MOCK TEST PAPER

FINAL (NEW) COURSE: GROUP – I

PAPER 1: FINANCIAL REPORTING

ANSWERS

1. (a) (i) For classification of assets

Para 6 of Ind AS 16 '*Property, Plant and Equipment' inter alia,* states that Property, plant and equipment are tangible items are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per para 6 of Ind AS 40 'Investment property', Investment property is 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.

According, to the facts given in the questions, since Property 1 and 2 are used as factory buildings, their classification as PPE is correct. However, Property 3 is held to earn rentals; hence, it should be classified as Investment Property. Thus, its classification as PPE is not correct. Property '3' shall be presented as separate line item as Investment Property as per Ind AS 1.

(ii) For valuation of assets

Paragraph 29 of Ind AS 16 states that an entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment. Also, paragraph 36 of Ind AS 16 states that If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

However, for investment property, paragraph 30 of Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property".

Also, paragraph 79 (e) of Ind AS 40 *inter alia* requires that an entity shall disclose the fair value of investment property.

Since property 1 and 2 is used as factory building, they should be classified under same category or class i.e. 'factory building'. Therefore, both the properties should be valued either at cost model or revaluation model. Hence, the valuation model adopted by A Ltd. is not consistent and correct as per Ind AS 16.

In respect to property '3' being classified as Investment Property, there is no alternative of revaluation model i.e. only cost model is permitted for subsequent measurement. However, A Ltd. is required to disclose the fair value of the investment property in the Notes to Accounts.

(iii) For changes in value on account of revaluation and treatment thereof

Paragraph 39 of Ind AS 16 states that if an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading 'revaluation surplus'. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Accordingly, the revaluation gain

shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

(iv) For treatment of depreciation

Paragraph 52 of Ind AS 16 states that Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount.

Accordingly, A Ltd. is required to depreciate these properties irrespective of that their fair value exceeds the carrying amount.

(v) Rectified presentation in the balance sheet

As per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet should be as follows:

Case 1: If A Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2 *INR in lakhs*

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	450	
Property '2'	180	630
Investment Property		
Property '3' (Fair value being 330 lakhs) (Cost = 300-30)		270

Case 2: If A Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2 *INR in lakhs*

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	550	
Property '2'	220	770
Investment Properties		
Property '3' (Fair value being 330 lakhs) (Cost = 300-30)		270
Equity and Liabilities		
Other Equity		
Revaluation Reserve*		
Property '1' (550-450)	100	
Property '2' (220-180)	40	140

*The revaluation reserve should be routed through Other Comprehensive Income (OCI) (subsequently not reclassified to Profit and Loss) in the Statement of Profit and Loss and shown as a separate column in Statement of Changes in Equity.

(b) Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1

(₹)

Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1

(₹)

Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000

2. (a) Consolidated Balance Sheet as on 31.3.20X1

Particulars	*Note No.*	*₹*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,00,000
(b) Reserves and Surplus	2	1,20,700
(2) Minority Interest		20,000
(3) Current Liabilities		
(a) Trade Payables	3	23,000
(b) Short Term Provisions	4	24,500
Total		2,88,200
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	2,15,500
(b) Non-current investment	6	17,200
(2) Current assets	7	55,500
Total		2,88,200

Notes to Accounts

			₹
1.	Share Capital		
	Called up equity shares of ₹ 1 each		1,00,000
2.	Reserves and Surplus		
	General Reserve	40,000	

	Profit and Loss A/c (W.N.3)	80,700	1,20,700
3.	Trade Payables		
	Holding & Subsidiary	20,000	
	Joint Venture (50%)	3,000	23,000
4.	Short term provisions		
	Provisions for Tax		
	Holding & Subsidiary	19,000	
	Joint Venture (50%)	5,500	24,500
5.	Tangibles Assets		
	Holding & Subsidiary	1,95,000	
	Joint Venture (50%)	20,500	2,15,500
6.	Non-current investment		
	Investment in Associate (W.N.4)		17,200
7.	Current Asset		
	Holding & Subsidiary	21,000	
	Joint Venture (50%)	34,500	55,500

Working Notes:

1. Analysis of Profit & Loss of Associate / Joint Venture

	Pre-acquisition	*Post-acquisition*
	₹	₹
Profit as on 31.3.20X1 27,000	16,000	11,000
Share of Associate company (20%)	3,200	2,200
Analysis of Profit and Loss of Joint Venture	Nil	83,000
Share of Joint Venture (50%)		41,500

2. Calculation of Goodwill/Capital Reserve

	Associate		*Joint Venture*	
		₹		₹
Investment		15,000		5,000
Less: Nominal Value	8,000		5,000	
Capital Profit	3,200	(11,200)	-	(5,000)
Goodwill		3,800		Nil

3. Calculation of Consolidated Profit and Loss Account

	₹
Profit and Loss Account of Holding & Subsidiary	37,000
Add: Share of Associate (W.N.1)	2,200
Joint Venture (W.N.1)	41,500
	80,700

4. Calculation of Investment in Associate

	₹
Goodwill (W.N.2)	3,800
Net worth	11,200
Cost	15,000
Add: Share of Revenue Profit	2,200
	17,200

Note: Out of ₹ 17,000 existed at the time of acquisition, only ₹ 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, ₹ 16,000 is taken as capital profit assuming that it is a part of that ₹ 17,000 existed at the time of acquisition.

(b) A. Financial Capital maintenance

Under this concept, a profit is earned only if the financial amount of the net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period, after excluding any distribution to, and contribution from, owners during the period.

B. Physical Capital maintenance

Under this conept, a profit is earned only if the physical productive or operating capability of the entity at the the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Major differences between Physical Capital & Financial Capital

- The physical capital maintenance concept requires the adoption of the current cost basis as measurement whereas financial capital maintenance concept does not require the use of a particular basis of measuerment.
- Financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit.

  Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

3. (a) (i) Paragraph 75 of Ind AS 1, inter alia, provides, "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 20X2, the loan will be classified as current.

(ii) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 20X2, the loan will retain its classification as non-current.

(b) **Either**

X Ltd. should determine the fair value of revenue by calculating the present value of the cash flows receivable.

Total amount receivable	= ₹ 40,00,000 x 1.03 = ₹ 41,20,000.
Present Value of receivable (Revenue)	= ₹ 41,20,000/1.08 = ₹ 38,14,815.
Interest income	= ₹ 41,20,000 - ₹ 38,14,815 = ₹ 3,05,185.

Therefore, on transaction date, ₹ 38,14,815 will be recognised as revenue from sale of goods and ₹ 3,05,185 will be recognised as interest income receivable for the period in accordance with Ind AS 109.

Or

The difference of ₹ 10,000 between the carrying value of interest receivable of ₹ 10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of ₹ 2,500 (₹ 10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1.

It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted or enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

(c) The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement (₹ 45,00,000) can be used as an indication (usually by discounting) of the likely cost, six years previously.

If an appropriate discount rate is 5% per annum, ₹ 45,00,000 discounted back six years amounts to ₹ 33,57,900 [₹ 45,00,000 / $(1.05)^6$], i.e., the approximate cost of turbine before 6 years.

The current carrying amount of the turbine which is required to be replaced of ₹ 13,43,160 would be derecognised from the books of account, (i.e., Original Cost ₹ 33,57,900 as reduced by accumulated depreciation for past 6 years ₹ 20,14,740, assuming depreciation is charged on straight-line basis.)

The cost of the new turbine, ₹ 45,00,000 would be added to the cost of machine, resulting in a revision of carrying amount of machine to ₹ 71,56,840. (i.e., ₹ 40,00,000* – ₹ 13,43,160 + ₹ 45,00,000).

*Original cost of machine ₹ 1,00,00,000 reduced by accumulated depreciation (till the end of 6 years) ₹ 60,00,000.

4. (a) Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200

Retained earnings	1,400
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X1	250
Weighted average number of ordinary shares outstanding [(150 × 9/12) + (250 × 3/12)]	175
Earnings per share [800 / 175]	4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

(b) (i) Value Added Statement of A Ltd. for the period ended on 31.3.20X1

			(₹ in lakhs)
Sales (net) (2,500 – 35)			2,465
Less:	Cost of Bought in Materials and Services:		
	Raw material consumed (180 + 714 – 240)	654	
	Printing and stationary	24	
	Auditors' remuneration	15	
	Rent paid	172	
	Other expenses	88	(953)
Value added by manufacturing and trading activities			1,512

Application of Value Added

		(₹ in lakh)	*(₹ in lakh)*	*%*
To	Pay Employees:			
	Wages and salaries	352		
	Employees state insurance	32		
	Provident fund contribution	26	410	27.12
To	Pay Government:			
	Income-tax		280	18.52

To	Pay Providers of Capital:			
	Interest on borrowings	40		
	Dividend	85	125	8.27
To	Provide for maintenance and expansion of the company:			
	Depreciation	132		
	Transfer to reserve	120		
	Retained profit	445	697	46.09
			1,512	100

(ii) Value Added Per Employee = Value Added/ No. of Employees

= 1,512 \ 87 = 17.38

(iii) Average Earnings Per Employee = Average Earnings of Employee / No. of Employees

= 410/87 = 4.71

5. (a) The repayment schedule for the original debt till the date of renegotiation is as below:

Date / year ended	Opening balance	Interest accrual	Cash flows	Closing balance
1 January 20X0	10,00,000			10,00,000
31 December 20X0	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X1	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X2	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X3	10,00,000	1,00,000	(1,00,000)	10,00,000
31 December 20X4	10,00,000	1,00,000	(1,00,000)	10,00,000

On 1 January 20X5, the discounted present value of the remaining cash flows of the original financial liability is ₹ 10,00,000.

On this date, Preet Ltd. will compute the present value of:

- cash flows under the new terms – i.e. ₹ 15,00,000 payable on 31 December 20Y1 and ₹ 50,000 payable for each of the 7 years ending 31 December 20Y1.
- any fee paid (net of any fee received) – i.e. ₹ 1,00,000

using the original effective interest rate of 10%.

The total of these amounts to ₹ 11,13,158 (Refer Working Note). This differs from the discounted present value of the remaining cash flows of the original financial liability by 11.32% i.e. by more than 10%. Hence, extinguishment accounting applies.

The next step is to estimate the fair value of the modified liability. This is determined as the present value of the future cash flows (interest and principal), using an interest rate of 11% (the market rate at which Preet Ltd. could issue new bonds with similar terms). The estimated fair value on this basis is ₹ 958,097 (Refer Working Note). A gain or loss on modification is then determined as:

Gain (loss) = carrying value of existing liability - fair value of modified liability - fees and costs incurred i.e. ₹ 10,00,000 – ₹ 9,58,097 – ₹ 1,00,000 = Loss of ₹ 58,097

Working Note:

Year	Discount factor @ 10%	Discount factor @ 11%
1	0.909091	0.900901
2	0.826446	0.811622
3	0.751315	0.731191
4	0.683013	0.658731
5	0.620921	0.593451
6	0.564474	0.534641
7	0.513158	0.481658
Annuity	4.868418	4.712195

Amount	Discounting factor @ 10%	Present value	Discounting factor @ 11%	Present value
15,00,000	0.513158	7,69,737	0.481658	7,22,487
1,00,000		1,00,000		
50,000 for 7 years	4.868418	2,43,421	4.712195	2,35,610
		11,13,158		9,58,097
PV of original cash flows @ original EIR		(10,00,000)		
Difference		1,13,158		
Difference %		11.32%		

(b) The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented:

1. Strategic Focus and Future Orientation

An integrated report should provide insight into the organization's strategy and how it relates to the organization's ability to create value and to its use of and effects on the capitals in short, medium and long term period. The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

2. Connectivity of Information

An integrated report shows the connections between the different components:

- Organisation's business model
- External factors that affect the organisation
- Various resources and relationships on which the organisation and its performance are dependent upon

3. Stakeholder Relationships

An integrated report should provide insight into nature and quality of the organization's relationships with its key stakeholders including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

4. Materiality

A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value over time. Additional information can be placed in supporting reports.

5. Conciseness

An integrated report should be concise. It implies that the information should be accessible through crisp presentation, the omission of immaterial information, and a logical easy-to-follow structure.

6. Reliability and Completeness

An integrated report should include all material matters, **both positive and negative**, in a balanced way and without material error. Integrated reporting requires that consideration is given to both good and bad news and performance. Furthermore, both the increases and reductions in the value of the important capitals should be reflected.

6. (a) Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	**20X2**	**20X3**
Total employees	500	500	500
Employees left (Actual)	(29)	(58)	(79)
Employees expected to leave in the next year	(31)	(23)	-
Year end – No of employees	440	419	421
Shares per employee	100	100	100
Fair value of share at grant date	122	122	122
Vesting period	1/2	2/3	3/3
Expenses-20X1 (Note 1)	26,84,000		
Expenses-20X2 (Note 2)		7,23,867	
Expenses-20X3 (Note 3)			17,28,333

Note 1:

Expenses for 20X1 = No. of employees x Shares per employee x Fair value of share x Proportionate vesting period

= 440 x 100 x 122 X ½

= 26,84,000

Note 2:

Expenses for 20X2 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1

= (419 x 100 x 122 x 2/3) – 26,84,000 = 7,23,867

Note 3:

Expenses for 20X3 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) – Expenses recognized in year 20X1 and 20X2

= (421 x 100 x 122 x 3/3) – (26,84,000 + 7,23,867) = 17,28,333.

Journal Entries

31-Dec-20X1			
Employee benefits expenses	Dr.	26,84,000	
To Share based payment reserve (equity)			26,84,000
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X2			
Employee benefits expenses	Dr.	7,23,867	
To Share based payment reserve (equity)			7,23,867
(Equity settled shared based payment expected vesting amount)			
31-Dec-20X3			
Employee benefits expenses	Dr.	17,28,333	
To Share based payment reserve (equity)			17,28,333
(Equity settled shared based payment expected vesting amount)			
Share based payment reserve (equity)	Dr.	51,36,200	
To Share Capital			51,36,200
(Share capital Issued)			

(b) Threshold amount is ₹ 10,00,000 (₹ 1,00,00,000 × 10%).

Segment A exceeds the quantitative threshold (₹ 30,00,000 > ₹ 10,00,000) and hence reportable segment.

Segment D exceeds the quantitative threshold (₹ 54,00,000 > ₹ 10,00,000) and hence reportable segment.

Segment B & C do not meet the quantitative threshold amount and may not be classified as reportable segment.

However, the total external revenue generated by these two segments A & D represent only 70% (₹ 35,000/50,000 x 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

In case of X Ltd., it is given that Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, X Ltd. designates this start-up segment C as a reportable segment, making the total external revenue attributable to reportable segments 87% (₹ 43,50,000/ 50,00,000 x 100) of total entity revenues.