FINAL CA – May 2018
ACCOUNTING STANDARDS (Part 2)

Test Code – F68
Branch (MULTIPLE) (Date : 18.02.2018)

(50 Marks)

Note: All questions are compulsory.

Question 1 (5 marks)

Carrying amount of investment in Separate Financial Statement of Power Ltd. as on 31.03.2017 (1 ½ marks)

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

Carrying amount of investment in Consolidated Financial Statements* of Power Ltd. as on 31.3.2017 as per AS 23 (1 ½ marks)

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

Carrying amount of investment in Consolidated Financial Statement of Power Ltd. as on 30.6.2017 as per AS 23 (2 marks)

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

Question 2 (5 marks)

As per paragraph 3 of AS 24 'Discontinuing Operations', a discontinuing operation isa component of an enterprise:

(i) that the enterprise, pursuant to a single plan, is:

(1) disposing of substantially in its entirety,

(2) disposing of piecemeal, or

(3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) that can be distinguished operationally and for financial reporting purposes.

(1 ½ mark)

As per para 8 of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation.

(1 mark)

As per para 9, examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business; (1 mark)

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation.

If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

(1 ½ mark)

Question 3 (6 marks)

) As per paragraph 14 of AS 29, a provision should be recognized when:

1. an enterprise has a present obligation as a result of a past event
2. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
3. a reliable estimate can be made of the amount of obligation. (1 Mark)

If these conditions are not met, no provisions should be recognized.

As per paragraph 10.4 of AS 29, a contingent liability is:

(1) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(2) a present obligation that arises from past events but is not recognized because:

(a) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(b) a reliable estimate of the amount of the obligation cannot be made.

4. In this case company is required to assess the probability of occurrence of contingencies on the basis of such events taken place in earlier period. (1 Mark)

Though there is a present obligation based on such past event and it is probable that an outflow of resources will be required, a reliable estimate of amount of obligation cannot be made.

Hence no provision for the same is to be created and the same is to be disclosed as contingent liability. (1 Mark)

(ii) Treatment of Provision already created in the Balance Sheet:

1. Reversal of provision should be netted off against the relevant expenditure and should not be shown as "Other Income". (1 Mark)
2. Where the reversal is greater than the current year's expenditure, the net amount would be negative which may be reflected as other income. (1 Mark)
3. If such provision is related to earlier year, then the same should be disclosed as prior period income. (1/2 Mark)
4. As required by AS 29, specific disclosure should be given for reversal of provision in the notes to accounts and reference of note should be given in the specific line item of expenditure in which reversal of provision is made. (1/2 Mark)

Question 4 (8 marks) (1 mark for each entry)

(b) Journal Entries

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
July, 2015	No entry in the books (Being Almighty Ltd. entered to sell a forward exchange contract for USD 100,000 having ten months maturity on April 30, 2016 when forward exchange rate is ` 65.00 per USD and spot rate as at July 01, 2015 is ` 64.50 per USD)			
Upto January 31, 2016	Forward Contract Receivable A/c	Dr.	3,80,000	
	To Cash Flow Hedge Reserve A/c			3,80,000
	(Being Almighty Ltd. accounts the MTM effect in the books when forward contract rate entered is ` 65.00 per USD and forward contract available in the market with similar maturity is ` 61.20 per USD)			
January 31, 2016	Recognition of Revenue			
	Accounts Receivable	Dr.	61,00,000	
	To Revenue			61,00,000
	Recognition of Hedging gain			
	Cash Flow hedge reserve	Dr.	3,80,000	
	To Profit & Loss A/c			3,80,000
	(Being Almighty Limited recognises the revenue by booking an invoice for USD 100,000, having credited period of 90 days (i.e. due date – April 30, 2016) when spot rate as at January 31, 2016 is ` 61.00 per USD and forward contract available in the market with similar maturity is ` 61.20 per USD)			
March 31, 2016	Restatement of Accounts Receivable			
	Forex Gain/Loss (P&L)	Dr.	50,000	
	To Accounts Receivable			50,000
	MTM Effect of Forward Cover			
	Forward Contract Receivable	Dr.	60,000	
	To Forex Gain/Loss (P&L)			60,000
	(Being year-end spot rate is		60.50	

Date	Particulars		Dr. (`)	Cr. (`)
	` 60.50 per USD and forward contract available in the market with similar maturity is ` 60.60 per USD)			
April 30, 2016	Realisation of Accounts Receivable			
	Bank	Dr.	60,00,000	
	Forex Gain/Loss (P&L)	Dr.	50,000	
	To Accounts Receivable			60,50,000
	Maturity of Forward Contract			
	Bank	Dr.	5,00,000	
	To Forward Contract Receivable			4,40,000
	To Forex Gain/Loss (P&L)			60,000
	(Being spot rate is ` 60.00 per USD)			

Question 5 (6 marks)

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. (3 marks)

Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances. (3 marks)

Question 6 (5 marks)

As per para 13 of AS 22, "Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first. (2 marks)

Out of ` 200 lakhs depreciation, timing difference amounting `80 lakh (` 10 lakh x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for ` 120 lakh (`200 lakh – ` 80 lakh), deferred tax liability will be recognised for ` 48 lakh (40% of ` 120

lakh) in first year. In the second year, the entire amount of timing difference of ` 400 lakh will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting ` 160 lakh (40% of ` 400 lakh) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ` 208 lakh (48 lakh + 160 lakh). (3 marks)

Question 7 (6 marks) (1 mark for each adjustment)

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date untill it is appropriate to defer at the end of the enterprise's financial year. Therefore dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy. Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(` in lakhs)
Profit before tax (as reported)	4
Add: Dividend income `(4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in the method, should be applied retrospectively ` (12-3) lakhs	9
Extra ordinary gain ` (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ` (3-2)lakhs	1
	18
Less: Sales promotion expenses (80% of ` 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	1

Question 8 (5 marks)

As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

(1) The combined result of all segments in profit; or

(2) The combined result of all segments in loss,

whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments. (2 marks)

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

(a) On the basis of turnover criteria segments M and N are reportable segments.

(b) On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of ` 200 lakhs).

(c) On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in atleast one of the above criteria all segments have to be reported upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong. (3 marks)

Question 9 (4 marks)
Pin Ltd. has direct economic interest in Rin Ltd. to the extent of 14%, and through Qin Ltd. (in which it is the majority shareholders) it has further control of 12% in Rin Ltd. (60% of Qin Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.

AS 18 'Related Party Disclosures', defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. (2 marks)

Since, Pin Ltd. has total control of 26% (directly and indirectly by Qin Ltd.) in Rin Ltd. which is less than half of the voting power of Rin Ltd., Pin Ltd. is said to have significant influence over Rin Ltd. Also it is given in the question that Rin Ltd. is a listed company and regularly supplies goods to Pin Ltd.
Therefore, related party disclosure, as per AS 18, is required by Rin Ltd. in its financial statements, in respect of goods supplied to Pin Ltd. (2 marks)

****