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CA FINAL NOVEMBER 2016 EXAM

FINANCIAL REPORTING

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BRANCH - (MUMBAI) (Date :03.07.2016)

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Answer-1 (a) :

Statement Showing Impairment Loss

	(Rs.in crores)
Carrying amount of the machine as on 1st April 2008	7.00
Depreciation for 4 years i.e. 2008-09 to 2011-12 $\left[\frac{7 \text{ crores}}{7 \text{ years}} \text{ x 4 years}\right]$ [	(4.00)
Carrying amount as on 31.03.2012	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April 2012 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2012-13& 2013-14 $\left[\frac{5.10 \text{ crores}}{3 \text{ years}} \text{ x 2 years}\right]$	(3.40)
Carrying amount as on 31.03.2014	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.2014:	
Balance in revaluation reserve as on 31.03.2012 2.10	
Less: Enhanced depreciation met from revaluation reserve	
2012-13& 2013-14 =[(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

(5 Marks)

Answer-1 (b) :

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) 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 Marks)

(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) 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

(3 Marks)

Answer-2 (a) :

As per AS 19 on Leases, **unearned finance income** is the difference between (a) the **gross investment** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease. Where:

(a) **Gross investment** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value(GRV)] + Unguaranteed residual value (URV)

= [(Rs. 1,00,000 × 5 years) + Rs. 20,000] + Rs. 20,000 = Rs. 5,40,000 (a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

(2 Marks)

Year	M.L.P. inclusive of URV Rs.	Internal rate of return (Discount factor @ 15%)	Present Value Rs.
1	1,00,000	0.8696	86,960
2	1,00,000	0.7561	75,610
3	1,00,000	0.6575	65,750
4	1,00,000	0.5718	57,180
5	1,00,000	0.4972	49,720
	20,000(GRV)	0.4972	9,944
	5,20,000		3,45,164 (i)
	20,000 (URV)	0.4972	9,944 (ii)
	5,40,000	(i) + (ii)	3,55,108 (b)

Unearned Finance Income = (a) – (b) = Rs.5,40,000 – Rs.3,55,108 = Rs.1,84,892

(2 marks)

Journal Entries in the books of SB Ltd.

Particulars		Rs.	Rs.
At the inception of lease			
Machinery account	Dr.	3,45,164	
To AS Ltd.'s account			3,45,164*
(Being lease of machinery recorded at present value of minimum lease payments)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	51,775	
To AS Ltd.'s account			51,775
(Being the finance charges for first year due)			
AS Ltd.'s account	Dr.	1,00,000	
To Bank account			1,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of Rs. 48,225 and finance charge of Rs. 51,775)			
Depreciation account[£]	Dr.	34,516	
To Machinery account			34,516
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	86,291	
To Depreciation account			34,516
To Finance charges account			51,775
(Being the depreciation and finance charges transferred to profit and loss account)			

(3 Marks)

* As per para 11 of AS 19, the lessee should recognize the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 4,00,000 is more than the present value amounting Rs. 3,45,164, the machinery has been recorded at Rs. 3,45,164 in the books of SB Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.
£ Depreciation has been provided on the basis that the machine has been leased at the beginning of the year.

Working Note:
Table showing apportionment of lease payments by SB Ltd. between the finance charges and the reduction of outstanding liability

Year	Outstanding liability (opening balance)(a)	Minimum lease payments (b)	Finance charges (c=a x 15%)	Reduction in principal amount (d=b–c)	Outstanding liability (closing balance (e=a–d)
Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
1	3,45,164	1,00,000	51,775	48,225	2,96,939
2	2,96,939	1,00,000	44,541	55,459	2,41,480
3	2,41,480	1,00,000	36,222	63,778	1,77,702
4	1,77,702	1,00,000	26,655	73,345	1,04,357
5	1,04,357	1,00,000	15,654	84,346	20,011*

* The difference between this figure and guaranteed residual value (Rs. 20,000) is due to approximation in computing the interest rate implicit in the lease.

(1 Mark)

Answer-2 (b) :

The fair value of the Loan to Coffee Ltd. is the present value of the interest it will receive over the next 5 years and the present value of repayment at the end of 5th year.

P.V. of interest discounted @ 8% = [(20,00,00,000 × 5%) × 3.9926] = Rs.3,99,26,000 (A)
P.V. of principal amount = Rs. 20,00,00,000 discounted @ 8%
= Rs.20,00,00,000 × 0.6806 =13,61,20,000 (B)
Fair Value of Loan (A + B) i.e. Rs. 17,60,46,000 (i.e. approximately Rs. 17,60,00,000 which is loan amount net of origination fee)
Therefore, Coffee Ltd will recognize the loan at Rs.17.60 crores only.
Coffee Ltd will recognize the interest using the effective interest rate method as worked out below:

Year	**Amortised Cost (Opening Balance) (1)**	**Interest income @ 8% to be recognised (2)**	**Total (3)**	**Payment received (4)**	**Amortised Cost (Closing Balance) (5) = (3) – (4)**
1	17,60,00,000	1,40,80,000	19,00,80,000	1,00,00,000	18,00,80,000
2	18,00,80,000	1,44,06,400	19,44,86,400	1,00,00,000	18,44,86,400
3	18,44,86,400	1,47,58,912	19,92,45,312	1,00,00,000	18,92,45,312
4	18,92,45,312	1,51,39,625	20,43,84,937	1,00,00,000	19,43,84,937
5	19,43,84,937	1,56,15,063*	21,00,00,000	21,00,00,000	Nil

***Note:** The interest in the 5th year, has been adjusted in accordance to the value received on closure.

(5 Marks)

Answer-3 (a) :

As per provisions of AS 10 'Accounting for Fixed Assets', expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period. In the present case, the company did stop production even if the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalization should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

(2 Marks)

Answer-3 (b) :

	Rs.
Cost incurred till 31st March, 2015	58,50,000
Prudent estimate of additional cost for completion	31,50,000
Total cost of construction	90,00,000
Less: Contract price	(80,00,000)
Total foreseeable loss	10,00,000

As per para 35 of AS 7 (Revised) 'Construction Contracts' when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Accordingly, the loss of Rs.10,00,000 is required to be recognized as an expense in the year 2014-15.

Also as per para 21 of the said standard when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

Accordingly,

Contract work in progress $= \frac{58,50,000 \times 100}{90,00,000} = 65\%$

Proportion of total contract value to be recognized as turnover

= 65% of Rs. 80,00,000 = Rs. 52,00,000

(5 Marks)

Answer-4 (a) :

The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes In Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. As per paragraph 8 of AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived. The amount so written-back (If material) should be disclosed as an extraordinary item as per AS 5.

(4 Marks)

Answer-4 (b) :

Para 29 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that a change in an accounting policy should be made only if

a. It is required by statute, or
b. for compliance with an accounting standard, or
c. if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

Therefore the change in the method of inventory valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements.

Disclosure: As per AS 2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements in Notes to Accounts.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards issued by ICAI, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing inventory unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing inventory as well as profit before tax for the year would have been higher by Rs. 7.60 lakhs."

(4 Marks)

Answer-5 (a) :

As per para 18 of AS 3 (Revised) on Cash Flow Statements, an enterprise should report cash flows from operating activities using either:

(a) the direct method whereby major classes of gross cash receipts and gross cash payments are disclosed; or
(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:
(a) from the accounting records of the enterprise; or
(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:
    (i) changes during the period in inventories and operating receivables and payables;
    (ii) other non-cash items; and
    (iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:
(a) changes during the period in inventories and operating receivables and payables;
(b) non-cash items such as depreciation, provisions, deferred taxes, and unrealized foreign exchange gains and losses; and
(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses, excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

(6 Marks)

Answer-5 (b) :

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. Calculation of net realizable value of by-product, BP

	Rs.
Selling price of by-product BP (1,600 units x R Rs. 25 per unit)	40,000

		Rs.
Less: Separate processing charges of by-product BP		(4,000)
Packing charges		(6,000)
Net realizable value of by-product BP		30,000

2. Calculation of cost of conversion for allocation between joint products MP1 and MP2

	Rs.	Rs.
Raw material		1,60,000
Wages		82,000
Fixed overhead		58,000
Variable overhead		40,000
		3,40,000
Less: NRV of by-product BP (See calculation 1)	(30,000)	
Sale value of scrap	(6,000)	(36,000)
Joint cost to be allocated between MP1 and MP2		3,04,000

3. Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2

	MP1	MP2
Output in units (a)	6,250 units	5,000 units
Sales price per unit (b)	Rs. 80	Rs. 50
Sales value (a x b)	Rs. 5,00,000	Rs. 2,50,000
Ratio of allocation	2	1
Joint cost of Rs. 3,04,000 allocated in the ratio of 2:1 (c)	Rs. 2,02,667	Rs. 1,01,333
Cost per unit [c/a]	Rs. 32.43	Rs. 20.27

4. Determination of value of closing inventory of MP1 and MP2

	MP1	MP2
Closing inventory in units	800 units	200 units
Cost per unit	Rs. 32.43	Rs. 20.27
Value of closing inventory	Rs. 25,944	Rs.4,054

(6 Marks)