SUGGESTED SOLUTION

CA FINAL May 2017 EXAM

FINANCIAL REPORTING

Test Code - F N J 6 0 5 9

BRANCH - (MUMBAI) (Date :)

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Answer-1 (a):

As per para 36 of AS 25 "Interim Financial Reporting", seasonal or occasionalrevenue and cost within a financial year should not be deferred as of interim dateuntill 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 the3rd quarter only.

(1 Mark)

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

(1 Mark)

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

(3 Marks)

Answer-1 (b) :

No. of bonus shares issued as on 1.1.2016

On existing shares (50,00,250 x ½) 25,00,125 shares

On convertible debentures as per SEBI Guidelines on Bonus Issue

(1,00,000 debentures x 10 shares x ½) 5,00,000 shares

Basic Earnings per share for the year 2015-16 =

$$\frac{\text{Net profit for the year ended 31.03.2016}}{\text{Weighted average number of equity share as on 31.3.2016}}$$

$$\frac{\text{Rs.}1{,}00{,}25{,}000}{(50{,}00{,}250+25{,}00{,}125+5{,}00{,}000)}=\text{Rs.}1.25$$

Adjusted earnings per share for the year 2014-15

$$=\frac{\text{Rs.}75{,}50{,}000}{(50{,}00{,}250+25{,}00{,}125+5{,}00{,}000)}=\text{Rs.}0.94$$

(2.5 Marks)

For Diluted EPS

Interest expense for the current year = Rs. 12,00,000

Tax relating to interest expense (30%) = Rs. 3,60,000

Adjusted net profit for the current year = Rs. 1,00,25,000 + (12,00,000 -3,60,000) x3/12

= Rs. 1,02,35,000

No. of equity shares resulting from conversion of debentures

= 1,00,000 x 10 shares = 10,00,000

No. of equity shares used to compute diluted earnings per share

= 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 x 3/12)

= 50,00,250 + 25,00,125 + 5,00,000 + 2,50,000

= 82,50,375 shares

Diluted earnings per share = 1,02,35,000/82,50,375 = Rs. 1.24

(2.5 Marks)

Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue withoutconsideration. Therefore, it is treated as if it had occurred prior to the beginning of theyear 2014-15, the earliest period reported.

Answer-1 (c) :

As per AS 19 'Leases', **a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset.** In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV - Annuity Factor can be computed as follows:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present value of minimum lease payments (for ` 3 lakhs each year)	` 10.08 lakhs (approx.)

Thus, **present value of minimum lease payments is ` 10.08 lakhs and the fair value of the machine is ` 30 lakhs.**

In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years.

Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Answer-2 :

Some key differences between Ind AS 1 and Existing AS 1 are:

Ind AS 1 deals with presentation of financial statements, whereas existing AS 1 (issued 1979) deals only with the disclosure of accounting policies. The scope of Ind AS 1 is thus much wider and line by line comparison of the differences with theexisting standard is not possible. However, the major requirements as laid down in Ind AS 1 are as follows:

(i) An enterprise shall make an explicit statement in the financial statements ofcompliance with all the Ind AS. Further, Ind AS 1 allows deviation from arequirement of an Accounting standard in case the management concludesthat compliance with Ind AS will be misleading and if the regulatory frameworkrequires or does not prohibit such a departure.

(ii) Ind AS 1 requires presentation and provides criteria for classification ofCurrent / Non-current assets / liabilities.

(iii) Ind AS 1 prohibits presentation of any item as 'Extraordinary Item' in thestatement of profit and loss or in the notes.

(iv) Ind AS 1 requires disclosure of judgments made by management while framingof accounting policies. Also, it requires disclosure of key assumptions aboutthe future and other sources of measurement uncertainty that have significantrisk of causing a material adjustment to the carrying amounts of assets andliabilities within next financial year.

(v) Ind AS 1 requires classification of expenses to be presented based on natureof expenses.

(vi) Ind AS 1 requires presentation of balance sheet as at the beginning of theearliest period when an entity applies an accounting policy retrospectively ormakes a retrospective restatement of items in the financial statements, orwhen it reclassifies items in its financial statements.

(vii) In respect of reclassification of items, Ind AS 1 requires disclosure of nature,amount and reason for reclassification in the notes to financial statements.

(viii) Ind AS 1 requires the financial statements to include a Statement of Changesin Equity to be shown as a separate statement, which, inter alia, includesreconciliation between opening and closing balance for each component ofequity.

(ix) Ind AS 1 requires that an entity shall present a single statement of profit andloss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or losssection presented first followed directly by the other comprehensive incomesection.

(x) As per Ind AS 1, an entity shall include certain comparative information forunderstanding the current period's financial statements.

(xi) Ind AS 1 clarifies that long term loan arrangement need not be classified ascurrent on account of breach of a material provision, for which the lender has agreed to waive before the approval of financial statements for issue.

(10Marks)

Answer-3 (a) :

IAS 17 requires all leases rentals to be charged to Statement of Profit and Loss on straight line basis in case of operating leases unless another systematic basis ismore representative of the time pattern of the user's benefit even if the payments tothe lessor are not on that basis.

Carve out: A carve-out has been made to provide that lease rentals, in case ofoperating leases, shall be charged to the Statement of Profit and Loss inaccordance with the lease agreement if the payments to the lessor are structured toincrease in line with expected general inflation to compensate for the lessor'sexpected inflationary cost increases. If payments to the lessor vary because offactors other than general inflation, then this condition is not met.

(2.5 Marks)

Reason: Companies enter into various kinds of lease agreements to get the right touse an asset of the lessor. Considering the Indian inflationary situation, leaseagreements contain periodic rent escalation. Accordingly, where there is periodic rent escalation in line with the expected inflation so as to compensate the lessor forexpected inflationary cost increases, the rentals shall not be straight-lined.

(2.5 Marks)

Answer-3 (b) :

The Companies (Indian Accounting Standards) Rules, 2015, states that thefollowing companies shall comply with Ind AS for the accounting periods beginningon or after 1st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely:-

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having networth of rupees five hundred crore or more;

(b) companies other than those covered by point (a) above and having net worthof rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companiescovered by point (a) and (b) as the case may be;

(3Marks)

Further, the Companies (Indian Accounting Standards) Rules, 2015, states that forthe purposes of calculation of net worth of companies, the following principles shallapply, namely:-

(a) the net worth shall be calculated in accordance with the stand-alone financial statements of the company as on 31st March, 2014 or the first audited financialstatements for accounting period which ends after that date;

(b) for companies which are not in existence on 31st March, 2014 or an existingcompany falling under any of thresholds specified for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the firstaudited financial statements ending after that date in respect of which it meetsthe thresholds specified.

(2Marks)

The companies meeting the specified thresholds for the first time at the end of anaccounting year shall apply Ind AS from the immediate next accounting year in themanner specified above.

Once a company starts following Ind AS either voluntarily or mandatorily on thebasis of criteria specified, it shall be required to follow Ind AS for all the subsequentfinancial statements even if any of the criteria specified in the rule does notsubsequently apply to it.

In view of the above requirements, Company A meets the criteria as specified theCompanies (Indian Accounting Standards) Rules, 2015, on 31st March, 2014.

Accordingly, the Companies (Indian Accounting Standards) Rules, 2015, will become applicable to the Company on mandatory basis from accounting periodscommencing 1st April, 2016.

A holding, subsidiary, joint venture or associate company of a Company to whichthe Companies (Indian Accounting Standards) Rules, 2015 applies will be requiredto follow the Companies (Indian Accounting Standards) Rules, 2015 for preparingand presenting its financial statements.

In the abovementioned case, Company A has net worth of more than Rs. 500 crore inthe financial year ending 31st March 2014. Therefore, ordinarily Company A alongwith its subsidiaries will have to apply Indian Accounting Standards (Ind ASs) forpreparing financial statements for the accounting periods commencing 1st April, 2016, except in situations covered by Case A and Case B as discussedbelow.

A Company A has sold off its entire investment in Company X on 31st December, 2014; Company X is no longer a subsidiary of Company A asat the beginning of 1st April, 2016.

Therefore, in this case, Company X would continue to prepare financial statements for the accounting periods commencing 1st April, 2016, as per theCompanies (Accounting Standards) Rules, 2006.

B Company A has sold its investment in subsidiary Company Y on 31st December, 2015, in consequence of which Company Y is no longersubsidiary of Company A as at the beginning of 1st April, 2016. Therefore, the Companies (Indian Accounting Standards) Rules, 2015 will not be applicableto Company Y. Therefore, Company Y would continue to prepare financialstatements for accounting periods commencing April 1, 2016 under theCompanies (Accounting Standards) Rules, 2006.

C Company A has sold its investment in subsidiary Company Z on 31st December, 2016; therefore, Company Z was a subsidiary of Company Aas at the beginning of 1st April, 2016. Company Z being subsidiary of CompanyA as at the beginning of 1st April, 2016, would have to prepare financial statements for the accounting periods commencing 1st April, 2016 as per theCompanies (Indian Accounting Standards) Rules, 2015.

(5Marks)

Answer-4 (a) :

The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases wherepayment promised to be made to an employee at or near retirement presentssignificant difficulties in the determination of periodic charge to the statement ofprofit and loss. The contention of the Company that the settlement allowance will beaccounted for on claim basis is not correct even if company's obligation under thescheme is uncertain and requires estimation. In estimating the obligation,assumptions may need to be made regarding future conditions and events, which
are largely outside the company's control. Thus,

(2Marks)

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should becalculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, thecompany can follow some other method of accounting for settlementallowances.

(3 Marks)

Answer-4 (b) :

As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

(1) The combined result of all segments in profit; or

(2) The combined result of all segments in loss,

whichever is greater in absolute amount; or

(iii) Its segment assets are 10% or more of the total assets of all segments.

If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until atleast 75% of total enterprise revenue is included in reportable segments.

(a) On the basis of turnover criteria segments M and N are reportable segments.

(b) On the basis of the result criteria, segments M, N and R are reportable

segments (since their results in absolute amount are 10% or more of

` 200 lakhs)

(c) On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in atleast one of the above criteria all segments have to be reported upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong.