SUGGESTED SOLUTION

CA FINAL MAY 2017 EXAM

FINANCIAL REPORTING

Test Code - F M J 4 0 0 5

BRANCH - (MULTIPLE) (Date : 04.12.2016)

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Answer-1 (a) :

A contingent liability is:

(a) 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

(b) A present obligation that arises from past events but is not recognized because;

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

(ii) A reliable estimate of the amount of the obligation cannot be made. (1)

In the given case, the probability of winning is 100% in respect of first five cases and hence, question of providing for contingent loss does not arise. The condition (i) of Para 10 of AS 4, as stated above, is not met in the other cases since the probability of winning the suits is 60% for next ten cases and 50% for the remaining five cases. **Therefore, the proper treatment is to disclose the contingent loss in respect of these cases.** (2)

The maximum loss for each of the next ten cases is 2,00,000 whereas the expected loss is Rs. 56,000 (1,20,000* 0.3 +2,00,000*0.1). The maximum loss for each of the remaining five cases is 2,10,000 whereas the expected loss is 72,000 (1,00,000*0.3 + 2,10,000*0.2). 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 9,20,000 (56,000* 10 + 72,000*5) as contingent liability. (1)

Answer-1 (b) :

According to AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses. (2)

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. (2)

Answer-2 (a) :

(i) Calculation of profit/ loss for the year ended 31st March, 2015 **(Rs. in crores)**

Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
Less: Total contract price	(2,400)
Total foreseeable loss to be recognized as expense	850

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. (2)

(ii) Contract work-in-progress i.e. cost incurred to date **(Rs. in crores)**

Work certified	1,250
Work not certified	250
	1,500

(1)

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250)×100 = 46.15%

Revenue to be recognized till date = 46.15% of Rs. 2,400 crores = Rs. 1,107.60 crores. (1)

(iv) **Amount due from / to customers**

= Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= Rs. [1,500 + Nil – 850 – (1100 + 300)] crores

= Rs. [1,500 – 850 – 1,400]crores

Amount due to customers (shown as liability) = Rs. 750 crores. (2)

(v) The relevant disclosures under AS 7 (Revised) are given below: **Rs. in crores**

Contract revenue till 31st March, 2015	1,107.60
Contract expenses till 31st March, 2015	1,500.00
Recognized losses for the year 31st March, 2015	(850)
Progress billings Rs. (1,100 + 300)	1,400
Retentions (billed but not received from contractee)	300
Gross amount due to customers	750

(2)

Answer-2 (b) :

As per Para 4.1 of AS 9 "Revenue Recognition", revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. (2)

In the given case, Prima Ltd. should record the sales at gross value of Rs. 50,000. Discount of Rs. 8,000 in price and goods returned worth Rs. 7,000 are to be adjusted by suitable provisions. Prime Ltd. might have sent the credit note of Rs. 15,000 to M/s Y & Co. to account for these adjustments. The contention of the accountant to book the sales for Rs. 35,000 is not correct. (2)

Answer-3 (a) :

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2014

(1) Carrying value of intangible as on 31.03.2014:

At the end of financial year 31st March 2014, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2013). (2)

(2) Expenditure to be charged to Profit and Loss account:

The Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2014. This expenditure will not form part of the cost of the production process recognized in the balance sheet. (2)

(ii) For the year ending 31.03.2015

(1) Expenditure to be charged to Profit and Loss account:

	(Rs. in lakhs)
Carrying Amount as on 31.03.2014	28
Expenditure during 2014 – 2015	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2015. (2)

(2) Carrying value of intangible as on 31.03.2015:

	(Rs.in lakhs)
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2015	72

(2)

Answer-3 (b) :
In this problem, it is required to identify the cost of an intangible asset, when it is acquired for non-cash consideration i.e. by exchange of assets. Paragraph 34 of AS26 provides that the cost would be identified in accordance with prescriptions in AS 10.
AS 10 provides that when a fixed asset in acquired in exchange for another asset, cost is usually determined by reference to the fair market value of asset given up (for FMV of asset acquired, if such a value is more clearly evident).

(a) FMV of Asset given up, where three is no further receipt or payment towards adjustment.	Mining rights given up (no cash is separately paid)	Rs.26.00 lacs
(b) FMV of Asset given up, subject to adjustment.	Mining rights given up	Rs.26.00 lacs
For any balancing receipt or payment	Further payments made	Rs.4.00 lacs
	Total	**Rs.30.00 lacs**

Answer-4 (a) :
As per para 10 of AS 12 **'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution,** i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. (2)

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, **it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs.** The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper. (2)

Answer-4 (b) :
As per AS 9 "Revenue Recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit & loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.
In the case of the Jewellery Business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.
Answer-5 (a) :
Basis of provisioning whether on no issues or on technical evaluation is the basis of making estimates and cannot be considered as Accounting Policy. **As per AS 5, due to uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated.** The estimation process involves judgments based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. (2)

The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving stock on account of change. Hence, it is not a change in accounting policy. Accounting policy is the valuation of inventory on cost or on net realizable value or on lower of cost or net realizable value. Any interchange of this valuation base would have constituted change in accounting policy. (1)

Further, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months issue. **If that is the case, then the company can change the method of provision.** (1)

Answer-5 (b) :

Total expected loss to be provided for

= Contract Price –Total Cost

= Rs. 50,00,000 – (21,00,000+ 31,50,000) Rs. -= 2,50,000

Calculation for 2014-15 on 40% work

Contract Revenue= 21,00,000

Contract Cost =21,00,000

Current loss on contract (2,50,000 x 40%)= Rs. 1,00,000 Total expected loss recognized as per AS 7= Rs.2,50,000

Further provision required in respect of Expected Loss = 2,50,000 -1,00,000 = Rs. 1,50,000 (2)

In the Books of Five Star Construction Limited

Profit & Loss A/c (Extract for the year ended 31st March 2015)

Particulars	Amount	Particulars	Amount
To Construction Costs (for 40% work)	21,00,000	By Contract Revenue	20,00,000
To Provision for Loss	1,50,000	By Net Loss	2,50,000
	22,50,000		**22,50,000**

(1)

Customer A/c

Particulars	Amount	Particulars	Amount
To Contract Revenue	20,00,000	By Bank	19,00,000
		By Balance c/d	1,00,000
	20,00,000		**20,00,000**

(1)