SUGGESTED SOLUTION

FINAL MAY 2019 EXAM

SUBJECT- FR

Test Code – FNJ 7086

BRANCH - () (Date :)

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Answer 1:

As per para 10 of AS 2 'Valuation of Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product. **(1 mark)**

1. **Calculation of net realizable value of by-product, BP** **(1 mark)**

		Rs.
Selling price of by-product BP	(1,600 units x Rs. 12.5 per unit)	20,000
Less: Separate processing charges of by-product BP		(2,000)
Packing charges		(3,000)
Net realizable value of by-product BP		15,000

2. **Calculation of cost of conversion for allocation between joint products MP 1 and MP 2** **(1 mark)**

	Rs.	Rs.
Raw material		80,000
Wages		41,000
Fixed overhead		29,000
Variable overhead		20,000
		1,70,000
Less: NRV of by-product BP (See calculation 1)	(15,000)	
Sale value of scrap	(3,000)	(18,000)
Joint cost to be allocated between MP1 and MP2		1,52,000

3. **Determination of "basis for allocation" and allocation of joint cost to MP 1 and MP 2** **(1 mark)**

	MP 1	MP 2
Output in units (a)	6,250 units	5,000 units
Sales price per unit (b)	Rs. 40	Rs. 25
Sales value (a x b)	Rs. 2,50,000	Rs. 1,25,000
Ratio of allocation	2	1
Joint cost of Rs. 1,52,000 allocated in the ratio of 2:1 (c)	Rs. 1,01,333	Rs. 50,667
Cost per unit [c/a]	Rs. 16.21	Rs. 10.13

4. **Determination of value of closing inventory of MP 1 and MP 2** **(1 mark)**

	MP 1	MP 2
Closing inventory in units	800 units	200 units
Cost per unit	Rs. 16.21	Rs. 10.13
Value of closing inventory	Rs. 12,968	Rs. 2,026

Answer 2:

(i) Interest for the period 2017-2018

= US $ 20 lakhs x 4% × Rs. 65 per US $ = Rs. 52 lakhs **(0.5 mark)**

(ii) Increase in the liability towards the principal amount

= US $ 20 lakhs × Rs. (65 - 61) = Rs. 80 lakhs. **(0.5 mark)**

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US $ 20 lakhs × Rs. 61 x 10.5% = Rs. 128.1 lakhs **(0.5 mark)**

(iv) Difference between interest on local currency borrowing and foreign currency borrowing= Rs. 128.1 lakhs - Rs. 52 lakhs = Rs. 76.1 lakhs. **(0.5 mark)**

Therefore, out of Rs. 80 lakhs increase in the liability towards principal amount, only Rs. 76.1 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs.128.1 lakhs being the aggregate of interest of Rs Rs.52 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 76.1 lakhs. **(2 marks)**

Hence, Rs. 128.1 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining Rs. 3.9 lakhs (Rs. 80 lakhs– Rs. 76.1 lakhs) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates". **(1 mark)**

Answer 3:

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. **(2.5 marks)**

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. **(2.5 marks)**

Answer 4:

Statement of Profit and Loss (for the three years ending 31st March, 20X1, 20X2, 20X3)

(Rs. in thousands)

	20X1	20X2	20X3
Profit (loss)	(100)	50	60
Less: Current tax	—	—	(4)
Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year		(20)	(20)
Profit (loss) after tax effect	(60)	30	36

(5 marks)

Answer 5:

(i) Calculation of Employee Compensation Expense for the Year ended 31 st March 2015, 31st March 2016 and 31st March, 2017

(Refer Working Note) **(2 marks)**

Vesting Date as on 31st March	**Cost to be recognized in the year ending on 31st March 2015**	**2016**	**2017**
Lot I	6,24,000		
Lot II	2,88,000	2,88,000	
Lot III	2,40,000	2,40,000	2,40,000
Cost for the year	11,52,000	5,28,000	2,40,000
Cumulative cost	11,52,000	16,80,000	19,20,000

(ii) Balance of ESOP Outstanding Account as on 31st March 2015, 31st March 2016 and 31st March, 2017 **(5 marks)**

	Total	**2015**	**2016**	**2017**
ESOS outstanding A/c at the end of 1st year	11,52,000	11,52,000		
Less: Vested Options lapsed during year (200 x 240)	(48,000)			
Less: Vested Options exercised during year (2,500 x 240)	(6,00,000)			
Add: ESOP credited in the 2nd year	5,28,000		10,32,000	
ESOP outstanding A/c at the end of 2nd year	10,32,000			
Less: Vested options lapsed (600 x 240)	(1,44,000)			
Less: Vested options exercised (2,000 x 240)	(4,80,000)			6,48,000

Add: ESOP credited in the 3rd year	2,40,000			
ESOP outstanding at the end of 3rd year	6,48,000			

Working Note: **(3 marks)**

Determination of number of options expected to vest under each group

Vesting Date (Year-end) 31st March		**Shares expected to vest**	**Value per Shares (Rs.) (400 – 160)**	**Compensatio Expense (Rs.)**
2015	(10,000 shares x 30%) - 400 shares	2,600 shares	240	6,24,000
2016	(10,000 shares x 30%) - 600 shares	2,400 shares	240	5,76,000
2017	(10,000 shares x 40%) - 1,000 shares	3,000 shares	240	7,20,000
				19,20,000

Total compensation expense of Rs.19,20,000, determined at the grant date, is attributed to 3 years.

Note: In the absence of estimated figures regarding lapse of unvested options, it is assumed that actual lapses were in accordance with the estimation.

Answer 6:

(A)

(a)	Amount of foreseeable loss	*(Rs. in lakhs)*
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognized as expense	100

(1 mark)

According to para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b)	Contract work-in-progress i.e. cost incurred to date are Rs. 605 lakhs	*(Rs. in lakhs)*
	Work certified	500
	Work not certified	105
		605

(1 mark)

This is 55% (605/1,100 x 100) of total costs of construction.

(a) Proportion of total contract value recognised as revenue as per para 21 of AS 7

(Revised). 55% of Rs. 1,000 lakhs = Rs. 550 lakhs

(b) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= [605 + Nil – 100 – (400 + 140)] Rs. in lakhs

= [605 – 100 – 540] Rs. in lakhs

Amount due to customers = Rs. 35 lakhs

The amount of Rs. 35 lakhs will be shown in the balance sheet as liability. **(1 mark)**

(c) The relevant disclosures under AS 7 (Revised) are given below: **(2 marks)**

	Rs. in lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognized losses	(100)
Progress billings Rs. (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

(B)

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also remote.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision. **(1.5 marks)**

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under: **(1.5 marks)**

Expected loss in next ten cases = 30% of Rs. 1,20,000 + 10% of Rs. 2,00,000

= Rs. 36,000 + Rs. 20,000

= Rs. 56,000

Expected loss in remaining five cases = 30% of Rs. 1,00,000 + 20% of Rs. 2,10,000

= Rs. 30,000 + Rs. 42,000

= Rs. 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of Rs. 9,20,000 (Rs. 56,000 × 10 + Rs. 72,000 × 5) as contingent liability. **(2 marks)**

Answer 7:

Included in Cost:

Point no. 1,2,5,6,7,8,10,11,12,14,15 and 17

Excluded from Cost:

Point no. 3,4,9,13,16,18 and 19 **(10 marks)**