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FINAL MAY 2019 EXAM

SUBJECT- FR

Test Code – FNJ 7085

BRANCH - () (Date :)

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Answer 1:

Paragraph 7 of Ind AS 16 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 16, 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. **(4 marks)**

Depreciation

As per paragraph 43 and 47 of Ind AS 16, 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. **(2 marks)**

Presentation

These assets should be presented within the class of asset to which they relate. **(1 mark)**

Answer 2:

(i) Calculation of capitalization rate on borrowings other than specific borrowings

Amount of loan (Rs.)	Rate of interest	Amount of interest (Rs.)
7,00,000	12%	= 84,000
9,00,000	11%	= 99,000
16,00,000		1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x 100		= 11.4375%

(2 mark)

(ii) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses

Date of incurrence of expenditure	Amount spent	Financed through	Calculation	Rs.
1st April, 2017	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 2017	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000 x 11.4375% x 6/12	8,578.125
1st October, 2017	3,50,000	General borrowing	3,50,000 x 11.4375% x 4/12	13,343.75
1st January, 2018	1,00,000	General borrowing	1,00,000 x 11.4375% x 1/12	953.125
				37,875

(3 marks)

Note: Since construction of building started on 1st April, 2017, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

(iii) Total expenses to be capitalized for building **(1 mark)**

	Rs.
Cost of building Rs. (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(iv) Journal Entry **(2 mark)**

Date	Particulars		Rs.	Rs.
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,00,0000
	To Interest payable (borrowing cost)			37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Note: In the above journal entry, it is assumed that interest amount will be paid at the year end. Hence, entry for interest payable has been passed on 31.1.2018.

Alternatively, following journal entry may be passed if interest is paid on the date of capitalization:

Date	Particulars		Rs.	Rs.
31.1.2018	Building account	Dr.	8,37,875	
	To Bank account			8,37,875
	(Being expenditure incurred on construction of building and borrowing cost thereon capitalized)			

Answer 3:

As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as 'adjusting events'.

(a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be Rs. 10 million and net realisable value would be Rs. 7.5 million (i.e. Expected selling price Rs. 8 million- estimated selling expenses Rs. 0.5 million). Accordingly, inventory shall be measured at Rs. 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of Rs. 2.5 million would be recorded in income statement of that year.

(b) As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is Rs. 1 million and net realisable value would be Rs. 10. 5 million (i.e. expected selling price Rs. 11 million – estimated selling expense Rs. 0.5 million). Accordingly, inventory would be recorded at Rs. 10 million and inventory write down carried out in previous year for Rs. 2.5 million shall be reversed.

(6 marks)

Answer 4:

Current tax= Taxable profit x Tax rate = Rs.104 thousand x 25% = Rs.26 thousand. **(1 mark)**

Computation of Taxable Profit: **(1 mark)**

	Rs. in thousand
Accounting profit	100
Add: Donation not deductible	8
Less: Excess Depreciation	(4)
Total Taxable profit	104

(1 mark)

		Rs. in thousand	**Rs. in thousand**
Profit & loss A/c	Dr.	26	
To Current Tax			26

Deferred tax: **(1 mark)**

Machine's carrying amount according to Ind AS is Rs. 118 thousand (Rs. 120 thousand – Rs. 2 thousand)

Machine's carrying amount for taxation purpose = Rs. 114 thousand (Rs. 120 thousand – Rs. 6 thousand)

Deferred Tax Liability = Rs. 4 thousand x 25% **(1 mark)**

		Rs. in thousand	
Profit & loss A/c	Dr	1	
To Deferred Tax Liability			1

Tax reconciliation in absolute numbers: **(1 mark)**

	Rs. in thousand
Profit before tax according to Ind AS	100

Applicable tax rate	25%
Tax	25
Expenses not deductible for tax purposes (Rs. 8 thousand x 25%)	2
Tax expense (Current and deferred)	27

Tax rate reconciliation **(1 mark)**

Applicable tax rate	25%
Expenses not deductible for tax purposes	2%
Average effective tax rate	27%

Answer 5:

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. **(1 mark)**

Workings: **(4 marks)**

	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: **(1 mark)**

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: **(1 mark)**

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: **(1 mark)**

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 **(4 marks)**

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)			

Answer 6:

Options

Increase in earnings	Nil	
Number of incremental shares issued for no consideration {1,00,000 x (75 – 60) / 75}	20,000	
EPS on increased share	Nil	**(1 mark)**

8% Convertible Prefernce Shares of 100 each

Increase in net profit attributable to ordinary shareholders As adjusted by attributable tax {(Rs.8 x 8,00,000) + 10%(8 x 8,00,000)]	Rs.70,40,000	
Number of incremental shares {2 x 8,00,000}	16,00,000	
EPS on increased shares (7040000 / 1600000)	4.40	**(1 mark)**

12% Convertible Debenture

Increased in Net Profit

{Rs.10,00,00,000 x 0.12 x (1 – 0.30)}		Rs. 84,00,000	
Number of incremental shares	{10,00,000 x 4}	40,00,000	
EPS on increased shares	(8400000 / 4000000)	= Rs. 2.10	**(1 mark)**

It may be noted from the above that options are most dilutive as their earning per incremental Share is nil. **(1 mark)**

Hence, for the purpose of computation of diluted EPS, options will be considered first. 12% convertible Debentures being second most dilutive will be considered next and thereafter convertible preference Shares will be considered. **(1 mark)**

Computation of Diluted EPS: **(4 marks)**

	Profit Attributable (Rs.)	**No. of equity Shares**	**Profit attributable per share (Rs.)**	
As Reported	1,00,00,000	20,00,000	5.00	
Options		20,000		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	84,00,000	40,00,000		
	1,84,00,000	60,20,000	3.06	Dilutive
Convertible				

Preference Shares	70,40,000	16,00,000		
	2,54,40,000	76,20,000	3.34	Anti – Dilutive

Since diluted EPS are increased when taking the convertible preference shares into account (from Rs. 3.06 to Rs. 3.34), the convertible preference shares are anti – dilutive and are ignored in the calculation of diluted EPS.

Therefore, diluted EPS is Rs. 3.06, which is to be reported. **(1 mark)**