Test Series: October, 2022

MOCK TEST PAPER 2

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) Feel Fresh Limited (the Company) is into manufacturing and retailing of FMCG products listed on stock exchanges in India. One of its products is bathing soap which the Company sells under the brand name 'Feel Fresh'. The Company does not have its own manufacturing facilities for soap and therefore it enters into arrangements with a third party to procure the soaps. The Company entered into a long term purchase contract of 10 years with M/s. Radhey. Following are the relevant terms of the contract with M/s. Radhey.

(i) M/s. Radhey has to purchase a machine costing ₹ 10,00,000 from the supplier as specified by the Company. The machine will be customized to produce the soaps as designed by the Company. This machine cannot be used by M/s. Radhey to produce the soaps for buyers other than the Company due to the design specifications. The machine has a useful life of 10 years and the straight line method of depreciation is best suited considering the use of the machine.

(ii) The Company will pay ₹ 4.75 per soap for the first year of contract. This is calculated based on the budgeted annual purchase of 7,00,000 soaps as follows:

Particulars	Per soap price
Variable cost of manufacturing	4.00
Cost of machine (₹ 1,74,015 / 7,00,000 soaps)	0.25
M/s. Radhey's margin	0.50
Per soap cost to the Company	4.75

In case the Company purchases more than 7,00,000 (i.e. budgeted number of soaps) soaps in the first year then the cost of the machine (i.e. 0.25 per soap) will not be paid for soaps procured in excess of 7,00,000 units. However, in case Company procures less than budgeted number of soaps, then the Company will pay the differential unabsorbed cost of the machine, at the end of the year. For example, if the Company purchases only 6,00,000 soaps in first year then the differential amount of ₹ 24,015 (1,74,015 - (6,00,000 x 0.25)) will be paid by the Company to M/s. Radhey at the end of the year. Variable cost will be actualized at the end of the year.

(iii) The cost per soap will be calculated for each year in advance based on the budgeted number of soaps to be produced each year. An amount of ₹ 1,74,015 shall be considered each year for the cost of machine for year 1 to year 8 while calculating the cost per soap. Any differential under absorbed amount shall be paid by the Company to M/s. Radhey at the end of that year. A charge of ₹ 1,74,015 per annum for the machine is derived using

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borrowing cost of 8% p.a. For year 9 and year 10, only variable cost and margins will be paid.

(iv) M/s. Radhey does not have any right to terminate the contract but the Company has the right to terminate the contract at the end of each year. However, if the Company terminates the contract, it has to compensate M/s. Radhey for any unabsorbed cost of Machine. For example, if the Company terminates the contract at the end of second year then it has to pay ₹ 10,44,090 (i.e. 1,74,015 per year x 6 remaining years). If it terminates the contract after the 8th year then the Company does not have to pay the compensation since the cost of the machine would have been absorbed.

(v) In the first year, the Company purchases 5,50,000 soaps at ₹ 4.75 per soap.

Evaluate the contract of the Company with M/s. Radhey and provide necessary accounting entries for first year in accordance with Ind AS with working notes. Assume all cash flows occur at the end of the year. **(15 Marks)**

(b) High Speed Ltd. has entered into a Share Purchase Agreement ("SPA") with the shareholders of Fast Move Limited to purchase 30% stake in Fast Move Limited as at 1st June, 20X1 at a price of ₹ 30 per share. As per the terms of SPA, High Speed Ltd. has an option to purchase additional 25% stake in Fast Move Limited on or before 15th June, 20X1 at a price of ₹ 30 per share. Similarly, the selling shareholder has an option to sell additional 25% stake in Fast Move Limited on or before 15.6.20X1 to High Speed Ltd. at a price of ₹ 30 per share. The decisions on relevant activities of Fast Move Limited are made in Annual General Meeting / Extraordinary General Meeting (AGM / EGM). A resolution in AGM / EGM is passed when more than 50% votes are casted in favor of the resolution. An AGM / EGM can be called by giving atleast 21 days advance notice to all shareholders.

With respect to the SPA entered by High Speed Ltd., you are required to determine whether High Speed Ltd. has control over Fast Move Limited as at 1st June, 20X1. **(5 Marks)**

2. (a) During 20X4-20X5, Cheery Limited discovered that some products that had been sold during 20X3-20X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500.

Cheery Limited's accounting records for 20X4-20X5 show sales of ₹ 1,04,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

In 20X3-20X4, Cheery Limited reported:

	₹
Sales	73,500
Cost of goods sold	(53,500)
Profit before income taxes	20,000
Income taxes	(6,000)
Profit	14,000
Basic and diluted EPS	2.8

The 20X3-20X4 opening retained earnings was ₹ 20,000 and closing retained earnings was ₹ 34,000. Cheery Limited's income tax rate was 30% for 20X4-20X5 and 20X3-20X4. It had no other income or expenses.

Cheery Limited had ₹ 50,000 (5,000 shares of ₹ 10 each) share capital throughout, and no other components of equity except for retained earnings.

State how the above will be treated /accounted in Cheery Limited's Statement of Profit and Loss, Statement of Changes in Equity and in Notes wherever required for current period and earlier period(s) as per relevant Ind AS. **(12 Marks)**

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(b) An Indian entity, whose functional currency is rupees, purchases USD denominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = ₹ 40 and USD 1 = ₹ 45, respectively. The weighted average exchange rate for the year is 1 USD = ₹ 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees) **(8 Marks)**

3. (a) On 1st April 20X1, Investor Ltd. acquires 35% interest in another entity, XYZ Ltd. Investor Ltd. determines that it is able to exercise significant influence over XYZ Ltd. Investor Ltd. has paid total consideration of ₹ 47,50,000 for acquisition of its interest in XYZ Ltd. At the date of acquisition, the book value of XYZ Ltd.'s net assets was ₹ 90,00,000 and their fair value was ₹ 1,10,00,000. Investor Ltd. has determined that the difference of ₹ 20,00,000 pertains to an item of property, plant and equipment (PPE) which has remaining useful life of 10 years.

During the year, XYZ Ltd. made a profit of ₹ 8,00,000. XYZ Ltd. paid a dividend of ₹ 12,00,000 on 31st March, 20X2. XYZ Ltd. also holds a long-term investment in equity securities. Under Ind AS, investment is classified as at FVTOCI in accordance with Ind AS 109 and XYZ Ltd. recognized an increase in value of investment by ₹ 2,00,000 in OCI during the year. Ignore deferred tax implications, if any.

Calculate the closing balance of Investor Ltd.'s investment in XYZ Ltd. as at 31st March, 20X2 as per the relevant Ind AS. **(8 Marks)**

(b) On 1st April, 20X1, QA Ltd. had granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 20X4 provided the employee remains in employment till 31st March, 20X4.

On 1st April, 20X1, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 20X4. This estimate was amended to 1,850 employees on 31st March, 20X2 and further amended to 1,840 employees on 31st March, 20X3.

On 1st April, 20X1, the fair value of an option was ₹ 1.20. The fair value increased to ₹ 1.30 as on 31st March, 20X2 but due to challenging business conditions, the fair value declined thereafter. In September, 20X2, when the fair value of an option was ₹ 0.90, the Directors repriced the option and this caused the fair value to increase to ₹ 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was ₹ 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 20X2 should be spread over the remaining vesting period from 30th September, 20X2 to 31st March, 20X4.

The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 20X3. **(6 Marks)**

(c) K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 20X2, K Ltd entered into the following transactions:

(a) On 1st April, 20X1, K Ltd purchased an equity investment for ₹ 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March, 20X2, the fair value of the investment was ₹ 2,40,000. In the tax jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not

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taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.

(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ₹ 80,000. The goods had cost to K Ltd for ₹ 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.

(c) On 31st October, 20X1, K Ltd received ₹ 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November, 20X1 to 31st July, 20X2. K Ltd recognised revenue of ₹ 1,20,000 in respect of this transaction in the year ended 31st March, 20X2 and will recognise the remainder in the year ended 31st March, 20X3. Under the tax jurisdiction in which K Ltd operates, ₹ 2,00,000 received on 31st October, 20X1 was included in the taxable profits of K Ltd for the year ended 31st March, 20X2.

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March, 20X2. Assume tax rate to be 25%. **(6 Marks)**

4. (a) On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy-duty equipment for a promised consideration of ₹ 20,00,000 with a bonus of ₹ 2,50,000 if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be ₹ 11,00,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 20X2, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115. However, on 4th June, 20X2, the contract is modified with the result that the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of Ind AS 115, for the year 20X1-20X2 and 20X2-20X3. **(12 Marks)**

(b) Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS as per Ind AS 33.

S. No.	Date	Particulars	No of shares
1	1st April, 20X1	Opening balance of outstanding equity shares	1,00,000
2	15th June, 20X1	Issue of equity shares	75,000
3	8th November, 20X1	Conversion of convertible preference shares in Equity	50,000
4	22nd February, 20X2	Buy back of shares	(20,000)
5	31st March, 20X2	Closing balance of outstanding equity shares	205,000

(4 Marks)

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(c) X Ltd. purchased a franchise from a restaurant chain at a cost of ₹ 1,00,00,000 under a contract for a period of 10 years. Can the franchise right be recognised as an intangible asset in the books of X Ltd. under Ind AS 38? **(4 Marks)**

5. (a) Given below are the balance sheets of a group of companies comprising LX Limited, MX Limited and NX Limited as on 31st March 20X2: **₹ in lakh**

Particulars	LX Limited	MX Limited	NX Limited
Assets			
Non-current Assets			
Property, Plant and Equipment	1,500	1,600	1,400
Investment			
17.0 lakh share in MX Limited	2,620	-	-
9.6 lakh shares in NX Limited	-	1,350	-
Current Assets			
Inventories	1,230	730	1,180
Financial Assets			
Trade Receivables	1,415	270	620
Bills Receivables	650	60	-
Cash in hand and at Bank	1,085	90	150
	8,500	4,100	3,350
Equity and Liabilities			
Shareholders' Equity			
Share Capital (₹ 100 per share)	3,400	2,000	1,600
Other Equity			
Reserves	1,150	810	580
Retained earnings	1,030	600	310
Current Liabilities			
Financial Liabilities			
Trade Payables	2,920	690	805
Bills Payable	-	-	
MX Limited			55
	8,500	4,100	3,350

LX Limited holds 85% shares in MX Limited, which were acquired on 1st April 20X1 and MX Limited holds 60% shares in NX Limited, which were acquired on 30th September 20X1.

The following balances stood in the books of MX Limited and NX Limited as on 1st April 20X1:

	MX Limited	NX Limited
	₹ in lakh	₹ in lakh
Reserves	760	520
Retained earnings	480	150

The business activities of NX Limited are not seasonal in nature.

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The parent company has adopted an accounting policy to measure non-controlling interest at fair value applying Ind AS 103. The fair value is to be determined at quoted market price. The given market price of MX Limited is ₹ 120 per share and NX Limited is ₹ 125 per share.

Prepare the consolidated Balance Sheet as on 31st March 20X2 of the group of companies LX Limited, MX Limited and NX Limited. **(14 Marks)**

(b) With respect to Integrated Reporting, state whether following statements are true or false with reason for your answer:

(i) An integrated report is necessarily to be a stand-alone report;

(ii) The framework of Integrated reporting is written primarily for private companies;

(iii) A report prepared as required by local law containing a management commentary or other report that provides context for its financial statements can serve the purpose of Integrated reporting; and

(iv) An integrated report should include only positive material matters. **(6 Marks)**

6. (a) Lovely Limited has a policy of providing subsidized loans to its employees for the purpose of buying 2 Wheelers and 4 Wheelers vehicle. Simran who is a Sales Executive, took a loan for a Four-wheeler vehicle from the Company. The following were the terms of the loan:

- Principal amount : ₹ 9,00,000
- Interest: 5% p.a. for the first ₹ 3,00,000 and 8% p.a. for the remaining amount.
- Loan disbursed date: 1st April 20X1
- Loan tenure: 3 Years
- Pre-payment : Full or Partial payment at the option of the employee.
- Simran shall remain in service till the term of the loan ends.
- The principal amount should be recovered in 3 equal installments at the end of each year and will be first applied to 8% interest bearing principal.
- The accrued interest shall be paid on annual basis.

The market rate of a comparable loan available to Simran is 12% per annum.

Following table shows the expected contractual cash flows from the loan given to Simran: *(In ₹)*

Date	Outflows	Inflows·			Principal Outstanding
		Principal	Interest Income 8%	Interest Income 5%	
01.04.20X1	(9,00,000)				9,00,000
31.03.20X2		3,00,000	48,000	15,000	6,00,000
31.03.20X3		3,00,000	24,000	15,000	3,00,000
31.03.20X4		3,00,000	-	15,000	-

Simran pre-pays ₹ 1,00,000 on 31st March, 20X3.

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Following table shows the actual cash flows from the loan, considering the prepayment on 31st March 20X3. (In ₹)

Date	Outflows	Inflows			Principal Outstanding
		Principal	Interest Income 8%	Interest Income 5%	
01.4.20X1	(9,00,000)				9,00,000
31.3.20X2		3,00,000	48,000	15,000	6,00,000
31.3.20X3		4,00,000	24,000	15,000	2,00,000
31.3.20X4		2,00,000	-	10,000	-

You are required to pass journal entries in the books of Lovely Limited considering the requirements of Ind AS 109. **(15 Marks)**

(b) **Either**

State any 5 major differences between Ind AS 24 and AS 18. **(5 Marks)**

OR

What is Equity, Income and Expenses as per 'Framework for Financial Reporting under Ind AS'? How the information with respect to income and expenses helps the users in understanding of the financial statements? **(5 Marks)**

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