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CA FINAL NOVEMBER 2016 EXAM

FINANCIAL REPORTING

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BRANCH - (MUMBAI) (Date :14.08.2016)

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Answer-1 (a):

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 until 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.

(1 Mark)

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.

(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 3 rd 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	<u>1</u>
	18
Less: Sales promotion expenses (80% of Rs. 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	<u>(5)</u>
Adjusted Profit before tax for the third quarter	<u>1</u>

(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) x 3/12
 = 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 without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2014-15, the earliest period reported.

Answer-1 (c) :

As per para 46 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

(2.5 Marks)

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it was viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

(2.5 Marks)

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 the existing 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 of compliance with all the Ind AS. Further, Ind AS 1 allows deviation from a requirement of an Accounting standard in case the management concludes that compliance with Ind AS will be misleading and if the regulatory framework requires or does not prohibit such a departure.
- (ii) Ind AS 1 requires presentation and provides criteria for classification of Current / Non-current assets / liabilities.
- (iii) Ind AS 1 prohibits presentation of any item as 'Extraordinary Item' in the statement of profit and loss or in the notes.
- (iv) Ind AS 1 requires disclosure of judgments made by management while framing of accounting policies. Also, it requires disclosure of key assumptions about the future and other sources of measurement uncertainty that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within next financial year.
- (v) Ind AS 1 requires classification of expenses to be presented based on nature of expenses.
- (vi) Ind AS 1 requires presentation of balance sheet as at the beginning of the earliest period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in the financial statements, or when 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 Changes in Equity to be shown as a separate statement, which, inter alia, includes reconciliation between opening and closing balance for each component of equity.
- (ix) Ind AS 1 requires that an entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.
- (x) As per Ind AS 1, an entity shall include certain comparative information for understanding the current period's financial statements.
- (xi) Ind AS 1 clarifies that long term loan arrangement need not be classified as current on account of breach of a material provision, for which the lender has agreed to waive before the approval of financial statements for issue.

(10 Marks)

Answer-3 (a) :

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

Carve out: A carve-out has been made to provide that lease rentals, in case of operating leases, shall be charged to the Statement of Profit and Loss in accordance with the lease agreement if the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors 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 to use an asset of the lessor. Considering the Indian inflationary situation, lease agreements contain periodic rent escalation. Accordingly, where there is periodic rent escalation in line with the expected inflation so as to compensate the lessor for expected 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 the following companies shall comply with Ind AS for the accounting periods beginning on 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 net worth of rupees five hundred crore or more;
- (b) companies other than those covered by point (a) above and having net worth of rupees five hundred crore or more;
- (c) holding, subsidiary, joint venture or associate companies of companies covered by point (a) and (b) as the case may be;

(3 Marks)

Further, the Companies (Indian Accounting Standards) Rules, 2015, states that for the purposes of calculation of net worth of companies, the following principles shall apply, 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 financial statements for accounting period which ends after that date;
- (b) for companies which are not in existence on 31st March, 2014 or an existing company 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 first audited financial statements ending after that date in respect of which it meets the thresholds specified.

(2 Marks)

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

Once a company starts following Ind AS either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow Ind AS for all the subsequent financial statements even if any of the criteria specified in the rule does not subsequently apply to it.

In view of the above requirements, Company A meets the criteria as specified in the Companies (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 periods commencing 1st April, 2016.

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

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

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 as at 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 the Companies (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 longer a subsidiary of Company A as at the beginning of 1st April, 2016. Therefore, the Companies (Indian Accounting Standards) Rules, 2015 will not be applicable to Company Y. Therefore, Company Y would continue to prepare financial statements for accounting periods commencing April 1, 2016 under the Companies (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 A as at the beginning of 1st April, 2016. Company Z being a subsidiary of Company A as at the beginning of 1st April, 2016, would have to prepare financial statements for the accounting periods commencing 1st April, 2016 as per the Companies (Indian Accounting Standards) Rules, 2015.

(5 Marks)

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 where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme 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,

(2 Marks)

- (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 be calculated according to actuarial valuation.
- (3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

(3 Marks)

Answer-4 (b) :

As per the Explanation to para 10 of AS 9 'Revenue Recognition' the amount of excise duty to be deducted from the turnover should be the total excise duty for the year except the excise duty related to the difference between the closing stock and opening stock.

However, standard does not require basic custom duty to be shown as deduction from sales. Basic custom duty is an expense of the company and should have been shown as a charge in the Statement of Profit and Loss. Showing basic custom duty as a deduction to sales will tantamount to contradiction of Generally Accepted Accounting Principles.

Therefore, the managements' contention that excise duty shall be deducted from gross sales is correct but with respect to deduction of basic custom duty, their contention is not correct.

(3 Marks)

Calculation of net sales:

	Rs.
Turnover (Gross)	56,25,000
Less: Excise Duty	<u>(6,25,000)</u>

Turnover (Net)

50,00,000

(2Marks)