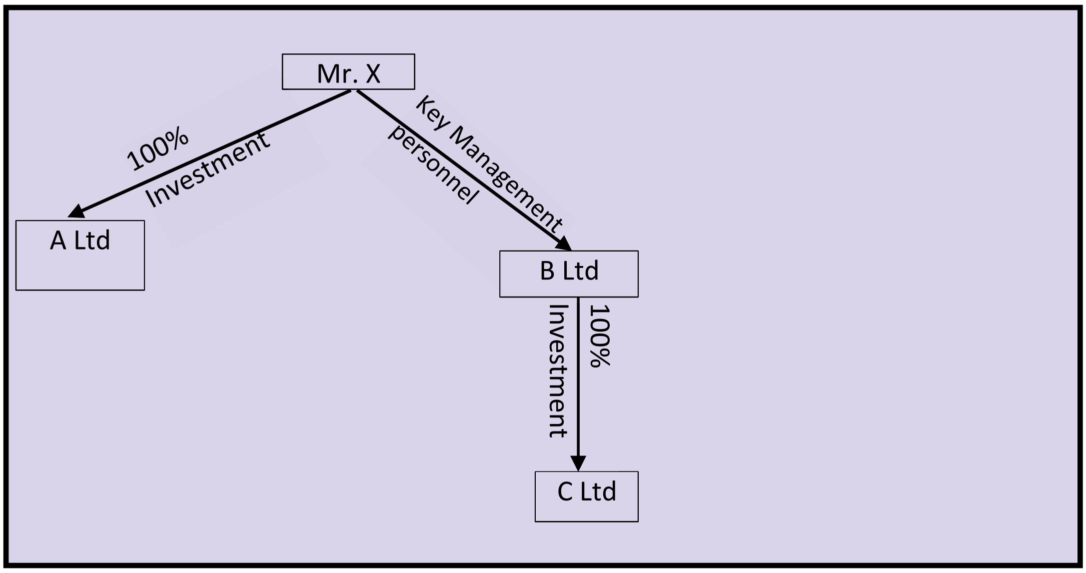
Unclaimed dividend	3
Interest on Term Loan	555
Billing in Advance	147
Total	705

(b) Para 9 of Ind AS 24 defines the term "key management personnel" as persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any director (whether executive or not). Further, significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Therefore, a key management personnel (KMP) has significant influence over the entity. Accordingly, Mr. X has significant influence over B Ltd. since he is a key management personnel of B Ltd.

Now, para 9(vii) of the standard states that an entity is related to a reporting entity if the person identified in para 9(a)(i) (here KMP ie. Mr. X) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)"

Therefore, if C Ltd. is a reporting entity, A Ltd. is related to C Ltd. because a key management personnel of parent B Limited has control over A Limited. Therefore, the relationship of C Ltd. and A Ltd. will be "Entities controlled by key management personnel of the Parent Entity".



2. (a) When 100% shares sold to independent party

Consolidated Balance Sheet of Preet Pvt. Ltd. and its remaining subsidiaries as on 31st March, 2018

Particulars	Note No.	(Rs. in million)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	1,900
(ii) Goodwill	2	200
(2) Current Assets		
(i) Inventories	3	100
(ii) Financial Assets		
(a) Trade Receivables	4	800
(b) Cash & Cash equivalents	5	5,100
Total Assets		**8,100**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	1,600
(ii) Other Equity	7	4,700
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	1,800
Total Equity & Liabilities		**8,100**

Notes to Financial Statements:

			(Rs. in million)
1.	**Property Plant & Equipment**		
	Land & Building		
	Group	3,240	
	Less: Stuti Pvt. Ltd.	(1,340)	1,900
2.	Intangible Assets		
	Goodwill		
	Group	380	
	Less: Stuti Pvt. Ltd.	(180)	200
3.	**Inventories**		
	Group	140	
	Less: Stuti Pvt. Ltd.	(40)	100
4.	**Trade Receivables**		
	Group	1,700	
	Less: Stuti Pvt. Ltd.	(900)	800
5.	**Cash & cash equivalents**		
	Group (WN 2)	5,100	5,100
8.	**Trade Payables**		
	Group	2,700	
	Less: Stuti Pvt. Ltd.	900	1,800

Statement of Changes in Equity:

6. Equity Share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1600	0	1600

7. Other Equity

	Share application money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				4,260		4,260
Total comprehensive income for the year			0			
Dividend			0			
Total comprehensive income attributable to the parent			0			

Gain on disposal of Stuti Pvt. Ltd.				440		440
Balance at the end of the reporting period			0	4,700		4,700

Working Notes:

1. When sold, the carrying amount of all assets and liabilities attributable to Stuti Pvt. Ltd. were eliminated from the consolidated statement of financial position.

2. Cash in hand (in million)

Cash before disposal of Stuti Pvt. Ltd. *Less:* Stuti Pvt. Ltd. Cash Add: Cash realized from disposal	3,100 (1,000) 3,000
Cash in hand	5,100

3. Gain / Loss on disposal of entity (in million)

Proceeds from disposal *Less:* Net assets of Stuti Pvt. Ltd.	3,000 (2,560)
Gain on disposal	440

4. Retained Earnings (in million)

Retained earnings before disposal *Add:* Gain on disposal	4,260 440
Retained earnings after disposal	4,700

(b) Disclosure is required in the notes to the combined / carve-out financial statements of the fact that the information presented may not be representative of the position which may prevail after the transaction. Similarly, the fact that resulting financial position may not be that which might have existed if the carve-out business/combining businesses had been a stand-alone business should also be disclosed. Comparatives are not necessarily required to be given for the combined/carve-out financial statements.

The following should also be disclosed in the combined/carve-out financial statements:

(i) The purpose of preparation of combined/carve-out financial statements;

(ii) A list of combining businesses together with brief description of activities;

(iii) Statement of compliance with the applicable Accounting Standards;

(iv) The principal accounting policies followed in preparing the combined/carve-out financial statements;

(v) The basis for allocation, critical assumptions, judgments, and estimates involved in the preparation of combined/ carve-out financial statements;

(vi) Other disclosures as per the requirements of applicable Accounting Standards to the extent relevant;

(vii) Where the accounting policies are not uniform in respect of the combining businesses, disclosure of that fact along with the accounting framework followed;

(viii) Extent of balances (not having the characteristics of debt) treated as part of equity;

(ix) The basis of pricing inter-group transfers and any change therein.

3. **(a)** The fair value of the loan is calculated at Rs. 74,76,656.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on Rs. 1,00,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	74,76,656	8,97,200	5,00,000	78,73,856
2	78,73,856	9,44,862	5,00,000	83,18,718
3	83,18,718	9,98,246	5,00,000	88,16,964
4	88,16,964	10,58,036	5,00,000	93,75,000
5	93,75,000	11,25,000	1,05,00,000	Nil

A Limited will recognise Rs. 25,23,344 (Rs. 1,00,00,000 – Rs. 74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	Rs. 1,00,00,000	
To Deferred Income			Rs. 25,23,344
To Loan Account			Rs. 74,76,656

Rs. 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognise the related costs (which the grant intends to compensate) as expenses.

If the loan is to finance a depreciable asset, Rs. 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

(b) **Either**

If Market A is the principal market for the sale of asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport cost of Rs. 24. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.

If neither market is the principal market for the sale of asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received by selling the asset, after taking into account transport cost (i.e., the net amount that would be received in the respective markets).

Since the entity would maximise the net amount that would be received for the asset in Market B, the fair value of the asset would be measured using the price in that market ie. sale of asset Rs. 25 less transport cost Rs. 2, resulting in a fair value measurement of Rs. 23.

Or

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	Value as per tax records	Tax base	Taxable temporary differences	Total Deferred tax liability @ 20%	Charged to P&L during the year
a	b	c	d	E= b-d	F = e x 20%	g
31st March, 2017	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore

31st March, 2018	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

(c) Ind AS 16 'Property, Plant and Equipment' states that property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per Ind AS 40 'Investment property', investment property is a property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business.

Further, as per para 8 of Ind AS 40, the building owned by the entity and leased out under one or more operating leases will be classified as investment property.

Here top three floors have been leased out for 5 years with a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less that the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e. 15 crore x 30% = 4.50 crore. Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor ie. UK Ltd.

However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment property(ies).

(in crore)

	Total	**PPE (70%)**		**Investment property (30%)**
		Land (25%)	Building (75%)	
Cost	10	1.75	5.25	3
FV	15	2.625	7.875	4.5
Valuation model followed		Cost	Cost	Cost (as per para 30 of Ind AS 40)
Value recognized in the books		1.75	5.25	3
Less: Depreciation		Nil	(5.25/50) = 0.105 crore	(3/50) = 0.06
Carrying value as on 31st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

4. (a) Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	**Rs. In lakhs**				
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780[1)]	780[1)]	-	-
Receivables	5,200	5,200[1)]	5,500[3)]	(300)	90
Plant and equipment	7,000	8,000[2)]	6,000[4)]	2,000	(600)
Brands		4,300[2)]	-[5)]	4,300	(1,290)
Goodwill (Balancing figure)		2,100[9)]			
Deferred tax asset	360	3,60[7)]			

Total assets		**20,740**			
Payables	(1,050)	(1,050) 1)	(1,050) 1)		
Borrowings	(4,900)	(4,900)1)	(4,900)1)		
Employee Entitlement liabilities	(900)	(900)1)	-6)	(900)	270
Deferred tax liability	(300)	(1,890)8)			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

(b) **Value Added Statement of P Ltd.**

		Rs. in lakhs
Sales		254.00
Less: Cost of bought in material and services:		
Operating cost (Rs. 222.00 lakhs – Rs. 82 lakhs)	140.00	
GST	11.20	

Interest on bank overdraft	1.00	(152.20)
Value added by trading activities		101.80
Add: Other income		6.00
Total Value Added		107.80

Application of value added

		Rs. in lakhs	*%*
To pay Employees:			
Wages, salaries and other benefits		82.00	76.07
To pay Government : Corporate tax		2.40	2.23
To pay Providers of Capital :			
Interest on 9% debentures	15.00		
Dividend	0.30	15.30	14.19
To provide for Maintenance and Expansion of the Company			
Depreciation	4.10		
Retained profit	4.00	8.10	7.51
		107.80	100

Reconciliation between Total Value Added and Profit before Taxation:

	Rs. in lakhs
Profit before tax	6.70
Add back:	
Depreciation	4.10
Wages, salaries and other benefits	82.00
Interest on debentures	15.00
Total Value Added	107.80

5. (a) (i) (1) At the time of initial recognition

	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs. 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs. 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component	
(Rs. 5,00,000 – Rs. 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since Rs. 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs. 100 each only.

Journal Entry

	Rs.	Rs.
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

(2) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	*Fair Value @ 9%*	*Difference*
	Rs.	*Rs.*	*Rs.*
Liability component			
Present value of 2 remaining yearly interest payments of Rs. 40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of Rs. 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	3,98,500	4,21,000	
Liability component	4,66,100	4,91,360	(25,260)
Equity component (5,25,000 -4,91,360)	72,300	33,640*	38,660
Total	**5,38,400**	**5,25,000**	**13,400**

*(5,25,000 – 4,91,360) = 33,640

Journal Entries

	Rs.	Rs.
8% Debentures (Liability component) Dr.	4,66,100	
Profit and loss A/c (Debt settlement expense) Dr.	25,260	
To Bank A/c		4,91,360
(Being the repurchase of the liability component recognised)		
8% Debentures (Equity component) Dr.	72,300	
To Bank A/c		33,640
To Reserves and Surplus A/c		38,660
(Being the cash paid for the equity component recognised)		

(ii) This derivative involves Entity X taking delivery of a fixed number of equity shares for a fixed amount of cash. Even though the obligation for Entity X to purchase its own equity shares for Rs. 22,000,000 is conditional on the holder of the option exercising the option, Entity X has an obligation to deliver cash which it cannot avoid.

As per para 23 of Ind AS 32 'Financial Instruments: Presentation', the accounting for financial instrument will be as below:

- The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity. This would imply that a financial liability for an amount of present value of Rs. 22,000,000, say Rs. 20,000,000 will be recognised through a debit to equity. The initial premium received (Rs. 5,00,000) is credited to equity.
- Subsequently, the financial liability is measured in accordance with Ind AS 109. While a subsequent paragraph will deal with measurement of financial liabilities. The financial liability of Rs. 20,000,000 will be measured at amortised cost as per Ind AS 109 and finance cost of Rs. 2,000,000 will be recognised over the exercise period.
- If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity ie. an amount of Rs. 22,000,000 will be reclassified from financial liability to equity.

(b) (i) Treatment of any unspent amount of CSR expenditure

Since the expenditure on CSR activities is to be disclosed only in the Board's Report, no provision for the amount which is not spent, (i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period) may be made in the financial statements.

The Act requires that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount.

However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial statements.

(ii) Treatment of excess amount spent on CSR Activities

Since 2% of average net profits of immediately preceding three years is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future.

6. (a)

	1st Jan., 2017	31st Dec., 2017	31st Dec., 2018
Cash alternative (990 x 212)	2,09,880		
Equity alternative (800 x 213)	1,70,400		
Equity option (2,09,880 – 1,70,400)	39,480		
Cash Option (cumulative) (using period end fair value)		88,000	1,85,600
Equity Option (cumulative)		19,740	39,480
Expense for the period			
Equity option		19,740	19,740
Cash Option		88,000	97,600
Total		1,07,740	1,17,340

Journal Entries

31st Dec., 2016			INR
Employee benefits expenses	Dr.	1,07,740	
To Share based payment reserve (equity)			19,740
To Share based payment liability			88,000
(Recognition of Equity option and cash settlement option)			
31st Dec., 2017			
Employee benefits expenses	Dr.	1,17,340	
To Share based payment reserve (equity)			19,740
To Share based payment liability			97,600
(Recognition of Equity option and cash settlement option)			
Share based payment liability	Dr.	1,85,600	
To Bank/ Cash			1,85,600
(Settlement in cash)			

(b) Statement Showing Impairment Loss

		(Rs. in crores)
Carrying amount of the machine as on 1st April, 2012		7.00
Depreciation for 4 years i.e. 2012-2013 to 2015-2016 $\left[\frac{7\text{ crores}}{7\text{ years}} \times 4\text{ years}\right]$		(4.00)
Carrying amount as on 31.03.2016		3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)		2.10
Carrying amount of the machine as on 1st April 2016 (revalued)		5.10
Less: Depreciation for 2 years i.e. 2016-2017 & 2017-2018 $\left[\frac{5.10\text{ crores}}{3\text{ years}} \times 2\text{ years}\right]$		(3.40)
Carrying amount as on 31.03.2018		1.70
Less: Recoverable amount		(0.79)
Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2018:		
Balance in revaluation reserve as on 31.03.2016	2.10	
Less: Enhanced depreciation met from revaluation reserve 2016-2017 & 2017-2018 = [(1.70 – 1.00) x 2 years]	(1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 “Impairment of Assets”		(0.70)
Impairment Loss to be debited to profit and loss account		0.21