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Answer Paper	
Financial Reporting	**Duration**: 90
Details: Test – 5	**Marks**: 50

Instructions:

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

Sol 1

In the instant case, the quarterly net profit has not been correctly stated.

As per Ind AS 34, Interim financial reporting, the quarterly net profit should be adjusted and restated as follows:

Bad debts of Rs. 1 lakh have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) Rs. 50,000 to the next quarter. The treatment is not correct as the expenses incurred during an interim reporting period should be recognized in the same period unless conditions mentioned in paragraph 39 of Ind AS 34 are fulfilled. Accordingly, 50,000 should be deducted from 20,00,000.

The treatment of extra- ordinary loss of Rs. 3 lakh being recognized in the same quarter is correct. Recognizing additional depreciation of Rs. 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.

As per Ind AS 34 the income and expense should be recognized when they are earned and incurred respectively. As per Para 39 of Ind AS 34, the costs should be anticipated or deferred only when:

i. It is appropriate to anticipate or defer that type of cost at the end of the financial year, and

ii. Costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of Rs. 5 lacs is not correct as expenditure are uniform throughout all quarters.

Thus considering the above, the correct net profit to be shown in Interim financial report of the third quarter shall be Rs. 14,50,000 (20 lakh- 5lakh- 50000).

Sol 2

STATEMENT OF CASH FLOWS

Cash flow from operating activities		
Net Profit after taxation	4450	
Add – Tax Paid	105	
Add – Depreciation & Amortisation (500+20)	520	
Less - Profit on sale of plant (70-60)	-10	
Less- Increase in DTA(855-750)	-105	
Add – Decrease in Financial Assets (170-145)	25	
Less- Increase in other non-current asset(800-770)	-30	
Less – increase in other current assets(195-85)	-110	
Less – Decrease in other non-current liabilities (3615-2740)	-875	
Add – Increase in other current liabilities (300-20)	100	
Add – Increase in Trade Payables(150-90)	60	
Less - Income taxes paid	-105	
Net cash generated from operating activities		**4025**
CASH FLOW FROM INVESTING ACTIVITIES		
Sale of Machineries	70	
Purchase of Machine [13000 – (12500 – 500 – 60)}	-1060	

Purchase of Intangible Assets [50-(30-20)]	-40	
Sale of Fin. Assets (2500 – 2300)	200	
Cash Outflow from Investing Activities		**-830**
CASH FLOW FROM FINANCING ACTIVITIES		
Dividend Paid	-450	
Long term borrowings Paid (5000 – 2000)	-3000	
Cash Outflow from Financing Act.		**-3450**
Net Decrease in Cash and Cash Eq.		-255
Cash and Cash Equivalents at beginning of year (460-60)		400
Cash and Cash Equivalents at end of year (200-75)		125

Sol 3:

On evaluation of the financial statements, following was observed:

1. Reserve for foreseeable loss for INR 500 million, due within 6 months, should be a part of provisions. Hence it needs to be regrouped, and if it was a part of previous year's comparatives, a note should be added in the notes to account on the regrouping do ne this year.

2. Interest accrued and due of INR 555 million on term loan will be a part of current liabilities since it is supposed to be paid within 12 months from the reporting date. Hence, it should be shown under the heading "Other Current Liabilities".

3. It can be inferred from Note 3, that the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, hence these shall be set off. The net DTA of INR 300 million shall be shown in the balance sheet.

4. The notes to trade receivables is incorrectly presented. The recommended notes would be as below:

Trade receivables (Unsecured) consists of the following:	**INR in million**
(a) Over six months from the date they were due for payment	
i. Considered good	0
ii. Considered doubtful	40
Less: Provisions for doubtful debts	(5)
(A)	**35**
(b) Others	
i. Considered good	1,065
ii. Considered doubtful	0
Less: Provisions for doubtful debts	0
(B)	**1,065**
Total	**1,100**

5. It is common to have a termination clause in service contracts and having a termination clause per se will not create a liability on the company. A provision will be recognized when:

(a) An enterprise has a present obligation as a result of a past event;

(b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized. In the above case, there is nothing to show that there is a present obligation, and hence there is no provision to be made.

A contingent liability is recognized only where the possibility of an outflow of resources embodying economic benefits is not remote. Since there is no onerous liability as of date, the possibility of an outflow being remote, no contingent liability arises. In fact, the management has wrongly worded 'onerous liability' in its notes to accounts. Onerous liability arises only if the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it, which doesn't seem to be the case as far as Arish Ltd. is concerned. Hence, this note shall be eliminated.

6. The demand notice from the tax department that is under litigation is a clear instance of a 'contingent liability'. Accordingly, the note should be revised as – 'Contingent Liability- Demand notice from income tax department pertaining to INR 6 Million, under contest with CIT (Appeals) as on the reporting date.

7. The Statement to Profit and Loss needs to represent earnings per share.

Revised extracts of the financial statements

Balance Sheet

(INR in Millions)

	Note No.	**As at 31st March,2018**
ASSETS		

Non- current assets		
Fixed Assets		5,655
Deferred Tax Assets	3	300
Current assets		
Inventories		1,000
Trade receivables	5	1,100
Cash and Cash Equivalents		1,200
Total		**9,255**
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital		1,000
Other Equity	1	1,500
Non–current liabilities		
Long term borrowings	2	5,000
Current liabilities		
Trade payables		300
Short- term provisions		750
Other current liabilities	4	705

Total		**9,255**

Statement of Profit and Loss

(INR in Millions)

	Note No.	**Year ended 31^{st} March, 2018**
Revenue from operations		5,500
Expenses		
Operating Costs		2,200
Employee Benefit expense		1,200
Depreciation		999
Total Expenses		**4,399**
Profit Before Tax		1,101
Tax Expense		150
Profit for the period		951
Earnings Per Equity Share		
Basic		9.51
Diluted		9.51
Number of equity shares (face value of Rs. 10 each)		100 million

Revised Notes (wherever applicable):

Note on Reserves and Surplus

(INR in Million)

Capital Reserve		500
Surplus from P& L		
Opening Balance	49	
Additions	951	1,000
Total		**1500**

Note on Long Term Borrowings

Term Loan from Bank	5,000
Total	**5,000**

Note on Other Current Liabilities

Unclaimed dividend	**3**
Interest on Term Loan	**555**
Billing inn Advance	**147**
Total	**705**

Sol 4

(a)1 January 20X5

Dr Cash CU1,000

Cr Loan payable CU1,000

To recognise the loan at the initial carrying amount of CU1,000.

(b)

The effective interest rate of the loan is 20.4%, being the interest rate that discounts the expected cash flows to the initial carrying amount of CU1,000.

$$\frac{CU100}{1.204}+\frac{CU250}{1.2042}+\frac{CU1{,}300}{1.2043}=CU1{,}000$$

(c)

On 31 December 20X5, Sports Star Ltd.'s actual EBITDA for the year is CU1,200 and Sports Star Ltd. makes a payment of CU120 to Sony Ten Ltd.

Sports Star Ltd. also re-estimates its expected EBITDA for the next two years.

Year	**EBITDA**	**10% of EBITDA**
31/12/20X6	CU2,800	CU280
31/12/20X7	CU3,500	CU350

31 December 20X5

Dr Interest expense* CU204

Cr Cash CU120

Cr Loan payable CU84

*Amount would qualify for capitalization if the borrowing is for a qualifying asset under Ind AS 23 Borrowing Costs.

Sol 5

1 January 20X1

Dr Financial asset CU1,000

Cr Cash CU1,000

Being the initial recognition of the financial asset at FVOCI.

31 December 20X1

Dr Cash CU60

Cr interest income CU60

Dr Impairment loss (P &L) CU30

Dr OCI CU20

Cr Financial asset CU50

Being the receipt of the coupon payment, recognition of a CU30 impairment loss at the end of the reporting period and the change in fair value of the financial asset. The impairment allowance is recognised in OCI instead of reducing the carrying amount of the financial asset in the balance sheet, because the carrying amount is required to be the fair value of the debt instrument.

1 January 20X2

Dr Cash	CU950
Cr Financial asset	CU950
Dr Loss on sale (P & L)	CU20
Cr OCI	CU20

Being the sale of the financial asset and reclassification adjustment of the accumulated loss from OCI to profit or loss.

<u>Sol 6</u>

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

Total proceeds = 50,000 Shares x Rs. 180 each = Rs. 90,00,000

Dividend @ 10% = Rs. 9,00,000

a. Computation of Liability & Equity Component

Date	**Particulars**	**Cash Flow**	**Discount Factor**	**Net present Value**
01-Apr-2017		0	1	0.00
31-Mar-2018	Dividend	9,00,000	0.8696	7,82,640
31-Mar -2019	Dividend	9,00,000	0.7561	6,80,490
31 –Mar-2020	Dividend	9,00,000	0.6575	5,91,750

31 –Mar-2021	Dividend	9,00,000	0.5718	5,14,620
31 –Mar -2022	Dividend	9,00,000	0.4971	4,47,390
Total Liability Component				30,16,890
Total Proceeds				90,00,000
Total Equity Component (Bal fig.)				59,83,110

b. Allocation of transaction costs

Particulars	**Amount**	**Allocation**	**Net Amount**
	a	**b**	**a-b**
Liability component	30,16,890	60,338	29,56,552
Equity Component	59,83,110	1,19,662	58,63,448
Total Proceeds	90,00,000	1,80,000	88,20,000

c. Accounting for liability at amortized cost

- Initial accounting = Present value of cash outflows less transaction costs

- Subsequent accounting = At amortized cost, i.e. initial fair value adjusted for interest and repayments of the liability

	Opening Financial Liability	Interest @ 15.86%	Cash Flow (Dividend payment)	Closing Financial Liability
	A	B	C	A+B+C
01 –Apr -2017	29,56,552			29,56,552
31 –Mar -2018	29,56,552	4,68,909	9,00,000	25,25,461
31 –Mar -2019	25,25,461	4,00,538	9,00,000	20,25,999
31 –Mar -2020	20,25,999	3,21,323	9,00,000	14,47,322
31 –Mar -2021	14,47,322	2,29,545	9,00,000	7,76,867
31 –Mar -2022	7,76,867	1,23,133*	9,00,000	-

* Difference of Rs. 78 (adjusted in the interest value of 31st March, 2022) is due to approximation of figures in the earlier years.

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars	Debit Rs.	Credit Rs.
01 –Apr -2017	Bank A/c Dr.	88,20,000	
	To Preference Shares A/c		29,56,552
	To Equity Component of Preference shares A/c		58,63,448

	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)		
31 –Mar -2018	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31 –Mar -2018	Finance cost A/c Dr.	4,68,909	
	To Preference Shares A/c		4,68,909
	(Being interest as per EIR method recorded)		
31 –Mar -2019	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10 % paid to the shareholders)		
31 –Mar -2019	Finance cost A/c Dr.	4,00,538	
	To Preference Shares A/c		4,00,538
	(Being interest as per EIR method recorded)		
31 –Mar -2020	Preference shares A/c Dr.	9,00,000	
	To Bank A/c (Being dividend at the coupon rate of 10 % paid to		9,00,000

	the shareholders)		
31 –Mar -2020	Finance cost A/c Dr.	3,21,323	
	To Preference Shares A/c		3,21,323
	(Being interest as per EIR method recorded)		
31 –Mar -2021	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10 % paid to the shareholders)		
31 –Mar -2021	Finance cost A/c Dr.	2,29,545	
	To Preference Shares A/c (being interest as per EIR method recorded)		2,29,545
31 –Mar -2022	Preference shares A/c Dr.	9,00,000	
	To Bank A/c (Being dividend at the coupon rate of 10 % paid to the shareholders)		9,00,000
31 –Mar -2022	Finance cost A/c Dr.	1,23,133	
	To Preference Shares A/c (Being interest as per EIR method recorded)		1,23,133
31 –Mar -2022	Equity Component of Preference shares A/c Dr.	58,63,448	

	To equity Share Capital A/c		1,25,000
	To Securities Premium A/c		57,38,448
	(Being preference shares converted in equity shares and remaining equity component is recognized as securities premium)		

Sol 7

(1) **(i)** Option (C) : Rs. 7,51,315

(ii) Option (C) : Rs. 1,98,948

(iii) Option (B) : Rs. 9,50,263

(iv) Option (B) : Bond interest Expenses A/c Dr. Rs. 95,026

To Discount on Bond A/c Rs. 15,026

To Cash/Bank A/c Rs. 80,000

Working for the above

Since the Effective interest rate on the loan is 10% while the Bond has been issued at 8%, the financial liability will be recognised at fair value determined as follows:

Calculations of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	**Rs.**
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	1,98,948
Total Present Value of long term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method

= Rs. 9,50,263 x 10% = Rs. 95,026

However, interest paid is @8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

(2) (a) Option (B) : Cash/Bank A/c Rs. 10,00,000

To 8% LT Bond series B A/c Rs. 9,50,263

To Share Option A/c Rs. 49,737

Working for the above

It is a compound instrument.

Calculations of initial recognition amount of 8% long term Loan Bond B Series liability and equity component.

Particulars	**Rs.**
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest[(10,00,000 x8%) x2.48685]	1,98,948
Total Present value of Long term Loan Bond B I	9,50,263

Issue proceeds from convertible bond II	10,00,000
Value of equity component (II –I)	**49,737**

(b) 8% LT Bond Series B A/c Rs. 10,00,000

Share option A/c Rs. 49,737

To Share Capital A/c Rs. 10,00,000

To Share Premium A/c Rs. 49,737

Reasoning:

As per Para AG32 of Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another).There is no gain or loss on conversion at maturity.