ANSWERS OF MODEL TEST PAPER 4

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

ANSWER TO PART – I CASE SCENARIO BASED MCQS

1. **Option (a) :** ₹ 8,40,000
2. **Option (b) :** ₹ 42,000
3. **Option (d) :** ₹ 50,000
4. **Option (c) :** 11.4375%
5. **Option (c) :** ₹ 15,000
6. **Option (a) :** ₹ 22,875
7. **Option (d) :** Loss on initial recognition of biological asset ₹ 6,000
8. **Option (a) :** Gain on remeasurement of biological asset ₹ 9,800
9. **Option (c) :** Equity
10. **Option (b) :** Financial Liability
11. **Option (b) :** Z Ltd. is an associate of H Ltd.
12. **Option (b) :** G Ltd. is an associate of H Ltd.
13. **Option (b) :** Y Ltd. is an associate of H Ltd.
14. **Option (d) :** Do not disclose assumptions and bases, so that users are not misled.
15. **Option (a) :** Ensure that all passwords are simple and are not changed regularly.

PART – II DESCRIPTIVE QUESTIONS

1. **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 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 balance sheet at 31st December, 20X1

The consolidated balance sheet immediately after the business combination is:

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

2. **(a)** Ind AS 109 requires that financial assets and liabilities are recognized on initial recognition at its fair value, as adjusted for the transaction cost. In accordance with Ind AS 113 Fair Value Measurement, the fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Both parent and subsidiary recognize financial asset and liability, respectively, at fair value on initial recognition. The difference

between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Accounting in the books of XYZ Ltd (Parent)

Particulars	Amount	Amount
On the date of loan		
Loan to ABC Ltd (Subsidiary) Dr.	7,51,315	
Deemed Investment (Capital Contribution) in ABC Ltd. Dr.	2,48,685	
To Bank		10,00,000
(Being the loan is given to ABC Ltd and recognised at fair value)		
Accrual of Interest income		
Loan to ABC Ltd Dr.	75,131	
To Interest income		75,131
(Being interest income accrued) – Year 1		
Loan to ABC Ltd Dr.	82,645	
To Interest income		82,645
(Being interest income accrued) – Year 2		
Loan to ABC Ltd Dr.	90,909	
To Interest income		90,909
(Being interest income accrued) – Year 3		
On repayment of loan		
Bank Dr.	10,00,000	
To Loan to ABC Ltd (Subsidiary)		10,00,000

Accounting in the books of ABC Ltd (Subsidiary)

Particulars	Amount	Amount
On the date of loan		
Bank Dr.	10,00,000	
To Loan from XYZ Ltd (Payable)		751,315
To Equity (Deemed Capital Contribution from XYZ Ltd)		2,48,685
(Being the loan taken from XYZ Ltd. and recognised at Fair value)		

Accrual of Interest		
Interest expense Dr.	75,131	
To Loan from XYZ Ltd (Payable)		75,131
(Being interest expense recognised) – Year 1		
Interest expense Dr.	82,645	
To Loan from XYZ Ltd (Payable)		82,645
(Being interest expense recognised) – Year 2		
Interest expense Dr.	90,909	
To Loan from XYZ Ltd (Payable)		90,909
(Being interest expense recognised) – Year 3		
On repayment of loan		
Loan from XYZ Ltd (Payable) Dr.	10,00,000	
To Bank		10,00,000

Working Notes:

1	**Computation of Present value of loan**	
	Rate	10%
	Amount of Loan	10,00,000
	Year	3
	Present Value	7,51,315
2	**Computation of interest for Year I**	
	Present Value	7,51,315
	Rate	10%
	Period of interest - for 1 year	1
	Closing value at the end of year 1	8,26,446
	Interest for 1st year	75,131
3	**Computation of interest for Year 2**	
	Value of loan as at the beginning of Year 2	8,26,446
	Rate	10%
	Period of interest - for 2nd year	1
	Closing value at the end of year 2	9,09,091
	Interest for 2nd year	82,645

4	**Computation of interest for Year 3**	
	Value of loan as at the beginning of Year 3	9,09,091
	Rate	10%
	Period of interest - for 3rd year	1
	Closing value at the end of year 3	10,00,000
	Interest for 3rd year	90,909

(b) **Either**

In accordance with Ind AS 24 'Related Party Disclosures', effective 1st January 20X3, Candour Ltd. would be regarded as a related party of Buildwell Ltd. This is because Candour Ltd. is controlled by the close family member of one of Buildwell Ltd.'s key management personnel. This means that from 1st January 20X3, the purchases from Candour Ltd. would be regarded as related party transactions.

As per the provisions of para 18 of Ind AS 24, transactions with related parties need to be disclosed in the notes to the financial statements, together with the nature of the relationship. It is irrelevant whether or not these transactions are at normal market rates. As per para 23 of the standard, disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

The disclosure is required to state that Candour Ltd., controlled by the spouse of a director, supplied goods to the value of ₹ 4·5 million (3 x ₹ 1·5 million) in the current accounting period.

Or

The entity should use First-in-first-out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.

However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

3. (a) **Statement of Cash Flows for the year ended 31st March 20X3**

(Indirect method)

Particulars	₹	₹
Cash flow from operating activities: Net Profit before taxes and extraordinary items (7,20,000+8,80,000) *Add*: Depreciation	16,00,000 6,00,000	
Operating profit before working capital changes	22,00,000	
Increase in inventories Decrease in trade receivables Advances Decrease in trade payables Increase in outstanding expenses	(1,80,000) 16,80,000 (12,000) (60,000) 2,40,000	
Cash generated from operations *Less*: Income tax paid (Refer W.N.4)	38,68,000 (8,68,000)	
Net cash from operations		30,00,000
Cash from investing activities: Purchase of land Purchase of building & equipment (Refer W.N.2) Sale of equipment (Refer W.N.3)	(4,80,000) (28,80,000) 3,60,000	
Net cash used for investment activities		(30,00,000)
Cash flows from financing activities: Issue of share capital Dividends paid	8,40,000 (7,20,000)	
Net cash from financing activities:		1,20,000

Net increase in cash and cash equivalents		1,20,000
Cash and cash equivalents at the beginning		6,00,000
Cash and cash equivalents at the end		7,20,000

Working Notes:

1. Building & Equipment Account

Particulars	₹	Particulars	₹
To Balance b/d	36,00,000	By Sale of assets	7,20,000
To Cash/bank (purchases)(bal.fig)	28,80,000	By Balance c/d	57,60,000
	64,80,000		64,80,000

2. Building & Equipment Accumulated Depreciation Account

Particulars	₹	Particulars	₹
To Sale of asset (acc. depreciation)	4,80,000	By Balance b/d	12,00,000
To Balance c/d	13,20,000	By Profit & Loss A/c (provisional)	6,00,000
	18,00,000		18,00,000

3. Computation of sale price of Equipment

Particulars	₹
Original cost	7,20,000
Less Accumulated Depreciation	(4,80,000)
Net cost	2,40,000
Profit on sale of assets	1,20,000
Sale proceeds from sale of assets	3,60,000

4. **Provision for tax Account**

Particulars	₹	Particulars	₹
To Bank A/c	8,68,000	By Balance b/d	1,20,000
To Balance c/d	1,32,000	By Profit & Loss A/c (provisional)	8,80,000
	10,00,000		10,00,000

(b) As per Ind AS 19, net remeasurement of ₹ 900 would be recognized in other comprehensive income.

Computation of Net remeasurement

= Remeasurement – Actuarial loss

= ₹ 1000 (Refer WN - 1) – ₹ 100 (Given in the question) = ₹ 900.

Computation of net interest expense

Particulars	₹
Defined benefit liability as at 1st April 20X1 **(A)** **(Given in the question)**	12,000
Fair value of plan asset as at 1st April 20X1 **(B)** **(Given in the question)**	(10,000)
Net defined benefit liability **(A - B)**	2,000
Net interest expense (as it is net liability) (Refer note given below)	200

Note: Net interest expense would be computed on net defined benefit liability using discount rate of 10% given in the question-

= Net defined benefit liability x Discount rate

= 2,000 x 10%

= ₹ 200.

Working Note:

Computation of amount of remeasurement

Particulars	₹
Actual return on plan asset for the year ended 31st March 20X2 **(Given in the question)** **(C)**	2,000

Less: Interest income on ₹ 10,000 held for 12 months at 10% **(D)**	(1,000)
Remeasurement **(E = C - D)**	1,000

4. (a) Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 20X2

i. The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is ₹ 30,00,000. However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

ii. The development costs have a carrying value of ₹ 15,20,000 (₹ 16,00,000 – (₹ 16,00,000 x 1/5 x 3/12)). The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be ₹ 4,56,000 (₹ 15,20,000 x 30%). All deferred tax liabilities are shown as non-current.

iii. The carrying value of the loan at 31st March, 20X2 is ₹ 1,07,80,000 (₹ 1,00,00,000 – ₹ 200,000 + (₹ 98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ₹ 7,80,000 and a potential deferred tax asset of ₹ 2,34,000 (₹ 7,80,000 x 30%).

(b) In the facts provided above, the entity has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2-4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations –

(i) Sale of machinery

(ii) Sale of spare parts

(iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- **Sale of machinery:** Machine has been sold to the customer and physical possession as well as legal title

passed to the customer on 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognized on 31st March, 20X3.

- **Sale of spare parts:** The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-hold basis if all below criteria are met:

(a)	the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory.
(b)	the product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer.
(c)	the product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery.
(d)	the entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.

- **Custodial services:** Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight-line basis over a period of time.

5. (a) Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity.

Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 'First Time Adoption of Ind AS'. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities.

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

(b) Identification of the contract (by applying para 9 of Ind AS 116)

(a) Identified asset

Feel Fresh Ltd. (a customer company) enters into a long-term purchase contract with M/s Radhey (a manufacturer) to purchase a particular type and quality of soaps for 10 year period.

Since for the purpose of the contract M/s Radhey has to buy a customized machine as per the directions of Feel Fresh Ltd. and also the machine cannot be used for any other type of soap, the machine is an identified asset.

(b) Right to obtain substantially all of the economic benefits from use of the asset throughout the period of use

Since the machine cannot be used for manufacture of soap for any other buyer, Feel Fresh Ltd. will obtain substantially all the economic benefits from the use of the asset throughout the period of use.

(c) Right to direct the use

Feel Fresh Ltd. controls the use of machine and directs the terms and conditions of the contract with respect to recovery of fixed expenses related to machine.

Hence the contract contains a lease.

Lease term

The lease term shall be 10 years assuming reasonable certainty. Though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate.

Identification of lease payment

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) fixed payments (including in-substance fixed payments), **less** any lease incentives

(b) variable lease payments that depend on an index or a rate

(c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option

(d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Here in-substance fixed payments in the given lease contract are ₹ 1,74,015 p.a. The present value of lease payment which would be recovered in 8 years @ 8% would be ₹ 10,00,000 (approx.)

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Hence, lease liability will be recognized by ₹ 10,00,000 in the books of Feel Fresh Ltd. Since there are no payments made to lessor before commencement date less lease incentives received from lessor or initial direct costs incurred by lessee or estimate of costs for restoration / dismantling of underlying asset, the right of use asset is equal to lease liability.

Journal Entries

On initial recognition

ROU Asset Dr.	10,00,000	
To Lease Liability		10,00,000
To initially recognise the Lease Liability and the corresponding ROU Asset		

At the end of the first year

Interest Expense Dr.	80,000	
To Lease Liability		80,000
To record interest expense and accrete the lease liability using the effective interest method (₹ 10,00,000 x 8%)		
Depreciation Expense (10,00,000 / 10 years) Dr.	1,00,000	
To ROU Asset		1,00,000
To record depreciation on ROU using the straight-line method (₹ 10,00,000 / 10 years)		
Lease Liability Dr.	1,74,015	
To Bank / M/s. Radhey		1,74,015
To record lease payment		
Cost of soap Dr.	24,75,000	
To Bank / M/s. Radhey {5,50,000 x (4 + 0.5)}		24,75,000
To record variable expenses paid as cost of the goods purchased		

6. (a) The above issue needs to be examined in the umbrella of the provisions given in Ind AS 1 '*Presentation of Financial Statements',* Ind AS 16 *'Property, Plant and Equipment'* in relation to property '1' and '2' and *Ind AS 40 'Investment Property'* in relation to property '3'.

Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2". It also required to depreciate these

properties irrespective of that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Venus ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.

Therefore, 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 is as follows:

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

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	9,000	22,500
Investment Properties		
Property '3'		10,800

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

Balance Sheet (extracts) as at 31st March, 20X2 ₹

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	11,000	27,000
Investment Properties		
Property '3'		10,800

Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property ‘1’ [16,000 – (15,000 – 1,500)]	2,500	
Property ‘2’ [11,000 – (10,000 – 1,000)]	2,000	4,500

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

(b) Ethical Considerations

Long-term success of any organization strongly depends on the fair treatment of employees, which in turn is based on the ethical behaviour of the management as well as how the same is perceived by the stakeholders. In the given case, the CFO has suggested not paying the discretionary bonus, which the directors are considering as it will enable the company to record profits of ₹ 2 crores, thereby ensuring a bonus pay out to the directors. This suggestion is not illegal at all as the bonus is discretionary rather than statutory/contractual. In other words, the company has no legal obligation to pay the bonus to the employees. However, the reason behind non-payment of the bonus is what gives rise to ethical considerations. The suggestion by the CFO will have the aforesaid impact of reducing expenses and improving profits.

On a moral ground, the suggestion is likely to have negative consequences for the company. The employees would be dissatisfied that the bonus has been withdrawn, and further, when they would see the directors withdrawing bonuses out of the profits arising on a saving in bonus costs, it would have a negative impact on employee morale, which would result in low employee satisfaction scores and poor retention rates, which are reported as non-financial information in the financial statements. Companies are also under increasing pressure to reduce the wage gap between the management and its employees. By not

paying a bonus, this metric will be adversely affected.

The CFO's statement that the above action will not negatively impact the company as the non-financial reporting indicators are not widely read by the users is misleading. The non-financial information is becoming increasingly important to the users of financial statements as they care about companies' treatment of their employees and view it as being important in the long-term success of the company.

A chartered accountant has a responsibility to exercise due diligence and clearly consider both financial and non-financial information while discharging his professional duty. It would be unethical for a chartered accountant to guide the management on matters which may result into any kind of disadvantage (it includes even non-financial matters) to the stakeholders.

Further, a distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A chartered accountant's responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Therefore, the Code contains requirements and application material to enable chartered accountants to meet their responsibility to act in the public interest. Hence, it is essential for a chartered accountant to uphold the professional standards and act in accordance with the ethical principles by ensuring transparency and accuracy in financial reporting.