SUGGESTED SOLUTION

FINAL NOVEMBER 2018 EXAM

SUBJECT- Financial Reporting

Test Code - FNJ 7021

BRANCH - () (Date : 02/09/2018)

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Answer 1:

(A)

As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present Value of minimum lease payments (Rs. 3 lakhs each year)	Rs. 10.08 lakhs (approx.)

Thus present value of minimum lease payments is Rs. 10.08 lakhs and the fair value of the machine is Rs. 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

(B)

Paragraph 7 of AS 10 states that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, paragraph 9 provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances.

Paragraph 17, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

<u>Depreciation</u>

As per paragraph 45 and 47 of AS 10, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment.

The useful lives of these assets should not exceed that of the asset to which it relates.

Presentation
These assets should be presented within the class of asset to which they relate.

Answer 2:
(A)

Net Realisable Value of Inventory as on 31st March, 2018
= Rs. 107.75 x 20 units = Rs. 2,155

Value of inventory as per Weighted Average basis

Total units purchased and total cost:

01.03.2018	Rs. 108 x 20 units = Rs. 2,160
08.3.2018	Rs. 107 x 15 units = Rs. 1,605
17.03.2018	Rs. 109 x 30 units = Rs. 3,270
25.03.2018	Rs. 107 x 15 units = Rs. 1,605
Total	80 units = Rs. 8,640

Weighted Average Cost = Rs. 8,640/80 units = Rs.108
Total Value = Rs. 108 x 20 units = Rs. 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2018 is, Cost or Net Realisable value whichever is lower i.e. Rs. 2,155.

(B)

Case 1: It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

In determining the value in use of A and B plus C, M Ltd. adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A's products.

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and
(b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M Ltd. as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

Answer 3:

(A)

(i) Carrying amount of investment in Separate Financial Statement of Full Ltd. as on 31.03.2017

	Rs.
Amount paid for investment in Associate (on 1.06.2016)	2,00,000
Less: Pre-acquisition dividend (Rs. 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.2017 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Full Ltd. as on 31.3.2017 as per AS 23

	Rs.
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of profit of investee as per equity method (30% of Rs. 3,00,000)	90,000
Carrying amount as on 31.3.2017	2,75,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Full Ltd. as on 30.6.2017 as per AS 23

	Rs.
Carrying amount as on 31.3.2017	2,75,000
Less: Dividend received (Rs. 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.2017	2,57,000

(B)

Para 10 of AS 16 'Borrowing Costs' states that to the extent the funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2016-17 should be calculated as follows:

Actual interest for 2016-17 (11% of Rs. 150 crores)	Rs. 16.50 crores
Less: Income on temporary investment from specific borrowings	(Rs. 3.50 crores)
Borrowing costs to be capitalized during year 2016-2017	Rs. 13.00 crores

Answer 4:

(A)

With the introduction of AS 26 'Intangible Assets', the concept of deferred revenue expenditure no longer prevails except in respect of a very few items, such as ancillary costs on borrowings, shares issue expenses etc. AS 26 does not permit the capitalization of expenses incurred on advertising or brand promotion, etc. Thus, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crore to the P & L account of the year is correct.

(B)

As per AS 21 “Consolidated Financial Statements”, the losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	*Details*	*Minority Interest (MI) (20%)*	*Minority's Share of losses borne by Ram Ltd.*
			Balance
Minority Interest at the time of acquisition i.e. on 31.3.2012		6,00,000 (W.N.)	
2012-13	(15,00,000 x 20%)	<u>(3,00,000)</u>	
on 31.3.2013		3,00,000	
2013-14	(20,00,000 x 20%)	<u>(4,00,000)</u>	
		(1,00,000)	1,00,000
	Loss amounting Rs. 1,00,000 of minority borne by majority shareholders on application of AS 21	<u>1,00,000</u>	
on 31.3.2014		<u>Nil</u>	
2014-15	(4,00,000 x 20%)	80,000	
	On application of AS 21, profit transferred to majority shareholders	<u>(80,000)</u>	(80,000)
on 31.3.2015		<u>Nil</u>	20,000
2015-16	(5,00,000 x 20%)	1,00,000	
	On application of AS 21, profit transferred to majority shareholders to the extent earlier loss was borne by majority share holders	<u>(20,000)</u>	(20,000)
on 31.3.2016		<u>80,000</u>	Nil

Working Note:

Calculation of Minority Interest as on 31.3.2012

	Total Amount (100%) (Rs.)	Minority Interest (20%) (Rs.)
Share Capital (20%)	25,00,000	5,00,000
Add: Share in Reserves (20%)	5,00,000	<u>1,00,000</u>
		<u>6,00,000</u>

Answer 5:

(A)

Computation of Number of Shares to be issued to former shareholders

Particulars	AB Ltd.	CD Ltd.
	Rs.	Rs.
Future Maintainable EBIT	2,30,000	1,12,000
Less: Interest on Debentures	(20,000)	-
	2,10,000	1,1,2,000
Less: Income tax @ 50%	(1,05,000)	(56,000)
Profit after tax	1,05,000	56,000
Less: Preference Dividend	-	(8,000)
Profit to Equity Shareholders	1,05,000	48,000
PE Ratio	10	8
Capitalised Earning	10,50,000	3,84,000
Number of shares to be exchanged in EF Ltd. @ Rs. 12 (including Premium of Rs. 2 each)	87,500	32,000

(B)

As per AS 13 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

And where investments are reclassified from current to long term, transfers are made at lower of cost and fair value on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at Rs.13 lakhs in the books.

(ii) The carrying / book value of the long term investment is same as cost i.e. Rs. 14 lakhs. Hence this long term investment will be reclassified as current investment at book value of Rs. 14 lakhs only.

(iii) In this case, reclassification of current investment into long-term investments will be made at Rs. 20 lakhs as cost is less than its market value of Rs. 24 lakhs.

(iv) In this case, market value is Rs. 28 lakhs which is lower than the cost of Rs. 30 lakhs. The reclassification of current investment as long-term investments will be made at Rs. 28 lakhs.