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CA FINAL NOVEMBER 2016 EXAM

FINANCIAL REPORTING

Test Code - F N J 6 0 3 0

BRANCH - (MUMBAI) (Date :31.07.2016)

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Answer-1 (a) :

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when anenterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.

(2 Marks)

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2014 and no profit had accrued for the financial year 2013-2014. Therefore, provision should be made for the full amount of compensation amounting Rs.1.50 crores.

(2 Marks)

Answer-1 (b) :

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date untill it is appropriate to defer at the end of the enterprise's financial year. Therefore dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy. Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively.

Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows:

Statement showing Adjusted Profit Before Tax for the third quarter

	(Rs. in lakhs)
Profit before tax (as reported)	4
Add: Dividend income Rs.(4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in the method, should be applied retrospectively Rs.(12-3) lakhs	9
Extra ordinary gain Rs.(2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively Rs. (3-2)lakhs	1
	18
Less: Sales promotion expenses (80% of Rs.15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	1

(4 Marks)

Answer-2 (a) :

Assumption: It is assumed that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year. The assumption has been taken on the basis that impairment loss is calculated on carrying value after charging depreciation of the year.

In the absence of specific instructions, deferred tax workings of current year have been shown as below:

Statement showing Deferred Tax workings for the current year

Rs.in lakhs

Depreciation as per Accounting books for the current year $\frac{999}{(1-.1391)}$ x .1391	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1-.15)}$ x .15	137.12
Timing difference	24.29
Tax effect of the above timing difference at 33%* (deferred tax asset) (A)	8.02
Impairment Loss recognised in the profit and loss account (999- 555)	444
Impairment Loss allowed for tax purposes	Nil
Timing difference	444
Tax effect of the above timing difference at 33% (deferred tax asset) (B)	146.52
Total deferred tax asset (A+B)	154.54

*Tax rate = 30%x 110%= 33%.

(6 Marks)

Note:

1. Deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. The Approving Authority of Acute Ltd. have issued signed statement confirming virtual certainty of taxable incomes in the foreseeable future. Therefore, the company can recognize deferred tax asset during the current year.

2. The deferred tax asset calculated on account of difference of depreciation as per accounting and tax records is actually a reversal of deferred tax liability created in the previous years.

Answer-2 (b) :

According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are Rs.8.8 crores [Rs. 10 crores – (Rs. 0.5 + Rs.0.4 + Rs.0.3)]. Segment X holds total assets of Rs. 1.5 crores (Rs. 2 crores – Rs. 0.5 crores); Segment Y holds Rs. 2.6 crores (Rs. 3 crores – Rs. 0.4 crores); and Segment Z holds Rs. 4.7 crores (Rs. 5 crores – Rs. 0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

(2 Marks)

Answer-3 :

Calculation of Earnings Per Share (EPS) of Beta Ltd.

			Rs. Year ended 31.3.15	**Rs.** Year ended 31.3.14
1.				
	A.	Earning after extra ordinary items for equity shareholders (Rs. 2,06,000 – Rs. 6,000) (Rs. 73,000 – Rs. 3,000)	2,00,000	70,000
	B.	No. of Equity Shares	20,000	20,000
	C.	Basic Earnings Per share [A/B]	10.00	3.50
	A.	Earning before extraordinary items	1,00,000	70,000
	B.	No. of Equity Shares	20,000	20,000*
	C.	Basic Earnings Per share [A/B]	5.00	3.50
2.	Tax rate applicable			
	Rs. 40,000 + Rs. 30,000 / Rs. 2,00,000×100		35%	
	Rs. 30,000 + Rs. 10,000 / Rs. 1,00,000×100			40%
3.	A.	Dividend on Weighted Average Preference Shares	6,000	3,000
	B.	Incremental shares	15,000	7,500
	C.	EPS on Incremental Shares [A/B]	0.40 (dilutive)	0.40 (dilutive)
4.	Convertible Debentures			
	A.	Increase in earnings $\left(1,00,000\text{x}\frac{15}{100}\text{x}.65\right)$	9,750	

	$1,00,000 \times \frac{15}{100} \times .60 \times \frac{9}{12}$		6,750
B.	Increase in shares	1,000	750
C.	Increase in EPS [A/B]	9.75	9.00
		(Anti dilutive)	(Anti dilutive)

(6 Marks)

* Since the bonus issue is without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2014.
It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

Calculation of Diluted EPS		**Year ended 31.3.15 (Rs.)**	**Year ended 31.3.14 (Rs.)**
A.	Profit from continuing ordinary activities before Preference Dividend	1,06,000	73,000
	No. of ordinary equity shares	20,000	20,000
	Adjustment for dilutive potential of 6% convertible pref. shares	15,000	7,500
B.	Total no. of shares	35,000	27,500
C.	Diluted EPS from continuing ordinary operations [A/B]	3.02	2.65
D.	Profit including extra ordinary items	2,06,000	73,000
E.	Adjusted No. of shares	35,000	27,500
F.	Diluted EPS including extra ordinary items [D/E]	5.88	2.65

(3 Marks)

Disclosure of EPS in accordance with AS 20 in the Profit and Loss Account

Earnings per share (Face value Rs. 100)	**31.3.15 (Rs.)**	**31.3.14 (Rs.)**
Basic EPS from continuing ordinary operations	5.00	3.50
Diluted EPS from continuing ordinary operations	3.02	2.65

(1 Mark)

Answer-4 (a) :

Computation of Expected Returns on Plan Assets as on 31st March, 2015, as per AS 15

	Rs.
Return on opening value of plan assets of Rs.2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of Rs. 30,000 (i.e. Rs. 55,000 – Rs. 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 2015	22,000

(3 Marks)

Computation of Actual Returns on Plan Assets as on 31st March, 2015, as per AS 15

	Rs.	**Rs.**
Fair value of Plan Assets as on 31st March, 2015		3,00,000
Less: Fair value of Plan Assets as on 1st April, 2014	(2,00,000)	
Add: Contribution received as on 30th September, 2014	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 2014		25,000
Actual returns on Plan Assets as on 31st March, 2015		70,000

(3 Marks)

Answer-4 (b) :

Objective

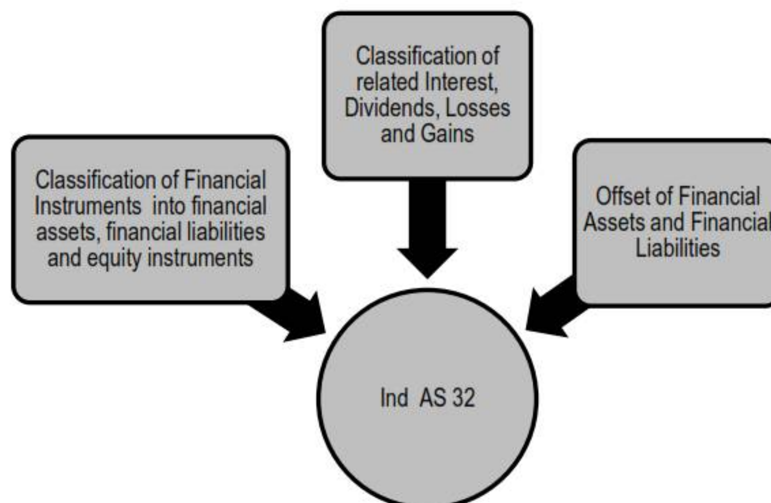
The objective of this Standard is to establish principles for presenting financial instruments asliabilities or equity and for offsetting financial assets and financial liabilities.

(1 Mark)

Applicability :

It applies to

1. The classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments;
2. The classification of related interest, dividends, losses and gains; and
3. The circumstances in which financial assets and financial liabilities should be offset.



(2 Marks)

Scope

This Standard shall be applied by all entities to all types of financial instruments except:

(a) interests in subsidiaries, associates or joint ventures that are accounted for in accordance with:
 * Ind AS 110 "Consolidated Financial Statements"
 * Ind AS 27 "Separate Financial Statements" or
 * Ind AS 28 "Investments in Associates and Joint Ventures".

 Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.

(b) employers rights and obligations under employee benefit plans, to which Ind AS 19, 'Employee Benefits', applies.

(c) insurance contracts as defined in Ind AS 104, 'Insurance Contracts'.
 However, this Standard applies to derivatives that are embedded in insurance contracts ifInd AS 109 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies Ind AS 109 inrecognising and measuring the contracts.

(d) financial instruments that are within the scope of Ind AS 104 because they contain adiscretionary participation feature. Furthermore, this Standard applies to derivatives thatare embedded in these instruments (Ind AS 109).

(e) financial instruments, contracts and obligations under share-based payment transactionsto which Ind AS 102, 'Share-based Payment', applies, except for:
 (i) contracts within the scope of this Standard, to which this Standard applies,
 (ii) to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other sharebasedpaymentarrangements.

This Standard shall be applied to those contracts to buy or sell a non-financial item that canbe settled net in cash or another financial instrument, or by exchanging financial instruments,as if the contracts were financial instruments, with the exception of contracts that wereentered into and continue to be held for the purpose of the receipt or delivery of a nonfinancialitemin accordance with the entitys expected purchase, sale or usage requirements.However, this Standard shall be applied to those contracts that an entity designates asmeasured at fair value through profit or loss in accordance with Ind AS 109, 'FinancialInstruments'.

(3 Marks)

Answer-5 (a) :

(i) Contracts for Contingent Consideration in a Business Combination in case ofAcquirers: AS 32 does not apply to contracts for contingent consideration in a businesscombination in case of acquirers. Ind AS 107 does not exempt such contracts.

(ii) Puttable Instruments: AS 32 does not exclude the same from its scope. Ind AS 107excludes from its scope puttable instruments dealt with by Ind AS 32.

(iii) Disclosures in case of Reclassification of a Financial Asset: Ind AS 107 specifiesdisclosures in case of reclassification of a financial asset out of fair value through profitor loss category or out of available-for-sale category in accordance with Ind AS 39. AS 32 does not provide for same.

(iv) Disclosures about Fair Value Measurements and Liquidity Risk: Ind AS 107 requiresenhanced disclosures about fair value measurements and liquidity risk, as compared toexisting AS 32.

(4 x 1 = 4 Marks)

Answer-5 (b) :

1. **Interest:** In case of other than financial entities, IAS 7 gives an option to classify theinterest paid and interest and dividends received as item of operating cash flows. Ind AS7 does not provide such an option and requires these items to be classified as items offinancing activity and investing activity, respectively.

(1 Mark)

2. **Dividend:** IAS 7 gives an option to classify the dividend paid as an item of operatingactivity. However, Ind AS 7 requires it to be classified as a part of financing activity only.

(1 Mark)

Answer-5 (c) :

(i) **Qualifying Asset measured at Fair Value:** Ind AS 23 does not require an entity to applythis standard to borrowing costs directly attributable to the acquisition, construction orproduction of a qualifying asset measured at fair value, for example, a biological assetwhereas the existing AS 16 does not provide for such scope relaxation.

(ii) **Applicability to Inventories:** Ind AS 23 excludes the application of this Standard toborrowing costs directly attributable to the acquisition, construction or production ofinventories that are manufactured, or otherwise produced, in large quantities on arepetitive basis whereas existing AS 16 does not provide for such scope relaxation and isapplicable to borrowing costs related to all inventories that require substantial period oftime to bring them in saleable condition.

(iii) **Inclusion as Borrowing Costs:** As per existing AS 16, Borrowing Costs, inter alia,include the following:

* interest and commitment charges on bank borrowings and other short -term andlong-term borrowings;
* amortisation of discounts or premiums relating to borrowings;
* amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

Ind AS 23 requires to calculate the interest expense using the effective interest rate method as described in Ind AS 109Certain items therein have been deleted, as some ofthose components of borrowing costs are considered as the components of interestexpense calculated using the effective interest rate method.

(iv) **Explanation of Substantial Period of Time:** Existing AS 16 gives explanation formeaning of =substantial period of time' appearing in the definition of the term =qualifyingasset'. This explanation is not included in Ind AS 23.

(v) **Reporting in Hyperinflationary Economies:** Ind AS 23 provides that when Ind AS 29,=Financial Reporting in Hyperinflationary Economies', is applied, part of the borrowingcosts that compensates for inflation should be expensed as required by that Standard(and not capitalized in respect of qualifying assets). The existing AS 16 does not containa similar clarification because at present, in India, there is no Standard on =FinancialReporting in Hyperinflationary Economies'.

(vi) **Borrowings of the Parent and its Subsidiaries for Computing Weighted Average:**Ind AS 23 specifically provides that in some circumstances, it is appropriate to include allborrowings of the parent and its subsidiaries when computing a weighted average of theborrowing costs while in other circumstances, it is appropriate for each subsidiary to usea weighted average of the borrowing costs applicable to its own borrowings. This specificprovision is not there in the existing AS 16.

(vii) **Disclosure of Capitalisation Rate:** Ind AS 23 requires disclosure of capitalization rateused to determine the amount of borrowing costs eligible for capitalization. The existingAS 16 does not have this disclosure requirement.

(6 Marks)