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Accounting Standards and Guidance Notes

BASIC CONCEPTS

- **ACCOUNTING STANDARDS**

  Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of **recognition, measurement, presentation and disclosure** of accounting transactions in the financial statements.

- **GUIDANCE NOTES**

  Guidance Notes are primarily designed to provide guidance to members of ICAI on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. In a situation where certain matters are covered both by an Accounting Standard and a Guidance Note, issued by the Institute of Chartered Accountants of India, the Guidance Note or the relevant portion thereof will be considered as superseded from the date of the relevant Accounting Standard coming into effect, unless otherwise specified in the Accounting Standard.

General Questions

Question 1

Write short note on the advantages and disadvantages of setting of Accounting Standards.

Answer

The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance.

The advantages or benefits of accounting standards may be summarized as follows:

(i) **To improve the credibility and reliability of financial statements:** The accounting standards create an environment of confidence amongst the users of the accounting information by providing a uniform structure of uniform guidelines which provide credibility and reliability to the accounting information. In this way the financial statements present a true and fair view of the financial position and operating results (profit or loss) of a business organisation.

(ii) **Comparability:** The value of accounting information is enhanced (increased) if it can be compared easily in the same line of business activity. The comparability is possible only when same accounting standards are used in the preparation of the financial statements of different firms in the same industry. It is a positive step to protect the interests of the users of the accounting information.

(iii) **Benefits to accountants and auditors:** The accounting standards provide a basis for uniform accounting practices. In this way there is a less possibility of frauds to be committed by accountants. There is more transparency in the accounting information. Since the accounting profession follows the accounting standards without any exception, they are helpful not only to an accounting entity but to the accountants and auditors too.

(iv) **Additional disclosures:** There are certain areas where important information is not required to be disclosed by law. Standards require such additional disclosure such as the methods of depreciation used, change of method of depreciation etc. which help the users of financial statements such as investors, bankers, trade payables etc. to take important financial decisions.

(v) **Evaluation of managerial ability:** Accounting standards are useful in measuring the efficiency of management regarding the profitability, liquidity, solvency and general progress of the enterprise. In the absence of accounting standards, it would be difficult to evaluate the managerial efficiency, because there is no basis of comparing the financial results of one enterprise with that of another. Each enterprise would evolve its own rules or standards to suit its purpose and users of accounting information would fail to get a true and fair view of the functioning of an enterprise.

(vi) **Helpful to Government:** The government officials will find the financial information more useful for purposes of economic planning, market analysis and tax collections if it is based on established accounting standards.

(vii) **Reform in accounting theory:** The development of accounting standards has been very helpful in reforming accounting theory and practice in respect of accounting measurements and financial Information.

However, there are some disadvantages of setting of accounting standards:

(i) **Difficult choice:** Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

(ii) **Mechanical approach:** There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

(iii) **Different from law:** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

Question 2

Discuss the concept of cost v/s fair value with reference to Accounting Standards.

Answer

Cost vs. Fair value

***Cost basis*:** The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

***Fair value*:** Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm's length transaction. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

Accounting Standards are generally based on historical cost with a very few exceptions:

- AS 2 "Valuation of Inventories"– Inventories are valued at net realizable value (NRV) if cost of inventories is more than NRV.
- AS 10 "Property, plant and Equipment"– AS 10 has been revised in 2016. At various places like in determination of cost, revaluation and depreciation, fair value has to be considered. For eg-
  - Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.
  - One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The cost of such an item of property, plant and equipment is measured at fair value. If an enterprise is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.
  - Where several items of property, plant and equipment are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition. In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

- After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.
- Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount.

- AS 13 "Accounting for Investments"– Current investments are carried at lower of cost and fair value. The carrying amount of long term investments is reduced to recognize the permanent decline in value.
- AS 15 "Employee Benefits"– The provision for defined benefits is made at fair value of the obligations.
- AS 26 "Intangible Assets"– If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.
- AS 28 "Impairment of Assets"– Provision is made for impairment of assets.

Question 3

XYZ Ltd., with a turnover of ₹ 35 lakhs and borrowings of ₹ 10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2017. Advise the management on the exemptions that are available as per the Companies (AS) Rules, 2006.

If XYZ is a partnership firm is there any other exemptions additionally available.

Answer

The question deals with the issue of Applicability of Accounting Standards for corporate &non-corporate.

The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (AS) Rules, 2006.

As per the Companies (AS) Rules, 2006, criteria for above classification as SMCs, are:

"Small and Medium Sized Company" (SMC) means, a company-

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) which is not a bank, financial institution or an insurance company;

(iii) whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;

(iv) which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Since, XYZ Ltd.'s turnover of ₹ 35lakhs does not exceed ₹ 50 crores & borrowings of ₹ 10 lakhs is less than ₹ 10 crores, it is a small and medium sized company

The following relaxations and exemptions are available to XYZ Ltd.

1. AS 3 "Cash Flow Statements" is not mandatory.
2. AS 17 "Segment Reporting" is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 "Leases".
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 "Impairment of Assets".
6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets".
7. SMEs are exempt from certain requirements of AS 15 "Employee Benefits".
8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

However, if XYZ is a partnership firm and not a corporate, then its classification will be done on the basis of the classification of non-corporate entities as prescribed by the ICAI. Accordingly, to ICAI, non-corporate entities can be classified under 3 levels viz Level I, Level II (SMEs) and Level III (SMEs).

Since, turnover of XYZ, a partnership firm is less than ₹ 1 crore & borrowings of ₹ 10 lakhs is less than ₹ 1 crore, therefore, it will be classified as Level III SME. In this case, AS 3, AS 17, AS 18, AS 21, AS 23, AS 24, AS 27 will not be applicable to XYZ a partnership firm. Relaxations from certain requirements in respect of AS 15, AS 19, AS 20, AS 25, AS 28 and AS 29 are also available to XYZ a partnership firm.

Question 4

A company was classified as Non-SMC in 2015-2016. In 2016-2017 it has been classified as SMC. The management desires to avail the exemption or relaxations available for SMCs in 2016-2017. However, the accountant of the company does not agree with the same. Comment.

Answer

As per Rule 5 of the Companies (Accounting Standards) Rules, 2006, an existing company, which was previously not an SMC and subsequently becomes an SMC, shall not be qualified for exemption or relaxation in respect of accounting standards available to an SMC until the company remains an SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions available with the SMCs for the year ended 31st March, 2017.

Question 5

X Ltd. sold its building to Mini Ltd. for ₹ 60 lakhs on 30.09-2016 and gave possession of the property to Mini Ltd. However, documentation and legal formalities are pending. Due to this, the company has not recorded the sale and has shown the amount received as an advance. The book value of the building is ₹ 25 lakhs as on 31st March, 2017. Do you agree with this treatment? If you do not agree, explain the reasons with reference to the accounting standard.

Answer

Principles of prudence, substance over form and materiality should be looked into, to ensure true and fair consideration in a transaction. In the given case, the economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred. Hence, X Ltd. should record the sale and recognize the profit of ₹ 35 lakhs in its financial statements for the year ended 31st March, 2017; value of building should be removed from the balance sheet. Therefore, the treatment given by the company is not correct.

Guidance Notes

Question 6

Write short notes on:

(i) Graded vesting under an employee stock option plan.

(ii) Presentation of MAT credit in the financial statements.

Answer

(i) Graded vesting under an employee stock option plan: In case the options/shares granted under an employee stock option plan do not vest on one date but have graded vesting schedule, total plan should be segregated into different groups, depending upon the vesting dates. Each of such groups would be having different vesting period and expected life and, therefore, each vesting date should be considered as a separate option grant and evaluated and accounted for accordingly. For example, suppose an employee is granted 100 options which will vest @ 25 options per year at the end of the third, fourth, fifth and sixth years. In such a case, each tranche of 25 options would be evaluated and accounted for separately.

(ii) Presentation of MAT credit in the financial statements:

Balance Sheet: Where a company recognizes MAT credit as an asset on the basis of the considerations specified in the Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961, the same should be presented under the head 'Loans and Advances'* since, there being a convincing evidence of realization of the asset, it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Provision for Taxation' on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head 'Loans and Advances' if it continues to meet the considerations stated in paragraph 11 of the Guidance Note.

Profit and Loss Account: According to explanation given for paragraph 21 of Accounting Standard 22, "Accounting for Taxes on Income" in the context of Section 115JB of the Income-tax Act, 1961, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the statement of profit and loss in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the statement of profit and loss and presented as a separate line item therein.

Question 7

C Ltd. is a group engaged in manufacture and sale of industrial and FMCG products. One of their division also deals in Leasing of properties - Mobile Towers. The accountant showed the rent arising from the leasing of such properties as other income in the Statement of Profit and Loss.

Comment whether the classification of the rent income made by the accountant is correct or not in the light of Schedule III to the Companies Act, 2013.

Answer

As per the "General Instructions for preparation of Statement of Profit and Loss" given in Schedule III to the Companies Act, 2013, "Other Income" does not include operating income. The term "Revenue from operations" has not been defined under Schedule III to the Companies Act, 2013. However, as per the Guidance Note on Schedule III to the Companies Act, 2013 this would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities. Whether a particular income constitutes "Revenue from operations" or "Other income" is to be decided based on the facts of each case and detailed understanding of the company's activities. The classification of income would also depend on the purpose for which the particular asset is acquired or held.

** As per Schedule III to the Companies Act, 2013, it should be presented under the head 'Non-current Assets' sub head 'Long-term Loans and Advances'.*

As per the information given in the question, C Ltd. is a group engaged in manufacture and sale of industrial and FMCG products and its one of the division deals in leasing of properties - Mobile Towers. Since its one division is continuously engaged in leasing of properties, it shall be considered as its principal or ancillary revenue-generating activities. Therefore, the rent arising from such leasing shall be shown under the head "Revenue from operations" and not as "other income".

Hence, the presentation of rent arising from the leasing of such properties as "other income" in the Statement of Profit and Loss is not correct. It should be shown under the head "Revenue from operations".

Accounting Standard 1

Question 8

Write short note on 'Concept of Materiality'.

Answer

Para 17 of AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective, materiality has to do with the significance of an item or event to warrant attention in the accounting process. From a negative view point, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Individual judgments are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organization, may not be material for another organization.

For example, a long term investor is interested in the current value of fixed asset like building, while the banker may not consider it significant for a short-term loan. Similarly, a pair of scissors, ball pens, sharpeners, waste-paper baskets could be used for a number of years but still it is treated as an expense and not an asset. The omission of "paise" in the financial statements is also due to their insignificant effect to the users of the financial statement in making a decision.

Example: Requirements as to the Statement of Profit & Loss; Part II of Schedule III of the Companies Act, 2013

- Any item under which the income or expenditure exceeds 1 per cent of the revenue or ₹ 1,00,000, whichever is higher, is to be shown as a separate and distinct item against appropriate account head in the Statement of Profit & Loss.
- Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements.

The relevance of information is affected by its materiality. Information is material if its misstatements (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

Accounting Standard 2

Question 9

A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realisable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

Comment on the valuation of the inventories by the company.

Answer

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realizable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at net realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory of inventories of finished goods is not correct.

Question 10

U.S.A Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material?

Answer

As per Para 24 of AS 2 (Revised) "Valuation of Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, USA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 11

Night Ltd. sells beer to customers. Some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:

(i) Decide whether the inventory of empty bottles is an asset of the company;

(ii) If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

Answer

(i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Night Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

(ii) As per AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Inventory of empty bottles existing on the Balance Sheet date is the inventory and Night Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

Question 12

Anil Pharma Ltd. ordered 16,000 kg of certain material at ₹ 160 per unit. The purchase price includes GST ₹ 10 per kg in respect of which full input tax credit (ITC) is admissible. Freight incurred amounted to ₹ 1,40,160. Normal transit loss is 2%. The company actually received 15,500 kg and consumed 13,600 kg of material. Compute cost of inventory under AS 2 and amount of abnormal loss.

Answer

Calculation of total cost of material

	₹
Purchase price (16,000 kg. x ₹ 160)	25,60,000

Less: Input Tax Credit (16,000 kg. x ₹ 10)	(1,60,000)
	24,00,000
Add: Freight	1,40,160
Total material cost	25,40,160

Number of units after normal loss = 16,000 kg. x (100 - 2)% = 15,680 kg

Revised cost per kg. = $\frac{25,40,160}{15,680 \text{ kg}}$ = ₹ 162

Closing inventory = Material actually received – Material consumed

= 15,500 kg – 13,600 kg = 1,900 kg

Value of closing inventory = 1,900 kg x ₹ 162 = ₹ 3,07,800

Abnormal loss in kg = 15,680 kg. – 15,500 kg = 180 kg.

Abnormal loss in value = 180 kg x ₹ 162 = ₹ 29,160

Question 13

In a manufacturing process of Vijoy Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Detail of cost of production process is here under:

Item	*Unit*	*Amount (₹)*	*Output (unit)*	*Closing inventory as on 31-03-2017*
Raw material	*15,000*	*1,60,000*	*MP1-6,250*	*800*
Wages	-	*82,000*	*MP2- 5,000*	*200*
Fixed overhead	-	*58,000*	*BP-1,600*	-
Variable overhead	-	*40,000*	-	-

Average market price of MP1 and MP2 is ₹ 80 per unit and ₹ 50 per unit respectively, by-product is sold @ ₹ 25 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000, ₹ 6,000 was realised from sale of scrap.

Calculate the value of closing inventory of MP1 and MP2 as on 31-03-2017.

Answer

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

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

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

	₹	₹
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)	₹ 80	₹ 50
Sales value (a x b)	₹ 5,00,000	₹ 2,50,000
Ratio of allocation	2	1
Joint cost of ₹ 3,04,000 allocated in the ratio of 2:1 (c)	₹ 2,02,667	₹ 1,01,333
Cost per unit [c/a]	₹ 32.43	₹ 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	₹ 32.43	₹ 20.27
Value of closing inventory	₹ 25,944	₹ 4,054

Question 14

Sun Ltd. has fabricated special equipment (solar power panel) during 2014-15 as per drawing and design supplied by the customer. However due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-2016 are as follows:

Solar power panel (WIP)	*` 85 lakhs*
Solar power panel (finished products)	*` 55 lakhs*
Sundry Debtor (solar power panel)	*` 65 lakhs*

The petition for winding up against the customer has been filed during 2015-16 by Sun Ltd.

Comment with explanation on provision to be made of ` 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 2015-16.

Answer

From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per AS 2 'Valuation of Inventories', inventories are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per AS 2 for ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 2015-16, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹ 65 lakhs shall be made in the books against the debtors amount.

Accounting Standard 3

Question 15

Explain the difference between direct and indirect methods of reporting cash flows from operating activities with reference to Accounting Standard 3 revised.

Answer

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.

Question 16

Bellhop LLC submits the following information pertaining to year 2016-2017. Using the data, you are required to find the ending cash and bank balances given an opening figure thereof was ₹ 1.55 million.

	(₹ millions)
Additional shares issued	*6.50*
CAPEX (Capital expenditure)	*9.90*
Proceeds from assets sold	*1.60*
Dividends declared	*0.50*
Gain from disposal of assets	*(1.20)*
Net income	*3.30*
Increase in Accounts Receivable	*1.50*
Redemption of 4.5% debentures	*2.50*
Depreciation & Amortization	*0.75*

Answer

Bellhop LLC

Cash Flow Statement for the year ended 31st March, 2017

	₹ in millions	*₹ in millions*
Cash flows from operating activities		
Net income	3.30	
Add: Depreciation & amortization	0.75	
Loss from disposal of assets	1.20	
Less: Increase in accounts receivables	(1.50)	
Net cash generated from operating activities		3.75
Cash flows from investing activities		
Capital expenditure	(9.90)	
Proceeds from sale of fixed assets	1.60	
Net cash used in investing activities		(8.30)
Cash flows from financing activities		
Proceeds from issuance of additional shares	6.50	
Dividend declared	(0.50)	
Redemption of 4.5% debentures	(2.50)	
Net cash generated from financing activities		3.50
Net decrease in cash		(1.05)
Cash at beginning of the period		1.55
Cash at end of the period (Balancing figure)		0.50

Accounting Standard 4

Question 17

A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

Answer

According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

Question 18

While preparing its final accounts for the year ended 31st March, 2017, a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February 2017, trade receivables for 2 lakhs had suffered heavy loss due to earthquake. The loss was not covered by any insurance policy. In April, 2017, the trade receivable became bankrupt. Can the company provide for full loss arising out of insolvency of trade receivable in the final accounts for year ended 31st March, 2017?

Answer

As per Para 8.2 and 13 of Accounting Standard 4 'Contingencies and Events occurring after the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the date of balance sheet, that provide additional evidence to assist estimation of amounts relating to conditions existing at the Balance Sheet date. Therefore, in the given case, full provision for bad debt amounting ₹ 2 lakhs should be made to cover the loss arising due to insolvency in the final accounts for the year ended 31st March, 2017 as earthquake took place before the balance sheet date.

Accounting Standard 5

Question 19

Omega Ltd. has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the Suppliers' godown. Up to 2015-2016, the company has regularly included such charges in the valuation of closing inventory. This being in the nature of interest the company has decided to exclude it from closing inventory valuation for the year 2016-2017. This would result into decrease in profit by ₹ 7.60 lakhs. How would you deal with the following in the annual accounts of a company for the year ended 31st March, 2017?

Answer

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 the 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 ₹ 7.60 lakhs."

Question 20

State, how you will deal with in the accounts of U Ltd. for the year ended 31st March, 2017 with reference to Accounting Standard when the company finds that the inventory sheets of 31.3.2016 did not include two pages containing details of inventory worth ₹ 14.5 lakhs.

Answer

Paragraph 4 of Accounting Standard 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", defines Prior Period items as "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".

Rectification of error in inventory valuation is a prior period item vide para 4 of AS 5. ₹ 14.5 lakhs must be added to the opening inventory of 1/4/2016. It is also necessary to show ₹ 14.5 lakhs as a prior period adjustment in the Profit and loss Account. Separate disclosure of this item as a prior period item is required as per Para 15 of AS 5.

Question 21

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company Accountant felt that after the crash, the maintenance provision *created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss account as a prior period item.*

Is the Company's proposed accounting treatment correct? Discuss.

Answer

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.

Question 22

M/s Dinesh & Company signed an agreement with workers for increase in wages with retrospective effect. The outflow on account of arrears was for 2013-2014— ₹ 10.00 lakhs, for 2014-2015— ₹ 12.00 lakhs and for 2015-2016— ₹ 12.00 lakhs. This amount is payable in September, 2016. The accountant wants to charge ₹ 22.00 lakhs as prior period charges in financial statement for 2016-17. Discuss.

Answer

According to AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Question 23

X Limited was making provisions up to 31-3-2016 for non-moving inventories based on no issues for the last 12 months. Based on a technical evaluation the company wants to make provisions during the year 31-03-2017 in the following manner:

Total value of inventory ₹ 3 crores.

Provision required based on 12 months ₹ 8 lakhs.

Provision required based on technical evaluation ₹ 7.50 lakhs.

Does this amount to change in accounting policy?

Can the company change the method of provision?

Answer

Basis of provisioning whether on no issues or on technical evaluation is the basis of making estimates and cannot be considered as Accounting Policy. As per AS 5, due to uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

The basis of change in provisioning is a guideline and the better way of estimating the provision for non-moving inventory on account of change. Hence, it is not a change in accounting policy. Accounting policy is the valuation of inventory on cost or on net realizable value or on lower of cost or net realizable value. Any interchange of this valuation base would have constituted change in accounting policy.

Further, the company should be able to demonstrate satisfactorily that having regard to circumstances provision made on the basis of technical evaluation provides more satisfactory results than provision based on 12 months' issue. If that is the case, then the company can change the method of provision.

Accounting Standard 7

Question 24

Explain the provisions relating to combining of construction contracts.

Answer

When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

Question 25

Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.2017. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

The company undertook a contract for building a crane for ₹ 10 lakhs. As on 31.03.2017 it incurred a cost of ₹ 1.5 lakhs and expects that there will be ₹ 9 lakhs more for completing the crane. It has received so far ₹ 1 lakh as progress payment.

Answer

Para 21 of AS 7 (Revised) 'Construction Contracts' provides that when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively with reference to the stage of completion of the contract activity at the reporting date.

Para 35 of AS 7 states that when it is probable that total contract cost will exceed total contract revenue, the expected losses should be recognized as an expense irrespective of:

a. Whether or not work has commenced

b. Stage of completion of contract

c. The amount of profit on other contracts which are not treated as a single contract

Thus, when Estimated Contract Costs > Total Contract Revenue

Expected Loss = Work Certified + Work uncertified + Estimated cost to complete the project - Total value of contract

Thus, in the given case, the foreseeable loss of ₹ 50,000 (expected cost ₹ 10.5 lakhs less contract revenue ₹ 10 lakhs) should be recognized as an expense in the year ended 31st March, 2017.

The following disclosures should also be given in the financial statements:

(a) the amount of contract revenue recognized as revenue in the period;

(b) the aggregate amount of costs incurred and loss recognized upto the reporting date;

(c) amount of advances received;

(d) amount of retentions; and

(e) gross amount due from/due to customers amount*

Question 26

Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional ₹ 2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal? Discuss.

Answer

According to para 14 of AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

Question 27

Jain Construction Co. Ltd. undertook a contract on 1st January, 2017 to construct a building for ₹ 80 lakhs. The company found on 31st March, 2017 that it had already spent ₹ 58,50,000 on the construction. Prudent estimate of additional cost for completion was ₹ 31,50,000.

What amount should be charged to revenue and what amount of contract value to be recognized as turnover in the final accounts for the year ended 31st March 2017 as per provisions of AS 7 (revised)?

Answer

	₹
Cost incurred till 31st March, 2017	58,50,000

* Amount due from/to customers = contract costs + Recognised profits – Recognised losses – Progress billings = ₹ 1.5 + Nil – ₹ 0.5 – ₹ 1.0 = Nil.

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 ₹ 10,00,000 is required to be recognized as an expense in the year 2016-2017.

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,

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

Proportion of total contract value to be recognized as turnover

= 65% of ₹ 80,00,000 = ₹ 52,00,000

Question 28

On 1st December, 2016, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹ 108 lakhs. On 31st March, 2017 the company found that it had already spent ₹ 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹ 36.01 lakhs.

What is the provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2017 based on AS 7 "Accounting for Construction Contracts"?

Answer

Calculation of foreseeable loss for the year ended 31st March, 2017
(as per AS 7 "Construction Contracts")

	(₹ in lakhs)
Cost incurred till 31st March, 2017	83.99
Prudent estimate of additional cost for completion	36.01
Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹ 12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2017.

Question 29

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2017. Using this data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2017.

(ii) Arrive at the contract work in progress as at the end of financial year 2016-17.

(iii) Determine the amount of revenue to be recognized out of the total contract value.

(iv) Work out the amount due from/to customers as at year end.

(v) List down relevant disclosures with figures as per relevant Account Standard

	(₹ crore)
Total Contract Price	*2,400*
Work Certified	*1,250*
Work pending certification	*250*
Estimated further cost to completion	*1,750*
Stage wise payments received	*1,100*
Progress payments in pipe line	*300*

Answer

(i)	**Calculation of profit/ loss for the year ended 31st March, 2017**	*(₹ in crores)*
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

According to para 35 of AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(ii)	**Contract work-in-progress i.e. cost incurred to date**	*(₹ in crores)*
	Work certified	1,250
	Work not certified	250
		1,500

(iii) Proportion of total contract value recognised as revenue

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250)×100 = 46.15%

Revenue to be recognized till date = 46.15% of ₹ 2,400 crores = ₹ 1,107.60 crores.

(iv) Amount due from / to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= ₹ [1,500 + Nil – 850 – (1100 + 300)] crores

= ₹ [1,500 – 850 – 1,400] crores

Amount due to customers (shown as liability) = ₹ 750 crores.

(v) The relevant disclosures under AS 7 (Revised) are given below:

	₹ in crores
Contract revenue till 31st March, 2017	1,107.60
Contract expenses till 31st March, 2017	1,500.00
Recognized losses for the year 31st March, 2017	(850)
Progress billings ₹ (1,100 + 300)	1,400
Progress (billed but not received from contractee)	300
Gross amount due to customers	750

Accounting Standard 9

Question 30

Write short note on Effect of Uncertainties on Revenue Recognition.

Answer

Effect of Uncertainties on Revenue Recognition

Para 9 of AS 9 on "Revenue Recognition" deals with the effect of uncertainties on Revenue Recognition. The para states:

1. Recognition of revenue requires that revenue is measurable and at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.
2. Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc. revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise, revenue only when it is reasonably certain that the ultimate collection will be made. When there is no uncertainty as to ultimate collection,

revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

3. When the uncertainty relating to collectability arises subsequent to the time of sale or rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.
4. An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits; the recognition of revenue is postponed.
5. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognized.

Question 31

SM company has taken a Transit Insurance Policy. Suddenly in the year 2016-2017 the percentage of accident has gone up to 7% and the company wants to recognize insurance claim as revenue in 2016-2017 in accordance with relevant Accounting Standards. Do you agree? Explain in brief, as per the relevant Accounting Standards.

Answer

When to Recognize Revenue:

- Revenue recognition is mainly concerned with the **timing of recognition of revenue** in the profit and loss account.
- Where **there is no uncertainty** as to **ultimate collection**, revenue is **recognised at the time of sale** or **rendering of services**, as the case may be even though payments are made by installments.
- The amount of revenue is usually determined by agreement between the parties to the transaction

It may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made.

In the given case, SM company wants to suddenly recognize Insurance claim because it has increased over the previous year. **But, there are uncertainties involved in the settlement of the claim.** Also, the claim does not seem to be in the course of ordinary activity of the company.

Hence, SM company is not advised to recognize the Insurance claim as revenue.

Question 32

Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with registrar subsequent to Balance Sheet date. But before finalization, is it possible to recognize the sale and the gain at the Balance Sheet date? Give your view with reasons.

Answer

Yes, both sales and gain of Bottom Ltd. should be recognized. In accordance with AS 9, at the Balance Sheet date and what was pending was merely a formality to register the deed. It is clear that significant risk and rewards of ownership had passed before the balance sheet date. Further the registration post the balance sheet date confirms the condition of sale at the balance sheet date as per AS 4.

Question 33

Victory Ltd. purchased goods on credit from Lucky Ltd. for ₹ 250 crores for export. The export order was cancelled. Victory Ltd. decided to sell the same goods in the local market with a price discount. Lucky Ltd. was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified.

Answer

Lucky Ltd. had sold goods to Victory Ltd on credit worth for ₹ 250 crores and the sale was completed in all respects. Victory Ltd.'s decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. The price discount of 15% offered by Lucky Ltd. after request of Victory Ltd. was not in the nature of a discount given during the ordinary course of trade because otherwise the same would have been given at the time of sale itself. Now, as far Lucky Ltd is concerned, there appears to be an uncertainty relating to the collectability of the debt, which has arisen subsequent to the time of sale therefore, it would be appropriate to make a separate provision to reflect the uncertainty relating to collectability rather than to adjust the amount of revenue originally recorded. Therefore, such discount should be written off to the profit and loss account and not shown as deduction from the sales figure.

Question 34

Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales is that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy, with reference to AS 9.

Answer

As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Effect of Uncertainty- In the case of the jewellery business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in

Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

Question 35

Prima Ltd. sold goods worth ₹ 50,000 to M/s Y and Company. M/s Y and Co. asked for discount of ₹ 8,000 which was agreed by Prima Ltd. the sale was affected and goods were dispatched. After receiving goods worth ₹ 7,000 was found defective which they returned immediately. They made the payment of ₹ 35,000 to Prima Ltd. Accountant booked the sales for ₹ 35,000. Please discuss.

Answer

As per Para 4.1 of AS 9 "Revenue Recognition", revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

In the given case, Prima Ltd. should record the sales at gross value of ₹ 50,000. Discount of ₹ 8,000 in price and goods returned worth ₹ 7,000 are to be adjusted by suitable provisions. Prime Ltd. might have sent the credit note of ₹ 15,000 to M/s Y & Co. to account for these adjustments. The contention of the accountant to book the sales for ₹ 35,000 is not correct.

Question 36

Moon Ltd. entered into agreement with Sun Ltd. for sale of goods of ₹ 8 lakhs at a profit of 20% on cost. The sale transaction took place on 1st February, 2016. On the same day Sun Ltd. entered into another agreement with Moon Ltd. to resell the same goods at ₹ 10.80 lakhs on 1st August, 2016. State the treatment of this transaction in the financial statements of Moon Ltd. as on 31.03.14. The pre-determined re-selling price covers the holding cost of Sun Ltd. Give the Journal Entries as on 31.03.14 in the books of Moon Ltd.

Answer

In the given case, Moon Ltd. concurrently agreed to repurchase the same goods from Sun Ltd. on 1st Feb., 2016. Also the re-selling price is pre-determined and covers purchasing and holding costs of Sun Ltd. Hence, the transaction between Moon Ltd. and Sun Ltd. on 1st Feb., 2016 should be accounted for as financing rather than sale. The resulting cash flow of ₹ 9.60 lakhs received by Moon Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Moon Ltd.

		(₹ in lakhs)	
1.02.14	Bank Account Dr.	9.60	

	To Advance from Sun Ltd*.			9.60
	(Being advance received from Sun Ltd amounting [₹ 8 lakhs + 20% of ₹ 8 lakhs= 9.60 lakhs] under sale and re-purchase agreement)			
31.03.14	Financing Charges Account	Dr.	0.40	
	To Sun Ltd.			0.40
	(Financing charges for 2 months at ₹ 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.14	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P& L Account)			

Accounting Standard 10

Question 37

XYZ Ltd. has acquired a heavy road transporter at a cost of ₹ 1,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, the power train (one of its component) requires replacement, as further maintenance is uneconomical due to the off-road time required. The remainder of the vehicle is perfectly roadworthy and is expected to last for the next four years. The cost of a new power train is ₹ 45,000.

Can the cost of the new power train be recognized as an asset, and, if so, what treatment should be used?

Answer

The new power train will produce economic benefits to XYZ Ltd., and the cost is measurable. Hence the item should be recognized as an asset as per AS 10 (Revised) as the recognition criteria is satisfied.

The original invoice for the transporter did not specify the cost of the power train. However, its cost of the replacement is ₹ 45,000 which can be used as an indication (usually by discounting factor) of the likely cost, six years previously.

* The balance of Sun Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of Moon Ltd. as on 31st March, 2016.

If an appropriate discount rate is 5% per annum, ₹ 45,000 discounted back six years amounts to ₹ 33,570 (45,000 x 0.746), which would be written out of the asset records.

The cost of the new power train, ₹ 45,000, would be added to the asset record, resulting in a new asset cost of ₹ 1,11,430 (₹ 1,00,000 – ₹ 33,570 + ₹ 45,000).

Question 38

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants used for advice on the acquisition of the plant	₹ 7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹ 2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
7.	Operating losses before commercial production	₹ 4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with AS 10 (Revised).

Answer

According to AS 10 (Revised), these costs can be capitalized:

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
		₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 39

A Ltd. has an item of plant with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Pass Journal Entries with regard to Revaluation?

Answer

The entries to be passed would be:

		₹	₹
Accumulated depreciation	Dr.	55,000	
To Asset A/c			55,000
(Being elimination of accumulated depreciation against the cost of the asset)			
Asset A/c	Dr	20,000	
To Revaluation Surplus			20,000
(Being increase of net asset value to Fair value)			

Note: The net result is that the asset has a carrying amount of ₹ 65,000 [1,00,000 – 55,000 + 20,000.]

Question 40

B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹ 10,000.

How would the above changes in estimates be made by B Ltd.?

Answer

The above changes in estimates would be effected in the following manner:

The asset has a carrying amount of ₹ 56,000 at the end of year 8 [₹ 2,00,000 – ₹ 1,44,000] i.e. Accumulated Depreciation.

Accumulated depreciation is calculated as

Depreciable amount {Cost less residual value} = ₹ 2,00,000 – ₹ 20,000 = ₹ 1,80,000.

Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = ₹ 18,000.

Accumulated depreciation = 18,000 × No. of years (8) = ₹ 1,44,000.

Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8).

The revised depreciable amount is ₹ 46,000. (56,000 – 10,000)

Thus, depreciation should be charged in future at ₹ 11,500 per annum (₹ 46,000/4 years).

Question 41

Determine if the following costs can be added/subtracted to the invoiced purchase price for the initial recognition of the cost of the asset:

1. *Consultants fees for choosing the new asset*
2. *A trade discount received of 5% of the purchase price of the asset*
3. *A discount received for paying the invoice within 90 days*
4. *Interest paid on a short term loan taken to provide the necessary cash for payment of the purchase price*
5. *Import duties paid*
6. *Shipping costs and cost of road transport*
7. *Insurance for the shipping*
8. *An economic development rebate from the state*
9. *VAT paid on the purchase*
10. *Cost of laying a new concrete slab and installing special rubber mounted footings for the new press in order to reduce vibration during use*
11. *Hire of a crane to transfer the press from the vehicles into the factory*
12. *Costs associated with removing a section of the factory roof to allow the machine to be dropped into place and subsequently refitting the roof*
13. *Cost of installing soundproofing in the roof at the same time in order to provide protection for workers in other parts of the factory building*
14. *Professional fees charged by consulting engineer for overseeing the installation process*
15. *Electricians fees for connecting the press to the power supply*
16. *A portion of the operating costs (salaries, office expenses) of the purchasing department*
17. *Costs of materials (papers and inks) used in calibrating the machine and setting it up for operation*
18. *Costs of training the operators of the new machine*
19. *A portion of the inefficiencies in production for the first month of use while the operators became comfortable with using the machine*

Answer

Included in Cost:

Point no. 1,2,5,6,7,8,10,11,12,14,15 and 17

Excluded from Cost:

Point no. 3,4,9,13,16,18 and 19

Question 42

A Ltd. has carried out certain works on various machines in their engineering plant, which manufactures high quality metal patterns and templates for use in industry.

Determine in each case whether the costs of the improvements can be added to the existing carrying value of the assets concerned?

1. *The cost of an annual machine overhaul which will maintain the originally assessed standard of performance of the machine for the coming 12 months.*
2. *The cost of repairs to a press machine, which was damaged by the emergency services while trying to extricate the arm of a worker who had become trapped in the press.*
3. *Modifications to a cutting machine which will increase its rate of output from 500 to 560 patterns per shift.*
4. *Modifications to a lathe which will replace the current water cooling system with an oil-based system, thereby extending the life of the lathe by a forecast 2 years.*
5. *The upgrading of a cutting machine with new software which will improve the accuracy of its measurement and cutting tolerances by a number of microns, thereby raising the quality of output.*
6. *Alterations to a production line which will allow automatic feeding from a machine to the next one in the production process, thereby removing the need for an employee to manually load the second machine.*

Answer

Point 1: No. This may not be capitalized as subsequent expenditure, since it merely maintains the originally assessed standard of performance of the asset.

Point 2: Yes. An impairment loss should have been recognized when the damage occurred and any insurance payment received as compensation should have been recognized as income in the Statement of Profit and Loss when received.

When expenditure is incurred to restore the asset, such expenditure is added to the carrying amount of the asset to the extent that it is probable that future economic benefits will flow to the enterprise.

Point 3: Yes. The cost of such modifications may be added to the carrying amount of the asset.

Point 4: Yes. Such costs may be capitalized.

Point 5: Yes. Such costs may be capitalized.

Point 6: Yes. Such costs may be capitalized.

Question 43

An entity bought a plot of land for development of office buildings. Development of the land was scheduled into six phases. The land scheduled for development in phases five and six was leased to another entity on a short-term basis as a parking lot for heavy vehicles.

What is the treatment of rental income from car parking lot?

Answer

Rental income from the car park lease is recognized in the Statement of Profit and Loss for the period.

The car park activity is incidental to the entity`s principal activity of property development. Operations that are incidental to the construction or development of property, plant and equipment are not necessary to bring the asset to its working condition for its intended use.

The income and related expenses of incidental operations are recognized in the Statement of Profit and Loss for the period.

Question 44

An entity acquires the right to use an underground cave for gas storage purposes for a period of 50 years. The cave is filled with gas, but a substantial part of that gas will only be used to keep the cave under pressure in order to be able to get gas out of the cave. It is not possible to distinguish the gas that will be used to keep the cave under pressure and the rest of the gas.

Evaluate whether AS 10 would apply or AS 2?

Answer

The total volume of gas must be virtually split into

(i) Gas held for sale, and

(ii) Gas held to keep the cave under pressure.

The former must be accounted for under AS 2 as Inventories. The latter must be accounted for as PPE under AS 10 and depreciated over the period the cave is expected to be used.

Question 45

An entity operates an oil refining plant. For the refining process to take place, the plant must contain a certain minimum quantity of oil. This can only be taken out once the plant is abandoned and would then be polluted to such an extent that the plant's value is significantly reduced.

Evaluate whether AS 10 would apply or AS 2?

Answer

The part of the crude that is necessary to operate the plant and cannot be recouped (or can be recouped but would then be significantly impaired), even when the plant is abandoned, should be considered as an item of PPE under AS 10 and amortized over the life of the plant.

Accounting Standard 11

Question 46

Distinguish between Integral foreign operation and Non-integral foreign operation.

Answer

	Integral Foreign Operation	Non-Integral Foreign Operation (NFO)
Meaning	It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.	It is a foreign operation that is not an integral Foreign Operation.
Business	The business of IFO is carried on as if it were an extension of the reporting enterprise's operations.	The business of NFO is carried on in a substantially independent manner by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowings, in its local currency.
Example	Sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.	Production in a foreign country out of resources available in such nation independent of the reporting enterprise.
Currencies operated	Generally, IFO carries on business in a single foreign currency, i.e. of the country where it is located.	NFO business may also enter into transactions in foreign currencies, including transactions in the reporting currency.
Cash flows from operations	Cash flows from operations of the reporting enterprise are directly and immediately affected by a change in the exchange rate between the reporting currency and the currency in the country of IFO.	Change in the exchange rate between the reporting currency and the local currency, has little or no direct effect on the present and future Cash Flows from Operations of either the NFO or the reporting enterprise.
Effect of Change in Exchange Rate	Change in the exchange rate affects the individual monetary items held by the IFO rather than the reporting enterprise's Net Investment in the IFO.	Change in the exchange rate affects the reporting enterprise's net investment in the NFO rather than the individual monetary and non-monetary items held by that NFO.

Question 47

A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2017, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the *books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2017 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2017, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2017 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar.*

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

Answer

As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e, ₹ 48 at 31st March, 2017 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of ₹ 5 (₹ 48-₹ 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2017 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of ₹ 1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

Question 48

Mr. A bought a forward contract for three months of US $ 1,00,000 on 1st December at 1 US $ = ₹ 47.10 when exchange rate was US $ 1 = ₹ 47.02. On 31st December when he closed his books, exchange rate was US $ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books.

Answer

It is apparent from the facts given in the question that Mr. A entered into forward exchange contract for speculation purpose*.According to paragraphs 38 and 39 of AS 11(Revised) 'The Effects of Changes in Foreign Exchange Rates', gain or loss on forward exchange contracts intended for trading or speculation purpose should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be recognised in the statement of profit and loss for the period and the premium or discount on the forward exchange contract is ignored and not recognised separately. In recording such contract, at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

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*The forward contract is sold before its due date, hence considered as speculative.

Thus, the premium on contract i.e., the difference between the contract rate and the spot rate amounting ₹ 8,000 [US $ 1,00,000 x (₹ 47.10 – ₹ 47.02)] will be ignored and not be recorded in the books. However, the profit on contract i.e. the difference between the sale rate and contract rate amounting ₹ 8,000 [US$ 1,00,000 x 0.08* (₹ 47.18 – ₹ 47.10)] will be recognized in the books of Mr. A on 31st January.

Illustration 49

Opportunity Ltd. purchased an equipment costing ₹ 24,00,000 lakhs on 1.4.2015 and the same was fully financed by foreign currency loan (US Dollars) payable in four annual equal installments. Exchange rates were 1 Dollar = ₹ 60.00 and ₹ 62.50 as on 1.4.2015 and 31.3.2016 respectively. First installment was paid on 31.3.2016. The entire difference in foreign exchange has been capitalized. You are required to state that how these transactions would be accounted for.

Solution

As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, should be recognized as income or expenses in the period in which they arise. Thus, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets will be recognized as income or expense.

Calculation of Exchange Difference:

Foreign currency loan =	₹ 24,00,000/60 = 40,000 US Dollars
Exchange difference =	40,000 US Dollars x (62.50-60.00) = ₹ 1,00,000
(including exchange loss on payment of first instalment)	

Therefore, entire loss due to exchange differences amounting ₹ 1,00,000 should be charged to profit and loss account for the year.

Note: The above answer has been given on the basis that the company has not availed the option for capilisation of exchange difference as per para 46/46A of AS 11.

However, as per para 46A of the standard, the exchange differences arising on reporting of long term foreign currency monetary items at rates different from those at which they were initially recorded during the period, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset.

Accordingly, in case Opportunity Ltd. opts for capitalizing the exchange difference, then the

*The current market value of the forward contract on 31st December has not been given in the question. Therefore, no gain or loss can be recognised in the books on 31st December. The profit amounting ₹ 8,000 will be recognised in the year of sale only.

entire amount of exchange difference of ₹ 1,00,000 will be capitalsied to 'Equipment account'. This capitalized exchange difference will be depreciated over the useful life of the asset.

Cost of the asset on the reporting date

Initial cost of Equipment	₹ 24,00,000
Add: Exchange difference as on 31.3.2016	₹ 1,00,000
Total cost on the reporting date	₹ 25,00,000

Accounting Standard 12

Question 50

Write short note on 'Treatment of refund of Government grants'.

Answer

As per Para 11 of AS 12 "Accounting for Government Grants", government grant that becomes refundable should be treated as an extraordinary item. The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement. The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, *i.e.,* where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset. Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

Accounting Standard 13

Question 51

Write short note on Accounting for investment by a holding company in subsidiaries.

Answer

Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for not more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of income earned by a subsidiary before the acquisition of the shares by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) is carried normally at cost.

Question 52

'Suram' Ltd. wants to re-classify its Investment in accordance with AS 13. Decide on the treatment to be given in each of the following cases:

(1) A portion of Current Investments purchased for ₹ 20 lakhs to be reclassified as long-term Investments, as the company has decided to retain them. The market value as on the date of Balance Sheet was ₹ 25 lakhs.

(2) Another portion of Current Investments purchased for ₹ 15 lakhs has to be re classified as Long-term Investments. The market value of these investments as on the date of Balance Sheet was ₹ 6.5 lakhs.

(3) Certain Long-term Investments no longer considered for holding purposes have to be re-classified as Current Investments. The original cost of these was ₹ 18 lakhs but they had been written down to ₹ 12 lakhs to recognize permanent decline as per AS 13.

Answer

As per Para 24 of AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

In the first case, the market value* of the investment is ₹ 25 lakhs, which is higher than its cost i.e. ₹ 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ₹ 20 lakhs.

In the second case, the market value* of the investment is ₹ 6.5 lakhs, which is lower than its cost i.e. ₹ 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ₹ 6.5 lakhs. The loss of ₹ 8.5 lakhs should be charged to profit and loss account.

As per para 23 of AS 13, where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

* It is assumed that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller.

In the third case, the book value of the investment is ₹ 12 lakhs, which is lower than its cost i.e. ₹ 18 lakhs. Here, the transfer should be at carrying amount and hence this re-classified current investment should be carried at ₹ 12 lakhs.

Question 53

X Ltd. on 1-1-2017 had made an investment of ₹ 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2017 became ₹ 200 lakhs as Y Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2017.

Answer

X limited invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs. Irrespective of the fact that investment has been held by X Limited only for 3 months (from 1.1.2017 to 31.3.2017), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2017 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at ₹ 100 lakhs. The reduction of ₹ 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Y Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by ₹ 200 lakhs and shown the investments at ₹ 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of ₹ 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternatively, for treatment of long term investment, if one assumes that the decline in the value of long term investment is temporary and Y Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.

Question 54

Anischit Finance Ltd. is a company. It makes available to you the costs and market price of various investments held by it as on 31.3.2017:

(Figures in ₹ lakhs)

Scripts:		*Cost*	*Market Price*
A.	*Equity Shares-*		
	A	*60.00*	*61.20*
	B	*31.50*	*24.00*
	C	*60.00*	*36.00*
	D	*60.00*	*120.00*
	E	*90.00*	*105.00*
	F	*75.00*	*90.00*
	G	*30.00*	*6.00*
B.	*Mutual funds-*		
	MF-1	*39.00*	*24.00*
	MF-2	*30.00*	*21.00*
	MF-3	*6.00*	*9.00*
C.	*Government securities-*		
	GV-1	*60.00*	*66.00*
	GV-2	*75.00*	*72.00*

(i) Can the company adjust depreciation of a particular item of investment within a category?

(ii) What should be the value of investments as on 31.3.2017?

(iii) Is it possible to off-set depreciation in investment in mutual funds against appreciation of the value of investment in equity shares and government securities?

Answer

(i) Quoted current investments for each category shall be valued at cost or market value, whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Therefore, depreciation of a particular item of investments can be adjusted within the same category of investments.

(ii) Value of Investments as on 31.3.2017

Type of Investment	*Valuation Principle*	*Value ₹ in lakhs*
Equity Shares (Aggregated)	Lower of cost or market Value	406.50
Mutual Funds	NAV (Market value, assumed)	54.00
Government securities	Cost	135.00
		595.50

As per para 14 of AS 13 "Accounting for Investments", the carrying amount for current investments is the lower of cost and market price. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly, the investments may be computed at the lower of cost and market value computed category-wise.

(iii) Inter category adjustments of appreciation and depreciation in values of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation of the value of investments in equity shares and Government securities.

Accounting Standard 15

Question 55

What are the types of Employees benefits and what is the objective of Introduction of this Standard i.e. AS 15?

Answer

There are four types of employee benefits according to AS 15 (Revised 2005). They are:

(a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

Since each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Question 56

A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

Answer

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,

(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.

Question 57

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.15, calculate the actual return on plan assets:

- Benefits paid	*2,00,000*
- Employer contribution	*2,80,000*
- Fair market value of plan assets on 31.03.15	*11,40,000*
- Fair market value of plan assets as on 31.03.14	*8,00,000*

Answer

		₹
Fair value of plan assets on 31.3.14		8,00,000
Add: Employer contribution		2,80,000
Less: Benefits paid		(2,00,000)
	(A)	8,80,000
Fair market value of plan assets at 31.3.15	(B)	11,40,000
Actual return on plan assets	(B-A)	2,60,000

Question 58

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 2016. On 30th September, 2016 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2017 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2016 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	*10.25*
Realized gains on plan assets (after tax)	*3.00*
Fund administrative costs	*(3.00)*
Expected rate of return	*10.25*

Calculate the expected and actual returns on plan assets as on 31st March, 2017, as per AS 15.

Answer

Computation of Expected Returns on Plan Assets as on 31st March, 2017, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 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, 2017	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 2017, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 2017		3,00,000
Less: Fair value of Plan Assets as on 1st April, 2016	(2,00,000)	
Add: Contribution received as on 30th September, 2016	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 2016		25,000
Actual returns on Plan Assets as on 31st March, 2017		70,000

Question 59

Kumar Ltd., is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employee is estimated to be 6 years.

You are required to advise the company.

Answer

According to para 92 of AS 15 (Revised) "Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense. Therefore, surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the profit and loss statement of the current year. Hence, Kumar Ltd. cannot spread the actuarial gain of ₹ 6 lakhs over the next 2 years by reducing the annual contributions to ₹ 2 lakhs instead of ₹ 5 lakhs. It has to contribute ₹ 5 lakhs annually for its pension schemes.

Accounting Standard 16

Question 60

In May, 2016, Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2017 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2017 amounted to ₹ 25 lakhs. Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

Answer

AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2017) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Question 61

X Ltd. began construction of a new building on 1st January, 2017. It obtained ₹ 1 lakh special loan to finance the construction of the building on 1st January, 2017 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	*Rate of Interest*
₹ 5,00,000	*11%*
₹ 9,00,000	*13%*

The expenditures that were made on the building project were as follows:

		₹
January	*2017*	*2,00,000*
April	*2017*	*2,50,000*
July	*2017*	*4,50,000*
December	*2017*	*1,20,000*

Building was completed by 31st December, 2017. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

Answer

(i) Computation of average accumulated expenses

		₹
₹ 2,00,000 x 12 / 12	=	2,00,000

₹ 2,50,000 x 9 / 12	=	1,87,500
₹ 4,50,000 x 6 / 12	=	2,25,000
₹ 1,20,000 x 1 / 12	=	10,000
		6,22,500

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	*Rate of interest*		*Amount of interest (₹)*
5,00,000	11%	=	55,000
9,00,000	13%	=	1,17,000
14,00,000			1,72,000
Weighted average rate of interest $\left(\frac{1,72,000}{14,00,000}\times 100\right)$		=	12.285% (approx)

(iii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 1,00,000 x 10%)	=	10,000
Non-specific borrowings (₹ 5,22,500* x 12.285%)	=	64,189
Amount of interest to be capitalized	=	74,189

(iv) Total expenses to be capitalized for building

	₹
Cost of building ₹ (2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	74,189
	10,94,189

(v) Journal Entry

Date	*Particulars*		*Dr. (₹)*	*Cr. (₹)*
31.12.2017	Building account	Dr.	10,94,189	
	To Bank account			10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalized)			

* (₹ 6,22,500 – ₹ 1,00,000)

Question 62

The borrowings profile of Santra Pharmaceuticals Ltd. set up for the manufacture of antibiotics at Navi Mumbai is as under:

Date	*Nature of borrowings*	*Amount borrowed (₹)*	*Purpose of borrowings*	*Incidental expenses*
1st January, 2016	*15% demand loan*	*60 lakhs*	*Acquisition of fixed assets*	*8.33%*
1st July, 2016	*14.5% Term loan*	*40 lakhs*	*Acquisition of plant and machinery*	*5%*
1st October, 2016	*14% bonds*	*50 lakhs*	*Acquisition of fixed assets*	*8%*

The incidental expenses consist of commission and service charges for arranging the loans and are paid after rounding off to the nearest lakh.

Fixed assets considered as qualifying assets are as under:

	(₹)
Sterile Manufacturing shed	*10,00,000*
Plant and machinery (total)	*90,00,000*
Other fixed assets	*10,00,000*

The Project is completed on 1st January, 2017 and is ready for commercial production. Show the capitalization of the borrowing costs.

Answer

Specific Borrowings

	₹
14.5% Term Loan for acquisition of Plant & Machinery	
Interest from 1st July, 2016 to 31st December, 2016	
$= ₹\ 40,00,000 \times 14.5\% \times \frac{6}{12}$	2,90,000
Incidental Expenses	2,00,000
Total	4,90,000
General Borrowings	
15% Demand Loan	
Interest from 1st January, 2016 to 31st December, 2016 = ₹ 60,00,000 × 15%	9,00,000
Incidental Expenses	5,00,000
Sub Total (A)	14,00,000

14% Bonds	
Interest from 1st October, 2016 to 31st December, 2016	
$= ₹\ 50,00,000 \times 14\% \times \frac{3}{12}$	1,75,000
Incidental Expenses	4,00,000
Sub Total (B)	5,75,000
Total General Borrowing Cost (A+B)	19,75,000
Total Average Outstanding Borrowings will be as under:	
$\frac{(60,00,000 \times 12 + 50,00,000 \times 3)}{12}$	72,50,000
Weighted Average Borrowing Cost (WABC)= $\frac{\text{Total Borrowing Cost} \times 100}{\text{Total Average Outstanding}}$	
$\frac{19,75,000 \times 100}{72,50,000}$	= 27.24%

Allocation of General Borrowing Fund

Item	*Cost (₹)*	*Specific Borrowing (₹)*	*Net of specific borrowing (₹)*
Sterile Manufacturing Shed	10,00,000	Nil	10,00,000
Plant & Machinery	90,00,000	40,00,000	50,00,000
Other Fixed Assets	10,00,000	Nil	10,00,000

Item	*Expenditure on qualifying asset out of general borrowing (₹)*	*Capitalization Rate*	*Cost eligible for capitalization (₹)*
Sterile Manufacturing Shed	10,00,000	27.24	2,72,400
Plant & Machinery	50,00,000	27.24	13,62,000
Other Fixed Assets	10,00,000	27.24	2,72,400

Borrowing Costs to be Capitalized

Assets	*Specific Borrowing Cost (₹)*	*General Borrowing Cost (₹)*	*Total (₹)*
Sterile Manufacturing shed	Nil	2,72,400	2,72,400
Plant & Machinery	4,90,000	13,62,000	18,52,000
Other Fixed Assets	Nil	2,72,400	2,72,400
Total	4,90,000	19,06,800•	23,96,800

• Borrowing cost capitalized on general borrowings is ₹ 19,06,800 which is less than the actual borrowing cost.

Question 63

Rainbow Limited borrowed an amount of ₹ 150 crores on 1.4.2016 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2017. Due to surplus fund out of ₹ 150 crores, income of ₹ 3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

Answer

Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2016-2017 should be calculated as follows:

	₹ in crores
Actual interest for 2016-2017 (11% of ₹ 150 crores)	16.50
Less: Income on temporary investment from specific borrowings	(3.50)
Borrowing costs to be capitalized during year 2016-2017	13.00

Question 64

Fee Ltd. borrows a sum of ₹ 20 crore from Coffee Ltd., repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market is 8%, Fee Ltd. paid an origination fee of ₹ 2.40 crores to Coffee Ltd. to compensate Coffee Ltd. for the lower rate of interest. Apart from the above, there are no other transactions between the two parties. You are required to show the value at which Coffee Ltd., would recognize the loan and the annual interest thereon.

Answer

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 5^{th} year.

P.V. of interest discounted @ 8% = [(20,00,00,000 × 5%) × 3.9926] = ₹ 3,99,26,000 (A)

P.V. of principal amount = ₹ 20,00,00,000 discounted @ 8%

= ₹ 20,00,00,000 × 0.6806 =13,61,20,000 (B)

Fair Value of Loan (A + B) i.e. ₹ 17,60,46,000 (i.e. approximately ₹ 17,60,00,000 which is loan amount net of origination fee)

Therefore, Coffee Ltd will recognize the loan at ₹ 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)*	*Interest income @ 8% to be recognised*	*Total*	*Payment received*	*Amortised Cost (Closing Balance)*
	(1)	*(2)*	*(3)*	*(4)*	*(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.

Question 65

Sun Co-operative Society Ltd. has borrowed a sum of US$12.50 million at the commencement of the financial year 2016-2017 for its solar energy project at LIBOR (London Interbank Offered Rate) of 1% + 4%. The interest is payable at the end of the respective financial year. The loan was availed at the then rate of ₹ 45 to the US dollar while the rate as on 31st March, 2017 is ₹ 48 to the US dollar. Had Sun Co-operative Society Ltd. borrowed the Rupee equivalent in India, the interest would have been 11%. You are required to compute 'Borrowing Cost'. Also show the amount of exchange difference as per prevailing Accounting Standards.

Answer

Computation of Borrowing Cost as per para 4(e) of AS 16" Borrowing Costs" and Amount of Exchange Difference as per AS 11 "The Effects of Changes in Foreign Exchange Rates":

(a) Interest for the period 2016-2017

= US$ 12.5 million x 5% × ₹ 48 per US$ = ₹ 30 million

(b) Increase in the liability towards the principal amount

= US $ 12.5 million × ₹ (48 - 45) = ₹ 37.5 million

(c) Interest that would have resulted if the loan was taken in Indian currency

= US$ 12.5 million × ₹ 45 x 11% = ₹ 61.875 million

(d) Difference between interest on local currency borrowing and foreign currency borrowing
= ₹ 61.875 million - ₹ 30 million = ₹ 31.875 million.

Therefore, out of ₹ 37.5 million increase in the liability towards principal amount, only ₹ 31.875 million will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 61.875 million being the aggregate of interest of ₹ 30 million on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 31.875 million.

Hence, ₹ 61.875 million would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 5.625 million (37.5 - 31.875) would be considered as the exchange difference to be accounted for as per AS 11.

Question 66

X Limited began construction of a new plant on 1st April 2016 and obtained a special loan of ₹ 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 per cent per annum.

The expenditure that was made on the project of plant construction was as follows:

	₹
1-4-2016	*10,00,000*
1-8-2016	*24,00,000*
1-1-2017	*4,00,000*

The Company's other outstanding non-specific loan was ₹ 46,00,000 at an interest of 12 percent per annum.

The construction of the plant was completed on 31-3-2017. You are required to calculate the amount of interest to be capitalized as per the provision of AS 16 of the borrowing cost (including cost).

Answer

(i) Computation of average accumulated expenses

		₹
₹ 10,00,000 x 12 / 12	=	10,00,000
₹ 24,00,000 x 8 / 12	=	16,00,000
₹ 4,00,000 x 3 / 12	=	1,00,000
		27,00,000

(ii) Non-specific Borrowings

Non-specific Borrowings= Average accumulated capital expenses – Specific borrowings

= ₹ 27,00,000 – ₹ 8,00,000 = ₹ 19,00,000

(ii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 8,00,000 x 10%)	=	80,000
Non-specific borrowings (₹ 19,00,000 × 12%)	=	2,28,000
Amount of interest to be capitalized	=	3,08,000

(iii) Total expenses to be capitalized for Plant

	₹
Cost of plant ₹ (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalised	3,08,000
Total cost of plant	41,08,000

Question 67

Growth Ltd. has undertaken a project for expansion of capacity as per the following details:

	Plan (₹)	*Actual (₹)*
October, 2015	*5,00,000*	*4,00,000*
November, 2015	*6,50,000*	*7,95,000*
December, 2015	*20,00,000*	*-*
January, 2016	*2,00,000*	*50,000*
February, 2016	*9,00,000*	*2,00,000*
March, 2016	*10,00,000*	*12,00,000*

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had ₹ 20 lakhs overdraft up to 31st December, surplus cash in January and again overdraft of ₹ 14 lakhs from 1.2.2016 and ₹ 30 lakhs from 1.3.2016. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month.

Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

Answer

Growth Ltd.

Month	*Actual Expenditure (₹)*	*Interest capitalized (₹)*	*Cumulative amount (₹)*
October, 2015	4,00,000	5,000	4,05,000
Nov., 2015	7,95,000	15,000	12,15,000
Dec., 2015	-	15,188	12,30,188
January, 2016	50,000	-	12,80,188
February,2016	2,00,000	17,500	14,97,688
March, 2016	12,00,000	33,721	27,31,409
	26,45,000	86,409	

Note:

1. As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
2. During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.
3. During February, actual overdraft (borrowings) was ₹ 14 lakhs only. Hence, interest of ₹ 17,500 on ₹ 14,00,000 has been calculated even though actual expenditure on project exceed ₹ 14 lakhs.

Question 68

Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several years but Phase I and Phase II of the building will be started as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(₹ in lakhs)

	Phase I	*Phase II*	*Phase III*	*Phase IV*
	₹	*₹*	*₹*	*₹*
Cash expenditure	*10*	*30*	*25*	*30*
Building purchased	*24*	*34*	*30*	*38*
Total expenditure	*34*	*64*	*55*	*68*
Total expenditure of all phases				*221*
Loan taken @ 15% at the beginning of the year				*200*

During the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Answer

	Particulars	₹
1.	Interest expense on loan ₹ 2,00,00,000 at 15%	30,00,000
2	Total cost of Phases I and II (₹ 34,00,000 +64,00,000)	98,00,000
3.	Total cost of Phases III and IV (₹ 55,00,000 + ₹ 68,00,000)	1,23,00,000
4.	Total cost of all 4 phases	2,21,00,000
5.	Total loan	2,00,00,000
6.	Interest on loan used for Phases I & II, based on proportionate Loan amount = $\frac{30,00,000}{2,21,00,000} \times 98,00,000$	13,30,317 (approx.)
7.	Interest on loan used for Phases III & IV, based on proportionate Loan amount= $\frac{30,00,000}{2,21,00,000} \times 1,23,00,000$	16,69,683 (approx.)

Accounting treatment:

1. **For Phase I and Phase II**

   Since Phase I and Phase II have become operational during the year (assumed as mid of the year), half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ₹ 6,65,158.50 (i.e. ₹ 13,30,317/2) relating to Phase I and Phase II should be expensed off during the year.

2. **For Phase III and Phase IV**

   Interest of ₹ 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Accounting Standard 17

Question 69

The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

₹ in lakhs

Particulars	*M*	*N*	*O*	*P*	*Q*	*R*	*Total*
Segment Assets	*40*	*80*	*30*	*20*	*20*	*10*	*200*

Segment Results	*50*	*(190)*	*10*	*10*	*(10)*	*30*	*(100)*
Segment Revenue	*300*	*620*	*80*	*60*	*80*	*60*	*1,200*

The Chief accountant is of the opinion that segments “M” and “N” alone should be reported. Is he justified in his view? Discuss.

Answer

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 is 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.

Question 70

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

Answer

AS 17 ‘Segment Reporting’ requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 71

XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crores. Segment X has ₹ 2.00 crores, segment Y has ₹ 3.00 crores and segment Z has ₹ 5.00 crores. Deferred tax assets included in the assets of each segments are X- ₹ 0.50 crores, Y— ₹ 0.40 crores and Z— ₹ 0.30 crores. The accountant contends that all the three segments are reportable segments. Comment.

Answer

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

Accounting Standard 18

Question 72

Who are related parties under AS 18? What are the related party disclosure requirements?

Answer

Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

Question 73

P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

Answer

P Ltd. has direct economic interest in R Ltd to the extent of 14%, and through Q Ltd. in which it is the majority shareholders, it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.

Para 10 of AS 18 'Related Party Disclosures', defines *related party* as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Here, Control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and *Significant Influence* is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

In the present case, control of P Ltd. in R Ltd. directly and through Q Ltd., does not go beyond 26%. However, as per para 12 of AS 18, significant influence may be exercised as an investing party (P Ltd.) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd. As R Ltd. is a listed company and regularly supplies goods to P Ltd. therefore, related party disclosure, as per AS 18, is required.

Accounting Standard 19

Question 74

Distinguish between operating lease and finance lease.

Answer

Basis of Classification: Leases are classified based on the extent to which risks and rewards incident to ownership of a leased asset lie with the Lessor or the Lessee.

- Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.
- Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

As per AS 19 "Accounting for Lease", Lease may be of two types: a) Finance Lease b) Operating Lease.

Finance Lease is a lease which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

Operating lease is a lease which does not transfers substantially all the risks and rewards incidental to ownership. To be precise, it is a lease other than “Financial Lease”.

Question 75

AS Ltd. leased a machine to SB Ltd. on the following terms:

	(₹ in lakhs)
Fair value of the machine	*4.00*
Lease term	*5 years*
Lease Rental Per annum	*1.00*
Guaranteed Residual value	*0.20*
Expected Residual value	*0.40*
Internal Rate of Return	*15%*

Depreciation is provided on straight line method at 10 per cent per annum. Ascertain Unearned Financial Income. Necessary Journal entries in the books of the Lessee in first year may be shown.

Answer

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)

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

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

Year	*M.L.P. inclusive of URV ₹*	*Internal rate of return (Discount factor @ 15%)*	*Present Value ₹*
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) = ₹ 5,40,000 – ₹ 3,55,108 = ₹ 1,84,892

Journal Entries in the books of SB Ltd.

		₹	₹
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 ₹ 48,225 and finance charge of ₹ 51,775)		

* 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 ₹ 4,00,000 is more than the present value amounting ₹ 3,45,164, the machinery has been recorded at ₹ 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 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)		

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)* ₹
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[•]

Question 76

Suraj Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advise.

[£] Depreciation has been provided on the basis that the machine has been leased at the beginning of the year.

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

Answer

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:

Annuity Factor (Year 1 to Year 5)	3.36 (approx.)
Present Value of minimum lease payments (₹ 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.

Question 77

S. Square Private Limited has taken machinery on lease from S.K. Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000

Lease rent = ₹ 6,25,000 p.a. at the end of year

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Calculate the value of the lease liability as per AS 19.

Answer

According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the

• In calculating the present value of the of minimum lease payments, the discount rate is the interest rate implicit in the lease.

lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	*Minimum Lease Payment* ₹	*Internal rate of return (Discount rate @5%)*	*Present value* ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

Present value of minimum lease payments ₹ 18,55,850 is less than fair value at the inception of lease i.e. ₹ 20,00,000, therefore, the lease liability should be recognized at ₹ 18,55,850 as per AS 19.

Question 78

On 1st January, 2016, Santa Ltd. sold equipment for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for ten years term. The economic life of the asset is estimated as 10 years. The minimum lease rents payable by the lessee has been fixed at ₹ 1,00,000 payable annually beginning from 31st December, 2016. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% p.a. Calculate the net effect on the Statement of profit and loss in the books of Santa Ltd.

Answer

Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Santa Ltd.)

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is ₹ 6,14,400 [₹ 1,00,000 x 6.144 (Annuity factor of ₹ 1 @10% for 10 years)] and amounts to at least substantially all of the fair value (sale price i.e. ₹ 6,14,460) of the leased equipment. Thus lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of ₹ 5,14,460 (Sale value ₹ 6,14,460 less carrying amount ₹ 1,00,000) will not be

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* *Minimum Lease Payment of 4th year includes guaranteed residual value amounting ₹ 1,25,000.*

recognized as income in the year of sale in the books of lessee i.e. Santa Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that depreciation is charged on straight line basis, Santa Ltd. will recognize depreciation of ₹ 61,446 per annum for 10 years (₹ 6,14,460/ 10) and amortise profit of ₹ 5,14,460 over the lease term of 10 years, i.e. ₹ 51,446 p.a. The net effect is a debit of (₹ 61,446 - ₹ 51,446) ₹ 10,000 p.a. to the Statement of profit and loss, for 10 years as covered under the lease term.

Note: Had there been no sale and lease back transaction, the Statement of profit and loss for each year (covered in the lease term) would have been charged by (₹ 1,00,000/10) ₹ 10,000, towards depreciation. Thus, the sale and lease back transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.

Accounting Standard 20

Question 79

Mohur Ltd. has equity capital of ₹ 40,00,000 consisting of fully paid equity shares of ₹ 10 each. The net profit for the year 2016-2017 was ₹ 60,00,000. It has also issued 36,000, 10% convertible debentures of ₹ 50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings.

Answer

Interest on Debentures @ 10% for the year		$36{,}000 \times ₹\ 50 \times \frac{10}{100}$
	=	₹ 1,80,000
Tax on interest @ 30%	=	₹ 54,000
Diluted Earnings (Adjusted net profit)	=	(₹ 60,00,000 + ₹ 1,80,000 - ₹ 54,000)
	=	₹ 61,26,000

Question 80

From the following information of Beta Ltd. calculate Earnings Per Share (EPS) in accordance with AS 20:

		(₹) Year 31.3.17	(₹) Year 31.3.16
1.	*Net profit before tax*	*3,00,000*	*1,00,000*
2.	*Less: Current tax*	*(40,000)*	*(30,000)*
	Tax relating to earlier years	*(24,000)*	*13,000*
	Deferred tax	*(30,000)*	*(10,000)*

3.	*Profit after tax*	*2,06,000*	*73,000*
4.	*Other information:*		
	(a) Profit includes compensation from Central Government towards loss on account of earthquake in 2014 (non-taxable)	*1,00,000*	*NIL*
	(b) Outstanding convertible 6% Preference shares 1,000 issued and paid on 30.9.2015. Face value ₹ 100, conversion ratio 15 equity shares for every preference share.		
	(c) 15% convertible debentures of ₹ 1,000 each total face value ₹ 1,00,000 to be converted into 10 Equity shares per debenture issued and paid on 30.6.2015.		
	(d) Total number of equity shares outstanding as on 31.3.2017, 20,000 including 10,000 bonus shares issued on 1.1.2017, face value ₹ 100.		

Answer

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

			₹ *Year ended 31.3.17*	₹ *Year ended 31.3.16*
1.	A	Earning after extra ordinary items for equity shareholders (₹ 2,06,000 – ₹ 6,000) (₹ 73,000 – ₹ 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.	Earnings 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			
	₹ 40,000 + ₹ 30,000 / ₹ 2,00,000×100		35%	
	₹ 30,000 + ₹ 10,000 / ₹ 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)

* Since the bonus issue is without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2016.

4.	Convertible Debentures		
	A. Increase in earnings		
	$(1,00,000 \times \frac{15}{100} \times .65)$	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)

It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

Calculation of Diluted EPS		*Year ended 31.3.17 (₹)*	*Year ended 31.3.16 (₹)*
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

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

Earnings per share (Face value ₹ 100)	*31.3.17 (₹)*	*31.3.16 (₹)*
Basic EPS from continuing ordinary operations	5.00	3.50
Diluted EPS from continuing ordinary operations	3.02	2.65

Question 81

From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2016 to 31-03-2017 and adjusted EPS for the year 01-04-2015 to 31-03-2016.

Net profit for the year ended 31-03-2016	*₹ 75,50,000*
Net profit for the year ended 31-03-2017	*₹ 1,00,25,000*

No. of equity shares as on 01-04-2016	*50,00,250*
Bonus issue on 01-01-2017	*1 share for every 2 held*
No. of 12% Convertible Debentures of ₹ 100 each issued on 01-01-2017	*1,00,000*
Conversion ratio of Debentures	*10 shares per debenture*
Tax rate	*30 percent*

Answer

No. of bonus shares issued as on 1.1.2017

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 2016-2017 =

$$\frac{\text{Net profit for the year ended 31.3.2017}}{\text{Weighted average number of equity share as on 31.3.2017}}$$

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

Adjusted earnings per share for the year 2015-2016 = $\frac{₹\ 75,50,000}{(50,00,250+25,00,125+5,00,000)}$

= ₹ 0.94

For Diluted EPS

Interest expense for the current year = ₹ 12,00,000

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

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

= ₹ 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 = ₹ 1.24

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 2015-2016, the earliest period reported.

Question 82

The directors of Aqua Limited are considering the acquisition of an existing company Bose Limited engaged in a line of business suited to them. The financial data at the time of acquisition being:

	Aqua Ltd.	*Bose Ltd.*
Net profit after tax	*₹ 36,00,000*	*₹ 7,20,000*
Number of shares	*7,20,000*	*3,00,000*
Market price per share	*₹ 150*	*₹ 50*
Earnings per share	*₹ 5*	*₹ 2.50*
Price earnings ratio	*30*	*20*

It is expected that the net profit after tax of the two companies would continue to be ₹ 43,20,000. Aqua Limited would pay the amount in the form of shares of Aqua Limited.

Explain the effect on EPS of the merged company if Aqua Limited offers to pay ₹ 60 per share to the shareholders of Bose Limited.

Answer

In the given case, Aqua Ltd. offers to pay ₹ 60 per share to Bose Ltd.

The share exchange ratio would be $\frac{60}{150} = 0.4$

It means, Aqua Ltd. would give 0.4 share for every one share of Bose Ltd. In other words, Aqua Ltd. would give 2 shares for 5 shares of Bose Ltd.

The total number of shares to be issued by Aqua Ltd. to Bose Ltd.

= 3,00,000$\times$ 0.4 = 1,20,000 shares

Total number of shares of Aqua Ltd. after acquisition of Bose Ltd.

= 7,20,000 + 1,20,000 = 8,40,000 shares

Calculation of E.P.S. of the amalgamated company = $\frac{\text{Total Net Profit after Interest and Tax}}{\text{Total Number of shares}}$

= 43,20,000 / 8,40,000 = ₹ 5.14 per share

After amalgamation, the EPS of Aqua Ltd., will improve from ₹ 5 to ₹ 5.14.

Note: Earnings per share of Bose Ltd., i.e. ₹ 2.50 per share as given in the question, does not tally with the calculation i.e. 7,20,000 / 3,00,000 = ₹ 2.40 per share. However, the above solution has been given on the basis of EPS of Bose Ltd. as given in the question.

Accounting Standard 21

Question 83

A Ltd. had acquired 80% shares in the B Ltd. for ₹ 15 lakhs. The net assets of B Ltd. on that day are ₹ 22 lakhs. During the year, A Ltd. sold the investment for ₹ 30 lakhs and net assets of B Ltd. on the date of disposal was ₹ 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

Answer

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	₹
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd. (W.N.1)	(28,00,000)
	2,00,000
Add: Capital Reserve at the time of acquisition of shares in B Ltd. (W.N.2)	2,60,000
Profit on sale of investment	4,60,000

Working Notes:

1. A Ltd.'s share in net assets of B Ltd.

	₹
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ₹ 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

2. Capital Reserve at time of acquisition of shares in B Ltd.

	₹
A Ltd.'s share in the net assets of B Ltd. on the date of acquisition (80% of ₹ 22 lakhs)	17,60,000
Less: Cost of investment	(15,00,000)
Capital Reserve at time of acquisition of shares in B Ltd.	2,60,000

Question 84

Ram Ltd. holds 80% share in Shyam Ltd., its subsidiary. Share capital of Shyam Ltd. is ₹ 25,00,000 and reserves being ₹ 5,00,000 on the date of acquisition 31.3.2012.

Following is the results of Shyam Ltd.:

Year ended	*Profit/(Loss)*	*Net worth (₹ in lakhs)*
31.3.2013	*(15,00,000)*	*+15.00*
31.3.2014	*(20,00,000)*	*(5.00)*
31.3.2015	*4,00,000*	*(1.00)*
31.3.2016	*5,00,000*	*+4.00*

Calculate minority interest for the period from 2011-2012 to 2015-2016 as per AS 21.

Answer

As per AS 21 "Consolidated Financial Statements", the losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	*Details*	*Minority Interest (MI) (20%)*	*Minority's Share of losses borne by Ram Ltd.*
			Balance
Minority Interest at the time of acquisition i.e. on 31.3.2012		6,00,000 (W.N.)	
2012-13	(15,00,000 x 20%)	(3,00,000)	
on 31.3.2013		3,00,000	
2013-14	(20,00,000 x 20%)	(4,00,000)	
		(1,00,000)	
	Loss amounting ₹ 1,00,000 of minority borne by majority shareholders on application of AS 21	1,00,000	1,00,000
on 31.3.2014		Nil	
2014-15	(4,00,000 x 20%)	80,000	

	On application of AS 21, profit transferred to majority shareholders	<u>(80,000)</u>	(80,000)
on 31.3.2015		<u>Nil</u>	20,000
2015-16	(5,00,000 x 20%)	1,00,000	
	On application of AS 21, profit transferred to majority shareholders to the extent earlier loss was borne by majority share holders	<u>(20,000)</u>	(20,000)
on 31.3.2016		<u>80,000</u>	Nil

Working Note:

Calculation of Minority Interest as on 31.3.2012

	Total Amount (100%) (₹)	*Minority Interest (20%) (₹)*
Share Capital (20%)	25,00,000	5,00,000
Add: Share in Reserves (20%)	5,00,000	<u>1,00,000</u>
		<u>6,00,000</u>

Accounting Standard 22

Question 85

Write short note on Timing differences and Permanent differences as per AS 22.

Answer

In current practices, companies, in general, prepare books of accounts as per Companies Act, generating Accounting Profit/Loss and Income Tax Act, generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same.

Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.

Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Sales Tax, Bonus etc., U/s 43B.

Question 86

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2014-2015, 2015-2016 and 2016-2017 for ₹ 11,00,000, ₹ 16,00,000 *and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 2014-2015, 2015-2016 and 2016-2017 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2014-2015, 2015-2016 and 2016-2017.*

Answer

Omega Limited.

Calculation of Deferred Tax Asset/Liability

Year	*Accounting Income*	*Taxable Income*	*Timing Difference (balance)*	*Deferred Tax Liability (balance)*
2014-2015	11,00,000	7,00,000	4,00,000	1,40,000
2015-2016	16,00,000	18,00,000	2,00,000	70,000
2016-2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

Question 87

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹ 200 lakhs and ₹ 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Answer

As per para 13 of Accounting Standard (AS) 22, Accounting for Taxes on Income", deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income-tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of ₹ 200 lakhs depreciation, timing difference amounting ₹ 80 lakhs (₹ 1 0 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for ₹ 120 lakhs (₹ 200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for ₹ 48 lakhs (40% of ₹ 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting ₹ 160 lakhs (40% of ₹ 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 208 lakhs (48 lakhs + 160 lakhs).

Question 88

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	*= 2,00,000*
Depreciation as per income tax records	*= 5,00,000*
Unamortized preliminary expenses as per tax record	*= 30,000*

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment? Tax rate 50%.

Answer

Table showing calculation of deferred tax asset / liability

Particulars	*Amount*	*Timing differences*	*Deferred tax*	*Amount @ 50%*
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

Question 89

Acute Ltd. is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is ₹ 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets at ₹ 555 lakhs. The value of the block of assets as per the Income tax Records is ₹ 777 lakhs. The Approving Authority of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91%.

Answer

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

	₹ in lakhs
Depreciation as per Accounting books for the current year $\frac{999}{(1-.1391)}\times.1391$	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1-.15)}\times.15$	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

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.

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

Accounting Standard 23

Question 90

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2016 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.2016 is given below:

	₹
Share Capital	*5,00,000*
Reserves and Surplus	*5,00,000*
	10,00,000
Fixed Assets	*5,00,000*
Investments	*2,00,000*
Current Assets	*3,00,000*
	10,00,000

During the year ended 31.3.2017 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.2016 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2017.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.2017 on 30.4.2017.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Answer

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill (*₹ in lakhs)*

Cost of investment	3.00
Less: Share in the value of Equity of BLtd.	
as at the date of investment	
[25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs)]	(2.50)
Goodwill	0.50

(ii) **A Ltd.**

Consolidated Profit and Loss Account

for the year ended 31st March, 2017 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd.		1.75
Dividend received from B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) **A Ltd.**

Consolidated Balance Sheet as on 31.3.2017 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd.		
Share in B Ltd.'s Equity	2.50	
Less: Dividend received	(0.50)	
	2.00	
Share of profit for year 2016 – 2017	1.75	
	3.75	
Add: Goodwill	0.50	4.25

Working Notes:

1. Dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd. However goodwill will not change.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 2017. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 2017 will not be recognized in the consolidated financial statements of A Ltd.

Question 91

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-2016. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-2016 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-2016. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-2017 and declared dividends of ₹ 60,000 on 12-06-2017.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-2017;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-2017;

(iii) What will be the carrying amount as on 30-06-2017 in consolidated financial statements?

Answer

(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.2017

	₹
Amount paid for investment in Associate (on 1.06.2016)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.2017 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements* of Bright Ltd. as on 31.3.2017 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of profit of investee as per equity method (30% of ₹ 3,00,000)	90,000
Carrying amount as on 31.3.2017	2,75,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.2017 as per AS 23

	₹
Carrying amount as on 31.3.2017	2,75,000
Less: Dividend received (₹ 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.2017	2,57,000

Accounting Standard 24

Question 92

(i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

(ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

*It is assumed that Bright Ltd. has a subsidiary company and it is preparing Consolidated Financial Statements.

Answer

(i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;

(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

(ii) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Accounting Standard 25

Question 93

In view of the provisions of Accounting Standard 25 on Interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees?

Answer

Accounting Standard 25 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Question 94

On 30.6.2016, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal of a business segment. Also, on 30.7.2016, the company paid ₹ 60,000 for property taxes assessed for the calendar year 2016. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30.9.2016.

Answer

According to Para 10 of AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2016, As mitha Ltd., would report the entire ₹ 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since ₹ 60,000 Property Tax payment relates to entire calendar year 2016, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 2016 while out of the remaining ₹ 30,000, ₹ 15,000for January, 2016 to March, 2016 should be shown as payment of the outstanding amount of previous year and another ₹ 15,000 related to quarter October, 2016 to December, 2016 would be reported as prepaid expenses.

Question 95

An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 3,00,000.

Calculate the tax expense to be recognized in each quarter.

Answer

As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

		₹
Estimated Annual Income	(A)	10,00,000
Tax expense:		
30% on ₹ 5,00,000		1,50,000
40% on remaining ₹ 5,00,000		2,00,000
	(B)	3,50,000

Weighted average annual income tax rate = $\frac{B}{A} = \frac{3,50,000}{10,00,000}$ = 35%

Tax expense to be recognised in each of the quarterly reports	₹
Quarter I - ₹ 75,000 x 35%	26,250
Quarter II - ₹ 2,50,000 x 35%	87,500
Quarter III - ₹ 3,75,000 x 35%	1,31,250
Quarter IV - ₹ 3,00,000 x 35%	1,05,000
₹ 10,00,000	3,50,000

Question 96

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-2016. On enquiry you observe the following. Give the treatment required under AS 25:

(i) *Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.*

(ii) *80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.*

(iii) *In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹ 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.*

(iv) *₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.*

(v) *Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.*

(vi) *Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.*

Prepare the adjusted profit before tax for the third quarter.

Answer

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

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

Accounting Standard 26

Question 97

The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 2016-2017, but proved to be a failure.

State, how you will deal with this amount in the accounts of U Ltd. for the year ended 31st March, 2017 with reference to Accounting Standards:

Answer

In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to paras 41 to 43 of AS 26 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

Question 98

A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

Answer

According to paras 55 and 56 of AS 26 'Intangible Assets', expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

In the given case, advertisement expenditure of ₹ 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crores to the Profit and Loss account of the year is correct.

Question 99

U.K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2016, the total expenditure incurred was ₹ 50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2015. Expenditure incurred till this date was ₹ 22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2017 was ₹ 80 lakhs. As at 31st March, 2017, the recoverable amount of know-how embodied in the process is estimated to be ₹ 72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2016 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2017.

Ignore depreciation.

Answer

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2016

(1) Carrying value of intangible as on 31.03.2016:

At the end of financial year 31st March 2016, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹ 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st December 2015).

(2) Expenditure to be charged to Profit and Loss account:

The ₹ 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2016. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2017

(1) Expenditure to be charged to Profit and Loss account:

	(₹ in lakhs)
Carrying Amount as on 31.03.2016	28
Expenditure during 2016 – 2017	80
Total book cost	108
Recoverable Amount	(72)
Impairment loss	36

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2017.

(2) Carrying value of intangible as on 31.03.2017:

	(₹ in lakhs)
Total Book Cost	108
Less: Impairment loss	(36)
Carrying amount as on 31.03.2017	72

Accounting Standard 27

Question 100

What are the different forms of joint ventures? Elucidate the presentation and disclosure norms of Joint Ventures under AS 27.

Answer

Joint ventures take many different forms and structures. This Standard identifies three broad types – jointly controlled operations, jointly controlled assets and jointly controlled entities – which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control.

A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

(a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

(b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and

(c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

(a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and

(b) its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.

A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

Accounting Standard 28

Question 101

Write short notes on impairment of asset and its application to inventory.

Answer

The objective of AS 28 'Impairment of Assets' is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognize an impairment loss.

- If carrying amount < = Recoverable amount : **Asset is not impaired**
- If carrying amount > Recoverable amount : **Asset is impaired**

Impairment Loss = Carrying Amount – Recoverable Amount

Recoverable amount is the higher of net selling price and its value in use

This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

Question 102

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.2017 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

(i) Calculate impairment loss.

(ii) Prepare journal entries for adjustment of impairment loss.

(iii) Show, how impairment loss will be shown in the Balance Sheet.

Answer

(i) Recoverable amount is higher of value in use ₹ 400 lakhs and net selling price ₹ 375 lakhs.

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= ₹ 500 lakhs – ₹ 400 lakhs = ₹ 100 lakhs.

(ii) **Journal Entries**

	Particulars	*Dr. Amount (₹ in lakhs)*	*Cr. Amount (₹ in lakhs)*
(i)	Impairment loss account Dr. To Asset (Being the entry for accounting impairment loss)	100	 100

(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairment loss to profit and loss account)		

(iii) Balance Sheet of Venus Ltd. as on 31.3.2017

	(₹ in lakhs)
Fixed Asset	
Asset less depreciation	500
Less: Impairment loss	(100)
	400

Question 103

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2016 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2016-2017 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

Answer

As per provisions of Para 91(b) of AS 28 “Impairment of Assets”, impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Question 104

From the following details of an asset

(i) Find out impairment loss

(ii) Treatment of impairment loss

(iii) Current year depreciation

Particulars of asset:

Cost of asset	*₹ 56 lakhs*
Useful life period	*10 years*

Salvage value	*Nil*
Current carrying value	*₹ 27.30 lakhs*
Useful life remaining	*3 years*
Recoverable amount	*₹ 12 lakhs*
Upward revaluation done in last year	*₹ 14 lakhs*

Answer

According to AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	₹
Current carrying amount (including revaluation amount of ₹ 14 lakhs)	27,30,000
Less: Current recoverable amount	(12,00,000)
Impairment Loss	15,30,000
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

After the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

In the given case, the carrying amount of the asset will be reduced to ₹ 12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be ₹ 4,00,000.

Question 105

An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for?

Answer

As per AS 28 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where, recoverable amount is the higher of an asset's net selling price* and its value in use•. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (₹ 70,000)]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per para 58 of AS 28.

Question 106

G Ltd., acquired a machine on 1st April, 2010 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2014, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2016, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Answer

Statement Showing Impairment Loss

	(₹ in crores)
Carrying amount of the machine as on 1st April 2010	7.00
Depreciation for 4 years i.e. 2010-2011 to 2013-2014 $\left[\frac{7\text{crores}}{7\text{years}} \times 4\text{years}\right]$	(4.00)
Carrying amount as on 31.03.2014	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April 2014 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2014-2015 & 2015-2016 $\left[\frac{5.10\text{ crores}}{3\text{ years}} \times 2\text{ years}\right]$	(3.40)
Carrying amount as on 31.03.2016	1.70
Less: Recoverable amount	(0.79)

**Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – ₹ 70,000 = (₹ 70,000)*

•Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.

Impairment loss		0.91
Less: Balance in revaluation reserve as on 31.03.2016:		
Balance in revaluation reserve as on 31.03.2014	2.10	
Less: Enhanced depreciation met from revaluation reserve		
2014-2015 & 2015-2016 =[(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

Question 107

X Ltd. purchased a fixed asset four years ago for ₹ 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is ₹ 67.50 lakhs and expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at ₹ 60 lakhs?

Answer

Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is ₹ 64.50 lakhs (₹ 67.50 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs. Therefore, recoverable amount will be ₹ 64.50 lakhs. Impairment loss will be calculated as ₹ 10.50 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of ₹ 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the fixed asset at the end of the fourth year on revaluation

	(₹ in lakhs)
Purchase price of a fixed asset	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Accounting Standard 29

Question 108

Mini Ltd. took a factory premises on lease on 1.4.2016 for ₹ 2,00,000 per month. The lease is operating lease. During March, 2017, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2019.The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2019 should be provided in the accounts for the year ending 31.3.2017. Mini Ltd. seeks your advice.

Answer

In accordance with explanation to para 1(b) of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous* as the economic benefit of lease contract for next 33 months up to 31.12.2019 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of ₹ 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Therefore, provision on account of ₹ 66,00,000 is to be provided in the accounts for the year ending 31.03.2017. Hence auditor is right.

Question 109

EXOX Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2016. The company seeks your advice on the following:

(i) The Company's sales tax assessment for assessment year 2013-2014 has been completed on 14th February, 2016 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(ii) The Company has entered into a wage agreement in May, 2016 whereby the labour union has accepted a revision in wage from June, 2015.The agreement provided that the hike till May, 2016 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2016.

Answer

(i) Since the company is not appealing against the addition of ₹ 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2016. The amount paid

* For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of ₹ 2.10 crore.

(ii) The arrears for the period from June, 2015 to March, 2016 are required to be provided for in the accounts of the company for the year ended on 31st March, 2016 assuming that the negotiation for revision in wages initiated in the year 2015-2016.

Question 110

Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

Answer

(i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise 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 ₹ 1.5 crores as per AS 29.

(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, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.

Question 111

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 2017, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

Answer

As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

Question 112

Vishnu Company has at its financial year ended 31st March, 2017, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors. The directors have estimated the possible outcomes as below:

Result	*Probability*	*Amount of loss*
For first ten cases:		
Win	*0.6*	
Loss-low damages	*0.3*	*90,000*
Loss-high damages	*0.1*	*1,60,000*
For remaining five cases:		
Win	*0.5*	
Loss-low damages	*0.3*	*60,000*
Loss-high damages	*0.2*	*95,000*

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

Answer

In the given case, the probability of winning first 10 cases is 60% and for remaining five cases is 50%. In other words, probability of losing 10 cases and 5 cases is 40% and 50% respectively. According to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where it is not probable that a present obligation exists, an enterprise discloses a contingent liability. Since in the given case, chances of winning the case is more and losing the case is less, no provision will be recognized. In fact, it is a contingent loss / liability.

The amount of contingent loss may be calculated as under:

Expected contingent loss in first ten cases= [₹ 90,000 x 0.3 + ₹ 1,60,000 x 0.1] x 10 cases

= [₹ 27,000 + ₹ 16,000] x 10 cases

= ₹ 43,000 x 10 cases = ₹ 4,30,000

Expected contingent loss in remaining five cases = [₹ 60,000 x 0.3 + ₹ 95,000 x 0.2] x 5 cases

= [₹ 18,000 + ₹ 19,000] x 5 cases

= ₹ 37,000 x 5 cases = ₹ 1,85,000

Total contingent liability = ₹ 4,30,000 + ₹ 1,85,000

= ₹ 6,15,000.

An enterprise should recognise a contingent liability. For each class of contingent loss / liability at the balance sheet date, an enterprise should disclose, by way of a note, a brief description of the nature of the contingent liability.

Exercise

Question 1

Briefly indicate the items, which are included in the expression "borrowing cost" as explained in AS 16.

Question 2

A company obtained term loan during the year ended 31st March, 2016 to the extent of ₹ 650 lakhs for modernisation and development of its factory. Buildings worth ₹ 120 lakhs were completed and Plant and Machinery worth ₹ 350 lakhs were installed by 31st March, 2016. A sum of ₹ 70 lakhs has been advanced for Assets the installation of which is expected in the following year. ₹ 110 lakhs has been utilised for Working Capital requirements. Interest paid on the loan of ₹ 650 lakhs during the year 2016-2017 amounted to ₹ 58.50 lakhs. How should the interest amount be treated in the Accounts of the Company?

[Answer: Interest to be capitalized ₹ 48.6 lakhs, Interest to be charged to profit and loss account ₹ 9.9 lakhs]

Question 3

A Limited Company finds that the inventory sheets as on 31.3.2016 had included twice an item the cost of which was ₹ 20,000. You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31.3.2017.

[Answer: ₹ 20,000 should be deducted from opening inventory and ₹ 20,000 should be charged as prior period adjustment in the profit and loss account for the year ended 31st March 2017 in accordance with AS 5 (Revised)]

Question 4

M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

	(₹ '000)
Division A	
Sales to B	*3,050*
Other Sales (Home)	*60*

Export Sales	*4,090*
	7,200
Division B	
Sales to C	*30*
Export Sales to Europe	*200*
	230
Division C	
Export Sales to America	*180*

Divisions

	Head Office ₹ ('000)	*A ₹ ('000)*	*B ₹ ('000)*	*C ₹ ('000)*
Operating Profit or Loss before tax		*160*	*20*	*(8)*
Re-allocated cost from Head Office		*48*	*24*	*24*
Interest cost		*4*	*5*	*1*
Fixed assets	*50*	*200*	*40*	*120*
Net current assets	*48*	*120*	*40*	*90*
Long-term liabilities	*38*	*20*	*10*	*120*

Prepare a Segmental Report for publication in M Ltd. Group.

Question 5

Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

		(₹ in lacs)	*(₹ in lacs)*
Net Profit			*60,000*
Add:	*Sale of Investments*	*70,000*	
	Depreciation on Assets	*11,000*	
	Issue of Preference Shares	*9,000*	
	Loan raised	*4,500*	
	Decrease in Inventory	*12,000*	*1,06,500*
			1,66,500
Less:	*Purchase of Fixed Assets*	*65,000*	
	Decrease in trade payables	*6,000*	
	Increase in Trade receivables	*8,000*	
	Exchange gain	*8,000*	
	Profit on sale of investments	*12,000*	
	Redemption of Debenture	*5,700*	
	Dividend paid	*1,400*	

	Interest paid	*945*	*(1,07,045)*
			59,455
Add:	*Opening cash and cash equivalent*		*12,341*
Closing cash and cash equivalent			*71,796*

[Answer: Net cash from operating activities ₹ 49,000 lakhs, Net cash from Investing activities ₹ 5,000 lakhs , Net cash from financing activities ₹ 5,455 lakhs]

Question 6

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of the machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. Guaranteed Residual Value (GRV) is ₹ 22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance charges) in each year.

[Answer: Value of machine will be taken as ₹ 6,99,054; Finance charges- year 1 ₹ 1,04,858, year 2 ₹ 75,587, year 3 ₹ 41,925]

Question 7

A Cosmetic articles producing company provides the following information:

	Cold Cream	*Vanishing Cream*
January, 2016 – September, 2016 per month	*2,00,000*	*2,00,000*
October, 2016 – December, 2016 per month	*1,00,000*	*3,00,000*
January, 2017- March, 2017 per month	*0*	*4,00,000*

The company has enforced a gradual change in product-line on the basis of an overall plan. The Approving Authority of the company has passed a resolution in March, 2017 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer.

[Answer: Change-over is not a discontinuing operation]