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SUGGESTED SOLUTION

Final May 2019 EXAM

SUBJECT- FR

Test Code - FNJ 7057 N

BRANCH - () (Date :)

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Answer 1:
(A)

(i) If it is considered that there is no quarterly/seasonal variation, therefore normal expected pro-duction for each quarter is 600 MT and fixed production overheads for the quarter are RS. 2,400

Fixed production overhead to be allocated per unit of production in every quarter will be Rs. 4 per MT (Fixed overheads/Normal production).

First quarter:
Actual production overheads = Rs. 2,400
Fixed production overheads based on the allocation rate of Rs. 4 per unit allocated to actual production = Rs. 4 x 500 = Rs. 2,000
Unallocated fixed production overheads to be charged as expense as per Ind AS-2 and consequently as per Ind AS- 34 = Rs. 400

Second quarter:
Actual fixed production overheads on year-to-date basis Rs. 4,800
Fixed production overheads to be absorbed on year-to-date basis (700+500), 1200 x 4 = Rs.4,800
Rs. 400 was not allocated to production in the 1st quarter. To give effect to the entire Rs.4,800 to be allocated in the second quarter, as per Ind AS-34, Rs. 400 are reversed by way of a credit to the profit and loss account of the 2nd quarter.

Third quarter:
Actual production overheads on year-to-date basis = Rs. 7,200
Fixed production overheads to be allocated on year-to-date basis 1,600x4= Rs. 6,400
Under allocated overheads Rs. 800 to be expensed as per Ind AS-2 and consequently as per Ind AS-34.

Fourth quarter/Annual:
Actual fixed production overheads on year-to-date basis Rs. 9,600
Fixed production overheads to be allocated on year-to-date basis 2,300x4= Rs. 9,200
Rs. 400, i.e., [2,800 (i.e., Rs. 4x700) -2,400] over allocable in the 4th quarter, are to be reversed as per Ind AS-34 by way of a credit to the profit and loss account.
Unallocated overheads for the year Rs. 400 are expensed in the profit and loss account as per Ind AS-2.

The cumulative result of all the quarters would also result in unallocated overheads of Rs.400, thus, meeting the requirements of Ind AS-34 that the quarterly results should not affect the measurement of the annual results. **(8 marks)**

(ii) In a case where there are quarterly/seasonal variations, the estimates of normal capacity would have to be made on the quarterly/seasonal basis, the enterprise will have to estimate its normal capacity on the basis of the average of the relevant quarters/seasons of past few years, say, 3 to 5 years, also considering the demand of the product during the season. For example, where a company is having seasonal variations say, in the 3rd quarter of the year, then it should estimate the normal capacity for the 3rd quarter based on the capacity utilization of the 3rd quarter for the past few years, say 3 to 5 years, also keeping in view the future demand of the product during the quarter. Once the normal capacity for a quarter is determined, as aforesaid, the quarter should be considered for measurement purposes, as per Ind AS-34 on year-to-date basis, i.e., on cumulative basis, which would then be added up to determine the normal capacity for the year on the basis of which the absorption rate will be determined. The variations between the seasons would thus be considered normal and treated accordingly.

If there is an abnormal breakdown during a period, as per Ind AS-2, the amount of fixed production overheads not allocated to units of production is charged to the statement of profit and loss. However, the result of under allocation of overheads or over allocation of overheads should not affect the measurement of its annual results since interim periods are parts of a financial year. **(4 marks)**

(B)

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	**Value as per tax records**	**Tax base**	**Taxable temporary differences**	**Total Deferred tax liability @ 20%**	**Charged to P&L during the year**
a	**b**	**c**	**d**	**E= b-d**	**F = e x 20%**	**g**
31st March, 2017	70 crore	45 crore	45 crore	25 crore	5 crore	5 crore
31st March, 2018	75 crore	45 crore	45 crore	30 crore	6 crore	1 crore (6 crore – 5 crore)

(4 marks)

(C)

(i) Treatment of any unspent amount of CSR expenditure

Since the expenditure on CSR activities is to be disclosed only in the Board's Report, no provision for the amount which is not spent, (i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period) may be made in the financial statements.

The Act requires that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount.

However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in

accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial statements.

(ii) Treatment of excess amount spent on CSR Activities

Since 2% of average net profits of immediately preceding three years is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future. **(4 marks)**

Answer 2:

(A) (i) Legal Form

F Ltd. Profit or loss year to 31st March

Amt. (Rs.'000)

	2016	2017	2018	Total
Revenues	15,000	Nil	25,000	40,000
Cost of Sales	(12,000)	Nil	(19,965)	(31,965)
Gross Profit	3,000	Nil	5,035	8,035

The cost of sales in the year 2012 is the original selling price of Rs. 15 plus compound interest at 10% for the previous three years.

F Ltd. Statement of financial position as at 31st March

Amt. (Rs. '000)

	2010	2011	2012
Inventory	Nil	Nil	Nil
Loan	Nil	Nil	Nil

(4 marks)

(ii) Substance

F Ltd. Profit or Loss year to 31st March

Amt. (Rs.'000)

	2016	2017	2018	Total
Revenues	Nil	Nil	25,000	25,000
Cost of Sales	Nil	Nil	(12,000)	(12,000)
Gross Profit	Nil	Nil	13,000	13,000
Interest (Accrued @ 10%)	(1,500)	(1,650)	(1,815)	(4,965)
Profit /loss)	(1,500)	(1,650)	11,185	8,035

(4 marks)

F. Ltd. Statement of financial position as at 31st March

Amt. (Rs.'000)

	2016	2017	2018	
Inventory	12,000	12,000	Nil	
Loan	15,000	15,000	15,000	
Plus accrued interest	1,500	3,150	4,965	
			19,965	
	Repaid 31st March 2018		(19,965)	
				NIL

As can be seen from the figure in (i) if the legal form of the transaction is applied in results in a spreading of the profit, some in the year to 31st March 2016 the rest in 2018. Also no inventory or loans appear in the statement of financial position; this improves many ratios, particularly gearing.

In contrast (ii) applies the substance of the transaction and (ignoring F Ltd's other transactions)this result in "losses" in 2016 and 2018 and large profit in 2012; there is no profit 'smoothing'. It also shows an interest charge, which in (i) is "lost" in the cost of sales figure. In addition both the inventory and the loan (including accrued interest) appear in the statement of financial position. Note both methods eventually report the same profit. **(2 marks)**

(B)

	Payable		Currency Forward	P & L
	USD	INR	INR	INR
At initial recognition	10,000	6,22,000	0	0
As on 31st Mar – 2015	10,000	6,24,000		
Loss recognized in the profit or loss		- 2,000	1,442	1,442
As on 30th Jun – 2015	10,000	6,36,7000		
Loss recognized in the profit or loss		-12,7000	13,235	11,793
As on 30th Sep – 2015	10,000	6,41,000		
Loss recognized in the profit or loss		- 4,300	17,000	3,765
Total Profit or loss		- 19,000		17,000
Overall effectiveness of hedging				89.47%

Forward premium is not segregated and separately accounted for. **(5 marks)**

(C) As per Ind AS 2, inventory should be valued at lower of cost and net realizable value. As this is the case of specific order inventory, the cost of this inventory will be based on specific cost. The cost mentioned in the question is presumed to be specific cost. However, the net realizable value of the inventory cannot be readily available from the market as there is not ready market for specific order inventory. Considering that the company has filed a winding up petition against the customer, there is sufficient evidence that realizable value of the inventory which is made on specific order and only suitable for particular customer will be negligible. Therefore as per Ind AS – 2 the inventory has to be valued at realizable value which appears to be negligible, hence the qualification of auditor appears to be in order.

As regards sundry debtors of Rs. 75 lakhs, these have to be shown in the financial statements at their realizable value. Again there is a sufficient evidence of non – realization of debtors as the company has filed the winding up petition against the debtors. Hence, the provision for losses of Rs. 75 lakhs should be made and qualification of auditors also appears to be in Order. **(5 marks)**

Answer 3:

(A)

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

Item	Rs. In lakhs				
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780 1)	780 1)	-	-
Receivables	5,200	5,200 1)	5,500 3)	(300)	90
Plant and equipment	7,000	8,000 2)	6,000 4)	2,000	(600)
Brands		4,300 2)	- 5)	4,300	(1,290)
Goodwill (Balancing figure)		2,100 9)			
Deferred tax asset	360	3,60 7)			
Total assets		**20,740**			
Payables	(1,050)	(1,050) 1)	(1,050) 1)		
Borrowings	(4,900)	(4,900) 1)	(4,900) 1)		
Employee Entitlement liabilities	(900)	(900) 1)	- 6)	(900)	270
Deferred tax liability	(300)	(1,890) 8)			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

(6 marks)

Notes:

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of lnd AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

(4 marks)

(B) **(i)** Calculated the amount of Incentive payable to the employees

(Rs. In lakhs)

	2011 – 12	2012 – 13	2013 – 14	2014 – 15	2015 – 16
Value Added	3040	3600	4200	4800	5600
Less : Employee cost	1268	1476	1562	1838	2090
Contribution	1772	2124	2638	2962	2510
Turnover	6000	8000	10000	12000	14000
% of turnover	30%	27%	26%	25%	18%

Target index – 30%, highest one is year 2011 – 12

Contribution of 2016 – 17

		Rs. In lakhs
Sales		17,250
Cost of bought in material and services (6400 + 1600 + 700 + 600 + 150)		9,450
Value Added		7,800
Less : Employee cost		
Wages	1200	
Production salaries	400	
Salaries to Sales team	125	
Administrative salaries	600	2,325
Contribution		5475
Target contribution 30% of 17250		5,175
Excess		300
50% of excess as incentive		150

(6 marks)

(ii) Statement of Application of Value Added for the year 2016 – 17

Application of value added	**Rs. In lakhs**
Value added	7,800
Applied towards	
Employee cost (2325 + 150)	2,475
Director remuneration	60
Government for taxes	1,190
Providers of capital	880
Maintenance & Expansion (1000 + 350 + 120)	1,470
Retained profit	1725

(4 marks)

Answer 4:

(A)

Statement of cash flows

Particulars		**Amount (Rs.)**
Cash flows from operating activities		
Profit before taxation (10,00,000 + 18,00,000)	28,00,000	
Adjustment for unrealised exchange gains/losses:		
Foreign exchange gain on long term loan [€ 2,00,000 x Rs. (50 – 45)]	(10,00,000)	
Decrease in trade payables [1,00,000 x Rs. (50 – 45)]	(5,00,000)	
Operating Cash flow before working capital changes	13,00,000	
Changes in working capital (Due to increase in trade payables)	50,00,000	
Net cash inflow from operating activities		63,00,000
Cash inflow from financing activity		50,00,000
Net increase in cash and cash equivalents		1,13,00,000
Cash and cash equivalents at the beginning of the period		2,00,000
Cash and cash equivalents at the end of the period		1,15,00,000

(8 marks)

(B)

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

As per Ind AS 40 'Investment property', investment property is a 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.

Further, as per para 8 of Ind AS 40, the building owned by the entity and leased out under one or more operating leases will be classified as investment property.

Here top three floors have been leased out for 5 years with a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less that the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e. 15 crore x 30% = 4.50 crore. Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor ie. UK Ltd.

However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment property(ies).

(4 marks)

(in crore)

	Total	**PPE (70%)**		**Investment property (30%)**
		Land (25%)	Building (75%)	
Cost	10	1.75	5.25	3
FV	15	2.625	7.875	4.5
Valuation model followed		Cost	Cost	Cost (as per para 30 of Ind AS 40)
Value recognized in the books		1.75	5.25	3
Less: Depreciation		Nil	(5.25/50) = 0.105 crore	(3/50) = 0.06
Carrying value as on 31st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

(4 marks)

(C)

The profit and loss account was credited by Rs. 1,00,000 (US$ 2000 × Rs. 50) towards interest income. It was credited by the exchange difference of US$ 100,000 × (Rs. 50 - Rs.45) that is, Rs. 500,000. In preparing the cash flow statement, Rs. 500,000, the exchange difference, should be deducted from the 'net profit before taxes, and extraordinary item'. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference Rs. 500,000, should be added to the opening balance in note to cash flow statement.

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

(4 marks)

Answer 5:
(A)

Consolidated Balance Sheet as on 31.3.20X1

Particulars	**Note No.**	**Rs.**
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

(5 marks)

Notes to Accounts

			Rs.
1.	Share Capital		
	Called up equity shares of Rs. 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

(1 mark x 7 = 7 marks)

Working Notes:

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

	Pre-acquisition	Post-acquisition
	Rs.	*Rs.*
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	
		Rs.		**Rs.**
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

	Rs.
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

	Rs.
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 Rs. 17,000 existed at the time of acquisition, only Rs. 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, Rs. 16,000 is taken as capital profit assuming that it is a part of that Rs. 17,000 existed at the time of acquisition. **(1 mark x 4 = 4 marks)**

(B) The IIRC's framework is expected to help companies and investors make more informed decisions and help companies communicate clearly how they create value. The framework is based on three fundamental concepts. First, it recommends companies focus on the ways they create value in the short, medium, and long – term. Second, it asks companies to provide an overview of their business model, including a full value chain perspective. Finally, it emphasizes the relationship between companies and the resources, both financial and

non – financial, that underpin their success. The framework refers to these resources as the six "capitals" – financial, manufactured, intellectual, human, social and relationship, and natural. Since the framework is in the development stage, it would not be unexpected if the IIRC issues multiple iterations of the framework before it is finalized. **(4 marks)**

Answer 6:
(A)

Fair value of Equity option components:		
Fair value of a share with restrictive clause		Rs. 115
No. of shares		90,000 shares
Fair value (90,000 X 115)	A	Rs. 1,03,50,000
Fair value of a share at the date of grant		Rs. 135
No. of cash settled shares		74,000
Fair value (74,000 X 135)	B	Rs. 99,90,000
Fair value of equity component in compound instrument (A-B)		Rs. 3,60,000

(5 marks)

Journal Entries

31/3/2016			**Rs.**
Employee benefit expenses	Dr.	35,24,000	
To Share based payment reserve (equity) (3,60,000/3)			1,20,000
To Share based payment liability (138 x 74,000) / 3			34,04,000
(Recognition of equity option and cash settlement option)			
31/3/2017			
Employee benefits expenses	Dr.	36,22,667	
To Share based payment reserve (equity) (3,60,000/3)			1,20,000
To Share based payment liability (140 x 74,000) 2/3 - 34,04,000			35,02,667
(Recognition of equity option and cash settlement option)			
31/3/2018			
Employee benefits expenses	Dr.	40,91,333	
To Share based payment reserve (equity) (3,60,000/3)			1,20,000
To Share based payment liability (147 x 74,000) 3/3 - (34,04,000 + 35,02,667)			39,71,333
(Recognition of equity option and cash settlement option)			
Upon cash alternative chosen			
Share based payment liability (147 x 74,000)	Dr.	1,08,78,000	
To Bank/ Cash			1,08,78,000

(Being settlement made in cash)		
Upon equity alternative chosen Share based payment liability (147 x 74,000) Dr. To Share capital (Being settlement made in equity)	1,08,78,000	1,08,78,000

(5 marks)

(B)

(1) At the time of initial recognition

	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs. 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs. 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component	
(Rs. 5,00,000 – Rs. 4,27,700)	72,300
Total proceeds	5,00,000

Note: Since Rs. 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs. 100 each only.

(3 marks)

Journal Entry

	Rs.	Rs.
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

(1 mark)

(2) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	**Fair Value @ 9%**	**Difference**
	Rs.	**Rs.**	**Rs.**
Liability component			
Present value of 2 remaining yearly interest payments of Rs. 40,000, discounted at 12% and 9%, respectively	67,600	70,360	

Present value of Rs. 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	3,98,500	4,21,000	
Liability component	4,66,100	4,91,360	(25,260)
Equity component (5,25,000 - 4,91,360)	72,300	33,640*	38,660
Total	**5,38,400**	**5,25,000**	**13,400**

*(5,25,000 – 4,91,360) = 33,640 **(4 marks)**

Journal Entries

	Rs.	Rs.
8% Debentures (Liability component) Dr.	4,66,100	
Profit and loss A/c (Debt settlement expense) Dr.	25,260	
To Bank A/c		4,91,360
(Being the repurchase of the liability component recognised)		
8% Debentures (Equity component) Dr.	72,300	
To Bank A/c		33,640
To Reserves and Surplus A/c		38,660
(Being the cash paid for the equity component recognised)		

(1 mark x 2 = 2 marks)