2
Accounting Standards

Question 1

(a) *On 20.4.2003 JLC Ltd. obtained a loan from the Bank for ₹ 50 lakhs to be utilised as under:*

	₹
Construction of a shed	*20 lakhs*
Purchase of machinery	*15 lakhs*
Working capital	*10 lakhs*
Advance for purchase of truck	*5 lakhs*

In March, 2004 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2004 was ₹ 9 lakhs. Show the treatment of interest under AS 16.

(b) *A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2003-2004.*

Subsequently on a review of the credit period allowed and financial capacity of the customers, the company decided to increase the provision to 8% on debtors as on 31.3.2004. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or prior period item?

(4 Marks each, November 2004)(PE-II)

Answer

(a) As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time (usually 12 months or more) to get ready for its intended use or sale. If an asset is ready for its intended use or sale at the time of its acquisition then it is not treated as a qualifying asst for the purposes of AS 16.

Treatment of interest as per AS 16

	Particulars	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
(1)	Construction of a shed	Qualifying asset	$\left(₹\ 9\,\text{lakhs} \times \frac{₹\ 20\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 3.60 lakhs	
(2)	Purchase of machinery	Not a qualifying asset*		$\left(₹\ 9\,\text{lakhs} \times \frac{₹\ 15\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 2.70 lakhs.
(3)	Working capital	Not qualifying asset		$\left(₹\ 9\,\text{lakhs} \times \frac{₹\ 10\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 1.80 lakhs
(4)	Advance for purchase of truck	Not a qualifying asset		$\left(₹\ 9\,\text{lakhs} \times \frac{₹\ 5\,\text{lakhs}}{₹\ 50\,\text{lakhs}}\right)$ = ₹ 0.90 lakhs
	Total		₹3.60 lakhs	₹ 5.40 lakhs

(b) The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2003-2004. Subsequently in 2004 they revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed.

* *On the basis that machinery is ready for its intended use at the time of its acquisition/purchase.*

Question 2

(a) *A major fire has damaged assets in a factory of X Co. Ltd. on 8.4.2004, 8 days after the year end closing of accounts. The loss is estimated to be ₹ 16 crores (after estimating the recoverable amount of ₹ 24 crores from the Insurance Company).*

If the company had no insurance cover, the loss due to fire would be ₹ 40 crores.

Explain, how the loss should be treated in the Final accounts of the year ended 31.3.2004.

(b) *A Company had deferred research and development cost of ₹ 150 lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (₹ in lakhs)*
I	*400*
II	*300*
III	*200*
IV	*100*

You are asked to suggest how should Research and Development cost be charged to Profit and Loss account.

If at the end of the III year, it is felt that no further benefit will accrue in the IV year, how the unamortised expenditure would be dealt with in the accounts of the Company?

(c) In April, 2004 a Limited Company issued 1,20,000 equity shares of ₹ 100 each. ₹ 50 per share was called up on that date which was paid by all shareholders. The remaining ₹ 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is ₹ 2,64,000 after dividend on preference shares and dividend distribution tax of ₹ 64,000.

Compute basic EPS for the year ended 31.3.2005 as per Accounting Standard 20.

(d) On 1.4.2001 ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of a machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2004 due to non-fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd.?

(4 $\times$ 4 = 16 Marks, May, 2005) (PE-II)

Answer

(a) The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.3.2004. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March, 2004. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the Balance Sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

(b) (i) Based on sales, research and development cost to be allocated as follows:

Year	*Research and Development cost allocation*
	(₹ in lakhs)
I	$\frac{400}{1,000} \times 150 = 60$
II	$\frac{300}{1,000} \times 150 = 45$
III	$\frac{200}{1,000} \times 150 = 30$
IV	$\frac{100}{1,000} \times 150 = 15$

(ii) If at the end of the III year, the circumstances do not justify that further benefit will accrue in IV year, then the company has to charge the unamortised amount i.e. remaining ₹ 45 lakhs [150 – (60 + 45)] as an expense immediately.

Note: As per para 41 of AS 26 on Intangible Assets, expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. It has been assumed in the above solution that the entire cost of ₹ 150 lakhs is development cost. Therefore, the expenditure has been deferred to the subsequent years on the basis of presumption that the company can demonstrate all the conditions specified in para 44 of AS 26. An intangible asset should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Hence the remaining unamortised amount of ₹ 45,00,000 has been written off as an expense at the end of third year.

(c) Basic earnings per share (EPS) = $\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$

$$= \frac{₹\ 2,64,000}{88,000 \text{ shares (as calculated in working note)}} = ₹3$$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	*Nominal value of shares*	*Amount paid*
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

Shares

$1,20,000 \times \frac{1}{2} \times \frac{5}{12} = 25,000$

$96,000 \times \frac{7}{12} = 56,000$

$24,000 \times \frac{1}{2} \times \frac{7}{12} = 7,000$

88,000 shares

(d) According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		₹ (in lakhs)
1st April, 2001	Acquisition cost of machinery (₹ 1,500 – 300)	1,200.00
31st March, 2002	*Less*: Depreciation @ 20%	240.00
	Book value	960.00
31st March, 2003	*Less*: Depreciation @ 20%	192.00
	Book value	768.00
31st March, 2004	*Less*: Depreciation @ 20%	153.60

1st April, 2004	Book value	614.40
May, 2004	*Add*: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting ₹ 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2005 and 31st March, 2006.

Alternative 2:

ABC Ltd. can also debit the refund amount of ₹ 300 lakhs in capital reserve of the company.

Question 3

(a) *ABC Ltd. could not recover ₹ 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.*

The debtor became bankrupt in April, 2005 and nothing is recoverable from him.

Do you advise the company to provide for the entire loss of ₹ 10 lakhs in the books of account for the year ended 31st March, 2005?

(b) *X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2004. The wage revision is with retrospective effect from 1.4.2000. The arrear wages upto 31.3.2004 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2004 to 30.06.2004 (being the date of agreement) amounts to ₹ 7 lakhs.*

Decide whether a separate disclosure of arrear wages is required.

(c) *An intangible asset appears in Balance Sheet of A Co. Ltd. at ₹ 16 lakhs as on 31.3.2004. The asset was acquired for ₹ 40 lakhs in April, 1991. The Company has been amortising the asset value on straight line basis. The policy is to amortise for 20 years.*

Do you advise the Company to amortise the entire asset value in the books of the company as on 31.3.2004?

(d) *How refund of revenue grant received from the Government is disclosed in the Financial Statements?* *(4×4 = 16 Marks, November 2005) (PE-II)*

Answer

(a) As per AS 4 ‘Contingencies and Events occurring after the Balance Sheet Date’, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of ₹ 10 lakhs according to para 8 of AS 4.

(b) It is given that revision of wages took place in June, 2004 with retrospective effect from 1.4.2000. The arrear wages payable for the period from 1.4.2000 to 30.6.2004 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 87 lakhs (from 1.4.2000 to 30.6.2004) should be included in current year's wages.

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),' Net Profit or loss for the Period, Prior Period Items and Changes in the Accounting Policies', 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.

However, wages payable for the current year (from 1.4.2004 to 30.6.2004) amounting ₹ 7 lakhs is not a prior period item, hence need not be disclosed separately. This may be shown as current year wages.

(c) AS 26 'Intangible Assets', came into effect for accounting periods commencing on or after 1.4.2003 and is mandatory in nature. Para 67 of the standard provides that if there is persuasive evidence that the life of the intangible asset is 20 years, then no adjustment is required at 1.4.2003. However, para 63 of the standard states that if it cannot be demonstrated that the life of the intangible asset is greater than 10 years, then AS 26 would require the asset to be amortised over not more than 10 years. Since, in the given case, the amortisation period determined by applying para 63 has already expired as on 1.4.2003, the carrying amount of ₹ 16 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1.4.2003.

(d) The amount refundable in respect of a grant related to revenue should be applied first against any unamortised 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 should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be 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 should be provided prospectively over the residual useful life of the asset.

Question 4

AB Ltd. launched a project for producing product X in October, 2004. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2006. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard. *(4 Marks, May 2006) (PE-II)*

Answer

As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting ₹ 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2006.

Question 5

(a) *What are the costs that are to be included in Research and Development costs as per AS 8.*

(b) *What are the conditions that are to be satisfied for 'Amalgamation in the nature of Merger'?*

(c) *X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at ₹ 10 lacs to another company for ₹ 15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.* *(4 Marks each, November 2006) (PE-II)*

Answer

(a) According to paras 41 and 43 of AS 26*, "No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- Costs of activities aimed at obtaining new knowledge;

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* *AS 8 stands withdrawn w.e.f. 1st April, 2003 i.e. the date from which AS 26 'Intangible Assets' becomes mandatory. Therefore, the above answer has been given as per AS 26.*

- Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- Costs of the search for alternatives for materials, devices, products, processes, systems or services; and
- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services."

According to paras 45 and 46 of AS 26, "In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- Costs of the design of tools, jigs, moulds and dies involving new technology;
- Costs of the design, construction ad operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

(b) As per AS 14 "Accounting for Amalgamations", amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

(c) According to para 13 of AS 4 "Contingences and Events occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In this case the sale of immovable property was carried out before the closure of the books of Accounts. This is clearly an event occurring after the balance sheet date. Agreement to sell was effected before the balance sheet date and the registration was done after the balance sheet date. So the adjustment for the sale of immovable property is necessary in the books of account for the year ended 31st March, 2006.

Question 6

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2007 was detected only in May, 2007. The accounts of the company were not yet approved by the Board of Directors of the company. Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.2007. Decide. (2 Marks, May, 2007) (PCC)

Answer

As per paragraph 13 of AS 4 (revised) 'Contingencies and Events occurring after the Balance Sheet Date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. If a fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 2007.

Question 7

How Government grant relating to specific fixed asset is treated in the books as per AS-12?

(4 Marks, May, 2007) (PCC)

Answer

In accordance with AS 12, government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.

Question 8

From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	₹ in crores
Profit before V.R.S. payments but after depreciation	*75.00*
Depreciation	*10.00*
VRS payments	*32.10*
Provision for taxation	*10.00*
Fringe benefit tax	*5.00*
Paid up share capital (shares of ₹10 each fully paid)	*93.00*

(4 Marks, November, 2007) (PCC)

Answer

		₹ in crores
Profit after depreciation but before VRS Payment		75.00
Less: Depreciation – No. adjustment required	-	
VRS payments	32.10	
Provision for taxation	10.00	
Fringe benefit tax	5.00	47.10
Net Profit		27.90
No. of shares		9.30 crores

$$\text{EPS} = \frac{\text{Net profit}}{\text{No. of shares}}$$

$$= \frac{27.90}{9.30}$$

= ₹3 per share.

Question 9

What is meant by accounting estimate? Give two examples for accounting estimate.

(2 Marks, November, 2007) (PCC)

Answer

As a result of the uncertainties in business activities, many financial statement items cannot be measured with precision but can only be estimated. These are called accounting estimates. Therefore, the management makes various estimates and assumptions of assets, liabilities, incomes and expenses as on the date of preparation of financial statements. This process of estimation involves judgments based on the latest information available.

Examples of estimation in some fields are:

(i) Estimation of useful life of depreciable assets.

(ii) Estimation of provision to be made for bad and doubtful debts.

Question 10

(i) How would you record a non-monetary grant received from the Government as per AS 12?

(ii) An industry borrowed ₹ 40,00,000 for purchase of machinery on 1.6.2007. Interest on loan is 9% per annum. The machinery was put to use from 1.1.2008. Pass journal entry for the year ended 31.3.2008 to record the borrowing cost of loan as per AS 16.

(2 Marks each, May, 2008) (PCC)

Answer

(i) According to para 7.1 of AS 12 'Accounting for Government Grants', Government grants may take the form of non-monetary assets such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary grants given free of cost are recorded at a nominal value.

(ii)

		₹
Interest upto 31.3.2008 (40,00,000 × 9% × $\frac{10}{12}$ months)	=	3,00,000
Less: Interest relating to pre-operative period 3,00,000 × $\frac{7}{10}$	=	2,10,000
Amount to be charged to P&L A/c	=	90,000
Pre-operative interest to be capitalized	=	2,10,000

Journal Entry

	₹	₹
Machinery A/c Dr.	2,10,000	
To Loan A/c		2,10,000
(Being interest on loan for pre-operative period capitalized)		
Interest on loan A/c Dr.	90,000	
To Loan A/c		90,000
(Being the interest on loan for the post-operative period)		
Profit and Loss A/c Dr.	90,000	
To Interest on loan A/c		90,000
(Being interest on loan transferred to P&L A/c)		

Question 11

When can an item qualify to be a prior period item as per AS 5? (4 Marks, May, 2008) (PCC)

Answer

According to para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', prior period items refers to those income or expenses, which arise in the current period as a result of errors or omissions in the preparation of 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 e.g., arrears payable to workers in current period as a result of revision of wages with retrospective effect.

Question 12

The company finds that the stock sheets of 31.3.2007 did not include two pages containing details of inventory worth ₹ 20 lakhs. State, how will you deal with this matter in the accounts of A Ltd., for the year ended 31st March, 2008 with reference to AS 5.

(2 Marks, November, 2008) (PCC)

Answer

As per para 16 of AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', omission of two pages containing details of inventory worth ₹20 lakhs in 31.3.2007 is a prior period item. As per para 19 of the standard, prior period items are normally included in the determination of net profit or loss for the current period. Accordingly, ₹20 lakhs must be added to opening stock of 1.4.2007. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

Question 13

	Exchange Rate per $
Goods purchased on 1.1.2007 of US $ 10,000	*₹ 45*
Exchange rate on 31.3.2007	*₹ 44*
Date of actual payment 7.7.2007	*₹ 43*

Ascertain the loss/gain for financial years 2006-07 and 2007-08, also give their treatment as per AS 11. (4 Marks, November, 2008) (PCC)

Answer

As per AS 11 on 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2007 and corresponding creditor would be recorded at ₹4,50,000 (i.e. $10,000 × ₹ 45)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US $10,000 on 31.3.2007 will be reported at ₹4,40,000 (i.e. $10,000 × ₹ 44) and exchange profit of ₹10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2006-07.

On 7.7.2007, trade payables of $10,000 is paid at the rate of ₹ 43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, ₹10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2007-08.

Question 14

Enumerate two points which the financial statements should disclose in respect of Borrowing Costs as per AS 16. *(2 Marks, June, 2009) (PCC)*

Answer

As per AS 16, the Financial Statements should disclose the following:

(a) The accounting policy adopted for borrowing costs and

(b) The amount of borrowing costs capitalized during the period.

Question 15

(a) Explain the provisions of AS -5 regarding accounting treatment of prior period items.

(b) From the following information relating to X Ltd., calculate Diluted Earnings Per Share as per AS 20:

Net Profit for the current year	*₹ 2,00,00,000*
Number of equity shares outstanding	*40,00,000*
Basic earnings per share	*₹ 5.00*
Number of 11% convertible debentures of ₹100 each	*50,000*
Each debenture is convertible into 8 equity shares.	
Interest expense for the current year	*₹ 5,50,000*
Tax saving relating to interest expense (30%)	*₹ 1,65,000*

(4 Marks each, June, 2009) (PCC)

Answer

(a) As per AS 5, prior period items are income or expenses, which arise, in the current period as a result of errors or omission in the preparation of 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. Example: arrears payable to workers in current period as a result of retrospective revision of wages.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in manner that their impact on current profit or loss can be perceived.

As per para 19 of AS 5, prior period items are normally included in determination of net profit or loss for the current profit, they can be added (or deducted as the case may be) from the current profit. An alternative approach is to show such items in the statement of profit or loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

(b) Adjusted Net profit for the current year

= 2,00,00,000+5,50,000 – 1,65,000 = ₹ 2,03,85,000

Number of equity shares resulting from conversion of debentures

= 50,000 × 8 = 4,00,000 equity shares

Total number of equity shares resulting from conversion of debentures

= 40,00,000 + 4,00,000 = 44,00,000 shares

Diluted Earnings per share = $\frac{₹\,2{,}03{,}85{,}000}{44{,}00{,}000}$ = ₹4.63 (Approximately)

Question 16

(i) An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at ₹ 30 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

(ii) ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.2002. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.2009. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2009. (2 Marks each, November, 2009) (PCC)

Answer

(i) Para 8.3 of AS 4 "Contingencies and Events Occuring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to para 8.6 of the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the Report of the Directors for the financial year 2008-2009.

(ii) Journal Entry

		₹	₹
Profit and Loss A/c (Prior period item)	Dr.	12,00,000	
Depreciation A/c	Dr.	2,00,000	
To Know-how A/c*			14,00,000
[Being depreciation of 7 years (out of which depreciation of 6 years charged as prior period item)]			

Question 17

(i) *Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2006. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2006-07.*

In March, 2008, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2008.

(ii) *Briefly indicate the items which are included in the expressions "Borrowing Cost" as per AS 16.*

(iii) *Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2007 payable after 4 months. The company entered into a forward contract for 4 months @ ₹ 48.85 per dollar. On 31st December, 2007, the exchange rate was ₹ 47.50 per dollar.*

How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2008.

(iv) *A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2007-08. On 31st March, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 1,00,000. The accounts were approved by Board of Directors on 15th April, 2008.*

Explain the treatment of such revision in financial statements for the year ended 31st March, 2008.

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* *As per para 63 of AS 26 "Intangible Assets", there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.*

(v) *A company entered into an agreement to sell its immovable property to another company for 35 lakhs. The property was shown in the Balance Sheet at ₹7 lakhs. The agreement to sell was concluded on 15th February, 2008 and sale deed was registered on 30th April, 2008. The financial statements for the year 2007-08 were approved by the board on 12th May,2008.*

You are required to state, how this transaction would be dealt with in the financial statements for the year ended 31st March, 2008.

(vi) *X Ltd. received a revenue grant of ₹ 10 crores during 2006-07 from Government for welfare activities to be carried on by the company for its employees. The grant prescribed the conditions for utilization.*

However during the year 2008-09, it was found that the prescribed conditions were not fulfilled and the grant should be refunded to the Government.

State how this matter will have to be dealt with in the financial statements of X Ltd. for the year ended 2008-09. (2 Marks each, November, 2009 & May, 2011) (IPCC)

Answer

(i) As per the provisions, of AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", prior period items are income or expenses, which arise in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss.

In the given situation, it is clearly a case of error in preparation of financial statements for the financial year 2006-07. Hence claim received in the financial year 2007-08 is a prior period item and should be separately disclosed in the statement of profit and loss for the year ended 31st March, 2008.

(ii) Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing cost may include:

(a) Interest and commitment charges on bank borrowings and other short term and long term borrowings.

(b) Amortisation of discounts or premiums relating to borrowings.

(c) Amortisation of ancillary costs incurred in connection with the arrangement of borrowings.

(d) Finance charges in respect of assets required under finance leases or under other similar arrangements; and

(e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

(iii) Calculation of profit or loss to be recognised in the books of Sterling Limited

Forward contract rate	₹ 48.85
Less: Spot rate	(₹ 47.50)
Loss	₹ 1.35
Forward Contract Amount	$20,000
Total loss on entering into forward contract = ($20,000 × ₹ 1.35)	₹ 27,000
Contract period	4 months
Loss for the period 1st January, 2008 to 31st March, 2008 i.e. 3 months falling in the year 2007-2008 will be ₹27,000 $\times \frac{3}{4}$ =	₹ 20,250

Balance loss of ₹6,750 (i.e. ₹ 27,000 – ₹ 20,250) for the month of April, 2008 will be recognised in the financial year 2008-2009.

(iv) As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the change in amount of staff welfare provision amounting ₹ 25,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2007-08.

As per the provisions of the standard, normally, all items of income and expense which are recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

(v) According to para 13 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th February 2009 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2009, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March, 2009.

(vi) As per para 11 of AS 12 "Government Grants", a grant that became refundable should be treated as an extra-ordinary item as per Accounting Standard 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". The amount refundable in respect of a government grant related to revenue, is applied first against any unamortised 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. Therefore, refund of grant of ₹ 10 crores should be shown in the profit and loss account of the company as an extra-ordinary item during the financial year 2008-09.

Question 18

(i) *Axe Limited began construction of a new plant on 1st April, 2008 and obtained a special loan of ₹ 4,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.*

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

	₹
1st April, 2008	*5,00,000*
1st August, 2008	*12,00,000*
1st January, 2009	*2,00,000*

The company's other outstanding non-specific loan was ₹ 23,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2009. You are required to:

(a) Calculate the amount of interest to be capitalized as per the provisions of AS 16 "Borrowing Cost".

(b) Pass a journal entry for capitalizing the cost and the borrowing cost in respect of the plant.

(ii) Compute Basic Earnings per share from the following information:

Date	*Particulars*	*No. of shares*
1st April, 2008	*Balance at the beginning of the year*	*1,500*
1st August, 2008	*Issue of shares for cash*	*600*
31st March, 2009	*Buy back of shares*	*500*

Net profit for the year ended 31st March, 2009 was ₹ 2,75,000.

(5 Marks each, November, 2009) (IPCC)

Answer

(i) Total expenses to be capitalised for borrowings as per AS 16 "Borrowing Costs"

	₹
Cost of Plant (5,00,000 + 12,00,000 + 2,00,000)	19,00,000
Add: Amount of interest to be capitalised (W.N.2)	1,54,000
	20,54,000

Journal Entry

		₹	₹
31st March, 2009	Plant A/c Dr. To Bank A/c [Being amount of cost of plant and borrowing cost thereon capitalised]	20,54,000	 20,54,000

Working Notes:

1. Computation of average accumulated expenses

		₹
1st April, 2008	₹ 5,00,000 $\times \frac{12}{12}$	5,00,000
1st August, 2008	₹ 12,00,000 $\times \frac{8}{12}$	8,00,000
1st January, 2009	₹ 2,00,000 $\times \frac{3}{12}$	50,000
		13,50,000

2. Amount of interest capitalised

	₹
On specific borrowing (₹ 4,00,000 x 10%)	40,000
On non-specific borrowings (₹ 13,50,000 – ₹ 4,00,000) × 12%	1,14,000
Amount of interest to be capitalised	1,54,000

(ii) Computation of weighted average number of shares outstanding during the period

Date	*No. of equity shares*	*Period outstanding*	*Weights (months)*	*Weighted average number of shares*
(1)	(2)	(3)	(4)	(5) = (2) x (4)
1st April, 2008	1,500 (Opening)	12 months	12/12	1,500
1st August, 2008	600 (Additional issue)	8 months	8/12	400
31st March, 2009	500 (Buy back)	0 months	0/12	-
Total				1,900

$$\text{Basic Earnings Per Share} = \frac{\text{Net Profit or Loss for the period attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{₹\ 2,75,000}{1,900 \text{ shares}} = ₹\ 144.74$$

Question 19

(i) *Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.*

(ii) *A Company follows April to March as its financial year. The Company recognizes cheques dated 31st March or before, received from customers after balance sheet date, but before approval of financial statement by debiting 'Cheques in hand account' and crediting 'Debtors account'. The 'cheques in hand' is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company?*

(iii) *Closing stock for the year ending on 31.3.2010 is ₹ 50,000 which includes stock damaged in a fire in 2008-09. On 31.3.2009, the estimated net realisable value of the damaged stock was ₹ 12,000. The revised estimate of net realisable value of damaged goods amounting ₹ 4,000 has been included in closing stock of ₹ 50,000 as on 31.3.2010.*

Find the value of closing stock to be shown in Profit and Loss account for the year 2009-10. (2 Marks each, May, 2010) (IPCC)

Answer

(i) As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the grants is incorrect as per AS 12.

(ii) Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4 "Contingencies and Events Occurring after the Balance Sheet Date". Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

(iii) The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

Thus, the value of closing stock for the year 2009-10 will be as follows:

	₹
Closing Stock (including damaged goods)	50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	46,000

Question 20

B&P Ltd. availed a lease from N&L Ltd. The conditions of the lease terms are as under:

(i) *Lease period is 3 years, in the beginning of the year 2009, for equipment costing ₹10,00,000 and has an expected useful life of 5 years.*

(ii) *The Fair market value is also ₹10,00,000.*

(iii) *The property reverts back to the lessor on termination of the lease.*

(iv) *The unguaranteed residual value is estimated at ₹1,00,000 at the end of the year 2011.*

(v) *3 equal annual payments are made at the end of each year.*

Consider IRR = 10%.

The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513.

The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

State whether the lease constitute finance lease and also calculate unearned Finance income.

(4 Marks, May, 2010) (IPCC)

Answer

(a) Computation of annual lease payment to the lessor

	₹
Cost of equipment	10,00,000
Unguaranteed residual value	1,00,000
Present value of residual value after third year @ 10%	

(₹1,00,000 × 0.7513)	75,130
Fair value to be recovered from lease payments (₹10,00,000 – ₹75,130)	9,24,870
Present value of annuity for three years is 2.4868	
Annual lease payment = ₹ 9,24,870/ 2.4868	3,71,911.70

The present value of lease payment i.e., ₹ 9,24,870 equals 92.48% of the fair market value i.e., 10,00,000. As the present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(b) Computation of Unearned Finance Income

	₹
Total lease payments (₹3,71,911.70 x 3)	11,15,735
Add: Unguaranteed residual value	1,00,000
Gross investment in the lease	1,215,735
Less: Present value of investment (lease payments and residual value) (₹75,130 + ₹9,24,870)	(10,00,000)
Unearned finance income	2,15,735

Question 21

While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4% of its total debtors (as per trend follows from the previous years). In the first week of March 2010, a debtor for ₹ 3,00,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2010 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2010.

(5 Marks, November, 2010 & November, 2011) (IPCC)

Answer

As per para 8 of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 3,00,000 suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April, 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly, full provision for bad debts amounting ₹ 3,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.

Question 22

(a) *Ram Ltd. had 12,00,000 equity shares on April 1, 2009. The company earned a profit of ₹ 30,00,000 during the year 2009-10. The average fair value per share during 2009-10 was ₹ 25. The company has given share option to its employees of 2,00,000 equity shares at option price of ₹ 15. Calculate basic E.P.S. and diluted E.P.S.*

(b) *On 1st April, 2009, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as under:*

(i)	*Construction of sealink across two cities:*		
	(work was held up totally for a month during the year due to high water levels)	*:*	*₹ 25 crores*
(ii)	*Purchase of equipments and machineries*	*:*	*₹ 3 crores*
(iii)	*Working capital*	*:*	*₹ 2 crores*
(iv)	*Purchase of vehicles*	*:*	*₹ 50,00,000*
(v)	*Advance for tools/cranes etc.*	*:*	*₹ 50,00,000*
(vi)	*Purchase of technical know-how*	*:*	*₹ 1 crores*
(vii)	*Total interest charged by the bank for the year ending 31st March, 2010*	*:*	*₹ 80,00,000*

Show the treatment of interest by Amazing Construction Ltd.

(c) *M Ltd. launched a project for producing product A in Nov. 2008. The company incurred ₹ 30 lakhs towards Research and Development expenses upto 31st March, 2010. Due to unfavourable market conditions the management feels that it is not possible to manufacture and sell the product in the market for next so many years.*

The management hence wants to defer the expenditure write off to future years.

Advise the company as per the applicable Accounting Standard.

(4 Marks each, November, 2010) (IPCC)

Answer

(a) Computation of Earnings Per Share

	Earnings ₹	*Shares*	*Earnings per share* ₹
Net Profit for the year 2009-10	30,00,000		
Weighted average number of shares outstanding during the year 2009-10		12,00,000	

Basic Earning Per Share $= \frac{30,00,000}{12,00,000}$			2.50
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value (As indicated in Working Note) $\left[2,00,000 \text{ x } \frac{15}{25}\right]$		(1,20,000)	
Diluted Earnings Per Share $\left[\frac{30,00,000}{12,80,000}\right]$	30,00,000	12,80,000	2.34

Working Note:

The earnings have not been increased as the total number of shares has been increased only by the number of shares (80,000) deemed for the purpose of the computation to have been issued for no consideration.

(b) According to para 3 of AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

As per para 6 of the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Amazing Construction Ltd. can be shown as:

	Qualifying Asset	*Interest to be capitalized* ₹	*Interest to be charged to Profit & Loss A/c* ₹	
Construction of sea-link	Yes	62,50,000		[80,00,000*(25/32)]
Purchase of equipments and machineries	No		7,50,000	[80,00,000*(3/32)]
Working capital	No		5,00,000	[80,00,000*(2/32)]
Purchase of vehicles	No		1,25,000	[80,00,000*(.5/32)]
Advance for tools, cranes etc.	No		1,25,000	[80,00,000*(.5/32)]
Purchase of technical know-how	No		2,50,000	[80,00,000*(1/32)]
Total		62,50,000	17,50,000	

(c) As per para 41 of AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS 26. Therefore, the management can not defer the expenditure write off to future years and the company is required to expense the entire amount of ₹ 30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

Question 23

The following information is available for Raja Ltd. for the accounting year 2009-10 and 2010-11:

Net profit for	*₹*
Year 2009-10	*25,00,000*
Year 2010-11	*40,00,000*

No. of shares outstanding prior to right issue 12,00,000 shares.

Right issue : *One new share for each three outstanding i.e. 4,00,000 shares*

: *Right issue price ₹ 22*

: *Last date to exercise rights 30-6-2010*

Fair value of one equity share immediately prior to exercise of rights on 30-6-2010 = ₹ 28.

*You are required to compute the basic earnings per share for the years 2009-10 and 2010-11.**

(5 Marks, May, 2011) (IPCC)

Answer

Computation of basic earnings per share (EPS)

	Year 2009-10 (₹)	*Year 2010-11 (₹)*
EPS for the year 2009-10 as originally reported $= \dfrac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ $= \dfrac{₹\ 25,00,000}{12,00,000 \text{ shares}}$	2.08	

* *The requirement of the question was missing in the question paper and has been added later.*

EPS for the year 2009-10 restated for rights issue $= \dfrac{₹\ 25,00,000}{(12,00,000 \text{ shares} \times 1.06)}$ *	1.97 (approx.)	
EPS for the year 2010-11 including effects of right issue $= \dfrac{40,00,000}{\left(12,00,000 \times 1.06 \times \dfrac{3}{12}\right) + \left(16,00,000 \times \dfrac{9}{12}\right)}$		2.64 (approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{(₹\ 28 \times 12,00,000 \text{ shares}) + (₹\ 22 \times 4,00,000 \text{ shares})}{12,00,000 \text{ shares} + 4,00,000 \text{ shares}} = ₹\ 26.50$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-right value per share}}$$

$$= \frac{₹\ 28}{₹\ 26.5} = ₹\ 1.06 \text{ (approx.)}$$

Question 24

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. The Lessee has guaranteed a residual value of ₹ 22,000 on expiry of the lease to the Lessor. However Lessor Ltd., estimates that the residual value of the machinery will be only ₹ 15,000. The implicit rate of return 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 machinery to be considered by Lessee Ltd. and the finance charges in each year. (8 Marks, May, 2011) (IPCC)

Answer

As per para 11 of AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognision should be at an amount equal to

* The number of equity shares to be used in calculating basic earnings per share for periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the adjustment factor. The adjustment factor has been calculated in Working Note 2.

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 payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹ 7,00,000 and the net present value of minimum lease payments is ₹ 6,99,054*. As the present value of the machine is less than the fair value of the machine, the machine will be recorded at value of ₹ 6,99,054.

Calculation of finance charges for each year

Year	*Finance charge*	*Payment*	*Reduction in outstanding liability*	*Outstanding liability*
	₹	₹	₹	₹
1st year beginning	-	-	-	6,99,054
End of 1st year	1,04,858	3,00,000	1,95,142	5,03,912
End of 2nd year	75,587	3,00,000	2,24,413	2,79,499
End of 3rd year	41,925	3,00,000	2,58,075	21,424**

Question 25

A company signed an agreement with the employees' union on 01-09-2010 for revision of wages with retrospective effect from 01-04-2009. This would cost the company an additional liability of ₹ 10 lakhs per annum. Is a disclosure necessary for the amount paid in 2010-11.

(4 Marks, May, 2011) (IPCC)

Answer

It is given that revision of wages took place on 1st September, 2010 with retrospective effect from 1.4.2009. The arrear of wages payable for the period 01.4.2009 to 31.3.2010, cannot be taken as an error or omission in the preparation of financial statement and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 20 lakhs should be included in current years' wages.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 extra- ordinary item. However, as per AS 5 (Revised), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies",

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* *Present value of minimum lease payments:*

Annual lease rental x PV factor + Present value of guaranteed residual value

= ₹ 3,00,000 x (0.869 + 0.756 + 0.657) + ₹ 22,000 x (0.657)

= ₹ 6,84,600 + ₹ 14,454 = ₹ 6,99,054.

** *The difference between this figure and guaranteed residual value (₹ 22,000) is due to approximation in computing the interest rate implicit in the lease.*

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. Therefore, necessary disclosure should be made for the additional liability amounting ₹ 20 lakhs.

Question 26

(a) *On 25th April, 2010, Neel Limited obtained a loan from the bank for ₹ 70 lakhs to be utilized as under:*

	₹ in lakhs
Construction of factory shed	*28*
Purchase of machinery	*21*
Working capital	*14*
Advance for purchase of truck	*7*

In March, 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31st March, 2011 was ₹ 12 lakhs. Show the treatment of interest under Accounting Standard 16.

(5 Marks, May, 2010 & November, 2011) (IPCC)

(b) *An equipment having expected useful life of 5 years, is leased for 3 years. Both the cost and the fair value of the equipment are ₹ 6,00,000. The amount will be paid in 3 equal instalments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3rd year is ₹ 60,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513. State with reason whether the lease constitutes finance lease and also compute the unearned finance income.* *(5 Marks, November, 2011) (IPCC)*

Answer

(a) Treatment of Interest as per AS 16

S. No.	*Particulars*	*Nature*	*Interest amount to be capitalized*	*Interest amount to be charged to Profit & Loss account*
1	Construction of factory shed	Qualifying asset	$₹ 12 \text{ lakhs} \times \frac{₹ 28 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 4.80 lakhs	
2	Purchase of machinery	Not a qualifying asset		$₹ 12 \text{ lakhs} \times \frac{₹ 21 \text{ lakhs}}{₹ 70 \text{ lakhs}}$ = ₹ 3.60 lakhs

3	Working capital	Not a qualifying asset		$₹ 12\text{ lakhs} \times \frac{₹ 14\text{ lakhs}}{₹ 70\text{ lakhs}}$ = ₹ 2.40 lakhs
4	Advance for purchase of truck	Not a qualifying asset		$₹ 12\text{ lakhs} \times \frac{₹ 7\text{ lakhs}}{₹ 70\text{ lakhs}}$ = ₹ 1.20 lakhs
	Total		₹ 4.80 lakhs	₹ 7.20 lakhs

Note:

1. It is assumed that construction of factory shed was completed at the end of March, 2011. Accordingly, interest for the full year has been capitalized.
2. It is assumed that machinery was ready to use at the time of purchase only and on this basis it has been treated as non-qualifying asset.

(b) (i) Determination of Nature of Lease

It is assumed that the fair value of the leased equipments is equal to the present value of minimum lease payments.

Present value of residual value at the end of 3rd year = ₹ 60,000 x 0.7513

= ₹ 45,078

Present value of lease payments = ₹ 6,00,000 – ₹ 45,078
= ₹ 5,54,922

The percentage of present value of lease payments to fair value of the equipment is

(₹ 5,54,922 / ₹ 6,00,000) x 100 = 92.487%.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = ₹ 5,54,922 / 2.4868 =₹ 2,23,147 (approx)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (₹ 2,23,147 × 3) + ₹ 60,000 = ₹ 6,69,441 + ₹ 60,000 = ₹ 7,29,441

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= ₹ 7,29,441 – ₹ 6,00,000 = ₹ 1,29,441

Question 27

(a) *Sunshine Company Limited imported raw materials worth US Dollars 9,000 on 25th February, 2011, when the exchange rate was ₹ 44 per US Dollar. The transaction* *was recorded in the books at the above mentioned rate. The payment for the transaction was made on 10th April, 2011, when the exchange rate was ₹ 48 per US Dollar. At the year end 31st March, 2011, the rate of exchange was ₹ 49 per US Dollar.*

The Chief Accountant of the company passed an entry on 31st March, 2011 adjusting the cost of raw material consumed for the difference between ₹ 48 and ₹ 44 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

(b) *Explain the treatment of refund of Government Grants as per Accounting Standard 12.*

(4 Marks each, November, 2011) (IPCC)

Answer

(a) As per para 9 of AS 11, 'The Effects of Changes in Foreign Exchange Rates', initial recognition of a foreign currency transaction is done in the reporting currency by applying the exchange rate at the date of the transaction. Accordingly, on 25th February 2011, the raw material purchased and its creditors will be recorded at US dollar 9,000 × ₹ 44 = ₹ 3,96,000.

Also, as per para 11 of the standard, on balance sheet date such transaction is reported at closing rate of exchange, hence it will be valued at the closing rate i.e. ₹ 49 per US dollar (USD 9,000 x ₹ 49 = ₹ 4,41,000) at 31st March, 2011, irrespective of the payment made for the same subsequently at lower rate in the next financial year.

The difference of ₹ 5 (49 – 44) per US dollar i.e. ₹ 45,000 (USD 9,000 x ₹ 5) will be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2011 and will not be adjusted against the cost of raw materials.

In the subsequent year on settlement date, the company would recognize or provide in the Profit and Loss account an exchange gain of ₹ 1 per US dollar, i.e. the difference from balance sheet date to the date of settlement between ₹ 49 and ₹ 48 per US dollar i.e. ₹ 9,000. Hence, the accounting treatment adopted by the Chief Accountant of the company is incorrect i.e. it is not in accordance with the provisions of AS 11.

(b) Para 11 of AS 12, "Accounting for Government Grants", explains treatment of government grants in following situations:

(i) When government grant is related to revenue

(a) <u>*When deferred credit account has a balance:*</u> The amount of government grant refundable will be adjusted against unamortized deferred credit balance remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit the amount is immediately charged to profit and loss account.

(b) <u>*Where no deferred credit account balance exists:*</u> The amount of government grant refundable will be charged to profit and Loss account.

(ii) When government grant is related to specific fixed assets

(a) *Where at the time of receipt, the amount of government grant reduced the cost of asset:* The amount of government grant refundable will increase the book value of the asset.

(b) *Where at the time of receipt, the amount of government grant was credited to "Deferred Grant Account":* The amount of government grant refundable will reduce the capital reserve or unamortized balance of deferred grant account as appropriate.

(iii) When government grant is in the nature of Promoter's contribution

The amount of government grant refundable in part or in full on non-fulfilment of specific conditions, the relevant amount recoverable by the government will be reduced from capital reserve.

A government grant that becomes refundable is treated as an extra-ordinary item.

Question 28

(a) *A Company had deferred research and development cost ₹ 450 Lakhs. Sales expected in the subsequent years are as under:*

Years	*Sales (₹ in Lakhs)*
1	*1200*
2	*900*
3	*600*
4	*300*

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of ₹ 450 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the company ?

(b) *ABC Limited purchased a machinery for ₹ 25,00,000 which has estimated useful life of 10 years with the salvage value of ₹ 5,00,000. On purchase of the assets Central Government pays a grant for ₹ 5,00,000. Pass the journal entries with narrations in the books of the company for the first year, treating grant as deferred income.*

(5 Marks each, May 2012) (IPCC)

Answer

(a) (i) Based on sales, research and development cost (assumed that entire cost of ₹ 450 lakhs is development cost) is allocated as follows:

Year	*Research and Development cost allocation*
	(₹ in lakhs)
1^{st}	$\frac{450}{3,000} \times 1200 = 180$
2^{nd}	$\frac{450}{3,000} \times 900 = 135$
3^{rd}	$\frac{450}{3,000} \times 600 = 90$
4^{th}	$\frac{450}{3,000} \times 300 = 45$

(ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 135 lakhs [450 – (180 + 135)] as an expense immediately.

(b) Journal Entries in the books of ABC Ltd.

Year	Particulars		Dr. (₹)	Cr. (₹)
1st	Machinery Account	Dr.	25,00,000	
	To Bank Account			25,00,000
	(Being machinery purchased)			
	Bank Account	Dr.	5,00,000	
	To Deferred Government Grant Account			5,00,000
	(Being grant received from the government treated as deferred income)			
	Depreciation Account (25,00,000 – 5,00,000)/10	Dr.	2,00,000	
	To Machinery Account			2,00,000
	(Being depreciation charged on Straight line method)			
	Profit & Loss Account	Dr.	2,00,000	
	To Depreciation Account			2,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grant Account (5,00,000/10)	Dr.	50,000	
	To Profit & Loss Account			50,000
	(Being proportionate government grant taken to P/L Account)			

Question 29

(i) *Explain the concept of 'Weighted average number of equity shares outstanding during the period".*

State how would you compute, based on AS-20 the weighted average number of equity shares in the following cases:

		No. of Shares
1st April, 2011	*Balance of Equity Shares*	*4,80,000*
31st August, 2011	*Equity shares issued for cash*	*3,60,000*
1st February, 2012	*Equity shares bought back*	*1,80,000*
31st March, 2012	*Balance of equity shares*	*6,60,000*

(ii) *Compute adjusted earning per share and basic earning per share based on the following information:*

Net profit 2010-11	*₹ 11,40,000*
Net profit 2011-12	*₹ 22,50,000*
No. of equity shares outstanding	*₹ 5,00,000*

Until 31st December,2011

Bonus issue on 1st January, 2012

1 equity share for each equity share

outstanding as at 31st December, 2011 *(5 Marks, May 2012) (IPCC)*

Answer

(i) (a) As per para no. 16 of AS 20, the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. Therefore, For the purpose of calculating basic or diluted earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

(b) Weighted average number of equity shares

Period		Weighted shares
1st April, 2011 to 31st August, 2011	4,80,000 shares x 5/12	2,00,000 shares
1st September, 2011 to 31st January, 2012	8,40,000 shares x 5/12	3,50,000 shares
1st February, 2012 to 31st March, 2012	6,60,000 shares x 2/12	1,10,000 shares
		6,60,000 shares

(ii) Earnings per share

Basic EPS 2010-11 = ₹ 11,40,000/5,00,000 shares = ₹ 2.28

Basic EPS 2011-12 = ₹ 22,50,000/10,00,000 shares = ₹ 2.25

Adjusted EPS 2010-11 = ₹ 11,40,000/10,00,000 shares = ₹ 1.14

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2010-11, the earliest period reported.

Question 30

(a) *Tiger Motor Car Limited signed an agreement with its employees union for revision of wages on 01.07.2011. The revision of wages is with retrospective effect from 01.04.2008. The arrear wages up to 31.3.2011 amounts to ₹ 40,00,000 and that for the period from 01.04.2011 to 01.07.2011 amount to ₹ 3,50,000. In view of the provisions of AS 5 "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies", decide whether a separate disclosure of arrear wages is required while preparing financial statements for the year ending 31.3.2012.*

(b) *An airline is required by law to overhaul its aircraft once in every five years. The pacific Airlines which operate aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.*

(c) *X Ltd. sold JCB Machine having WDV of ₹ 50 Lakhs to Y Ltd for ₹ 60 Lakhs and the same JCB was leased back by Y Ltd to X Ltd. The lease is operating lease*

Comment according to relevant Accounting Standard if

(i) Sale price of ₹ 60 Lakhs is equal to fair value

(ii) Fair Value is ₹ 50 Lakhs and sale price is ₹45 Lakhs.

(iii) Fair value is ₹ 55 Lakhs and sale price is ₹ 62 lakhs

(iv) Fair value is ₹ 45 Lakhs and sale price is ₹ 48 Lakhs.

(d) *Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2012 . However same comes to the notice of Company management during April, 2012 only. financial statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March, 2012 ?*

What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Boar Directors of the company ? (4 Marks each, May 2012) (IPCC)

Answer

(a) It is given that revision of wages took place in July, 2011 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2011 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of

₹ 40,00,000 (from 1.4.2008 to 31.3.2011) should be included in current year's wages. 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 no. 12 of AS 5, 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. However, wages payable for the current year (from 1.4.2011 to 1.7.2011) amounting ₹ 3,50,000 is not a prior period item hence need not be disclosed separately. This may be shown as current year wages.

(b) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts.

Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime.

A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

(c) According to AS 19, following will be the treatment in the given situations:

(i) When sales price of ₹ 60 lakhs is equal to fair value, X Ltd. should immediately recognize the profit of ₹10 lakhs (i.e. 60 – 50) in its books.

(ii) When fair value of leased JCB machine is ₹ 50 lakhs & sales price is ₹ 45 lakhs, then loss of ₹ 5 lakhs (50 – 45) to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payments.

(iii) When fair value is ₹ 55 lakhs & sales price is ₹ 62 lakhs, profit of ₹ 5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of ₹ 7 lakhs (62-55) is to be amortised/deferred over lease period.

(iv) When fair value is ₹ 45 lakhs & sales price is ₹ 48 lakhs, then the loss of ₹ 5 lakhs (50-45) to be immediately recognized by X Ltd. in its books and profit of ₹ 3 lakhs (48-45) should be amortised/deferred over lease period.

(d) As per para no. 13 of AS 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Though the theft, by the cashier ₹ 6,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹ 6,00,000.

If embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. This being extra ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Question 31

A company acquired for its internal use a software costing ₹ 10 lakhs [*] *on 28.01.2012 from the USA for US $ 1,00,000. The exchange rate on that date was ₹ 52 per USD. The seller allowed trade discount @ 5 %. The other expenditure were:*

(i) Import Duty : 20%

(ii) Purchase Tax : 10 %

(iii) Entry Tax : 5 % (Recoverable later from tax department)

(iv) Installation expenses : ₹ 25,000

(v) Profession fees for Clearance from Customs : ₹ 20,000

Compute the cost of Software to be capitalized. *(5 Marks, November 2012) (IPCC)*

Answer

Calculation of cost of software (intangible asset) acquired for internal use

Purchase cost of the software	$ 1,00,000
Less: Trade discount @ 5%	($ 5,000)
	$ 95,000
Cost in ₹ (US $ 95,000 x ₹ 52)	49,40,000
Add: Import duty on cost @ 20% (₹)	9,88,000

[*] *The first sentence of this question should be read as "a company acquired for its internal use a software on 28.01.2012 from the USA for US $ 1,00,000."*

	59,28,000
Purchase tax @ 10% (₹)	5,92,800
Installation expenses (₹)	25,000
Profession fee for clearance from customs (₹)	20,000
Cost of the software to be capitalised (₹)	65,65,800

Note: Since entry tax has been mentioned as a recoverable / refundable tax, it is not included as part of the cost of the asset.

Question 32

Define the term Finance Lease. State any three situations when a lease would be classified as finance lease. (4 Marks, November 2012) (IPCC)

Answer

As per AS 19, a finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Classification of lease into a finance lease or an operating lease depends on the substance of the transaction rather than its form. Some of the situations which would normally lead to a lease being classified as a finance lease are:

(a) the lessor transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

Question 33

(a) *Annual lease rent = ₹ 40,000 at the end of each year*

Lease period = 5 years

Guaranteed residual value = ₹ 14,000

Fair value at the inception (beginning) of lease = ₹ 1,50,000

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.

Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

(b) *A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the* *opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company? (4 Marks each, November 2012) (IPCC)*

Answer

(a) In books of Lessee

Journal entry

		₹	₹
Asset A/c	Dr.	1,49,888	
To Lessor			1,49,888
(Being recognition of finance lease as asset and liability)			

Working Note:

Year	*Lease Payments* ₹	*DF (12.6%)*	*PV* ₹
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880
5	40,000	0.552	22,080
5	14,000	0.552	7,728
			1,49,888

(b) As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when

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

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

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

In the given situation the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

Question 34

Give two examples on each of the following items:

(i) Change in Accounting Estimate

(ii) Extra Ordinary Items

(iii) Prior Period Items. *(4 Marks, November 2012) (IPCC)*

Answer

(i) Changes in Accounting Estimates examples:

a. Estimation of provision for doubtful debts on sundry debtors.

b. Estimation of useful life of fixed assets.

(ii) Extraordinary items examples:

a. Loss due to earthquakes / fire / strike

b. Attachment of property of the enterprise

(iii) Prior period items examples:

a. Applying incorrect rate of depreciation in one or more prior periods.

b. Omission to account for income or expenditure in one or more prior periods.

Question 35

(a) *Net profit for the year 2012 : ₹ 24,00,000*

Weighted average number of equity shares outstanding during the year 2012: 10,00,000

Average Fair value of one equity share during the year 2012 : ₹ 25.00

Weighted average number of shares under option during the year 2012: 2,00,000

Exercise price for shares under option during the year 2012 : ₹ 20.00

Compute Basic and diluted earnings per share.

(b) *Closing Stock for the year ending on 31st March, 2013 is ₹ 1,50,000 which includes stock damaged in a fire in 2011-12. On 31st March, 2012, the estimated net realizable value of the damaged stock was ₹ 12,000. The revised estimate of net realizable value of damaged stock included in closing stock at 2012-13 is ₹ 4,000. Find the value of closing stock to be shown in Profit and Loss Account for the year 2012-13, using provisions of Accounting Standard 5.*

(c) *An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:*

Less than 1 year : 2% provision

More than 1 year : 3% provision

The company has raised invoices as under:

Invoice Date	*Amount (₹)*
19th January, 2011	*40,000*
29th January, 2012	*25,000*
15th October, 2012	*90,000*

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013.

(d) *An enterprise acquired patent right for ₹ 400 lakhs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of estimated future cash flows which are as under:*

Year	*Estimated Future Cash Flows (₹ in lakhs)*
1	*200*
2	*200*
3	*200*
4	*100*
5	*100*

After 3rd year, it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5th year is expected to be ₹ 50 lakhs. Determine the amortization under Accounting Standard 26.

(4 x 5 = 20 Marks, May 2013) (IPCC)

Answer

(a) Computation of earnings per share

	Earnings (₹)	*Shares*	*Earnings per share*
Net profit for the year 2012	24,00,000		
Weighted average number of shares outstanding during the year 2012		10,00,000	
Basic earnings per share			₹ 2.40
Number of shares under option		2,00,000	
Number of shares that would have been issued at fair value: (2,00,000 x 20.00)/25.00	-*	(1,60,000)	
Diluted earnings per share	24,00,000	10,40,000	₹ 2.31

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of computation to have been issued for no consideration.

(b) The fall in estimated net realisable value of damaged stock ₹ 8,000 is the effect of change in accounting estimate. As per para 25 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the effect of a change in accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. It is presumed that the loss by fire in the year ended 31.3.2012, i.e. difference of cost and NRV was shown in the profit and loss account as an extra-ordinary item. Therefore, in the year 2012-13, revision in accounting estimate should also be classified as extra-ordinary item in the profit and loss account and closing stock should be shown excluding the value of damaged stock.

Value of closing stock for the year 2012-13 will be as follows:

	₹
Closing Stock (including damaged goods)	1,50,000
Less: Revised value of damaged goods	(4,000)
Closing stock (excluding damaged goods)	1,46,000

(c) Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2012 = ₹ 40,000 x .02 + ₹ 25,000 x .03
= ₹ 800 + ₹ 750 = ₹ 1,550

As at 31st March, 2013 = ₹ 25,000 x .02 + ₹ 90,000 x .03
= ₹ 500 + ₹ 2,700 = ₹ 3,200

Amount debited to Profit and Loss Account for year ended 31st March, 2013

	₹
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Note: No provision will be made on 31st March, 2013 in respect of sales amounting ₹ 40,000 made on 19th January, 2011 as the warranty period of 2 years has already expired.

(d) Amortization of cost of patent as per AS 26

Year	*Estimated future cash flow (₹ in lakhs)*	*Amortization Ratio*	*Amortized Amount (₹ in lakhs)*
1	200	.25	100

2	200	.25	100
3	200	.25	100
4	100	.40 (Revised)	40
5	100	.40 (Revised)	40
6	50	.20 (Revised)	20
			400

In the first three years, the patent cost will be amortised in the ratio of estimated future cash flows i.e. (200: 200: 200: 100: 100).

The unamortized amount of the patent after third year will be ₹ 100 (400-300) which will be amortised in the ratio of revised estimated future cash flows (100:100:50) in the fourth, fifth and sixth year.

Question 36

(a) *Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.*

(i) *Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.*

(ii) *Cheques sent by the stockists through courier on or before 31st March, 2013.*

(b) *Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item:*

(i) Share Capital

(ii) Trade Receivables

(iii) Investments

(iv) Fixed Assets. *(4 Marks each, May 2013) (IPCC)*

Answer

(a) (i) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS 4 'Contingencies and Events Occurring after the Balance Sheet Date'. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

(b) As per AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

Question 37

Answer the following questions:

(a) *State with reasons, how the following events would be dealt with in the financial* *statements of Pradeep Ltd. for the year ended 31st March, 2013:*

(i) *An agreement to sell a land for ₹ 30 lakh to another company was entered into on 1st March, 2013. The value of land is shown at ₹ 20 lakh in the Balance Sheet as on 31st March, 2012. However, the Sale Deed was registered on15th April, 2013.*

(ii) *The negotiation with another company for acquisition of its business was started on 2nd February, 2013. Pradeep Ltd. invested ₹ 40 lakh on 12th April, 2013.*

(b) *Cost of a machine acquired on 01.04.2009 was ₹ 5,00,000. The machine is expected to realize ₹ 50,000 at the end of its working life of 10 years. Straight-line depreciation of ₹ 45,000 per year has been charged upto 2011-2012. For and from 2012-13, the company switched over to 15% p.a. reducing balance method of depreciation in respect of the machine. The new rate of depreciation is based on revised useful life of 15 years. The new rate shall apply with retrospective effect from 01.04.2009. State how would you deal with the above in the annual accounts of the Company for the year ended 31st March, 2013 in the light of AS 5.*

(c) *Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2012 payable in foreign currency (US$) on 05.04.2013. Exchange rate of 1 US$ = ₹ 50.00 and ₹ 54.98 as on 01.04.2012 and 31.03.2013 respectively.*

The company also obtained a soft loan of US$ 1 lakh on 01.04.2012 payable in three annual equal instalments. First instalment was due on 01.05.2013.

You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2013. *(5 Marks each, November 2013) (IPCC)*

Answer

(a) (i) According to AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2013 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2013, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Pradeep Ltd. for the year ended 31st March, 2013.

(ii) AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2013.

Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 40 lakhs in April, 2013 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

(b) WDV of asset at the end of year 2011-12= ₹ 5,00,000 – ₹ 45,000 x 3 = ₹ 3,65,000

WDV of asset at the end of year 2011-12 (by reducing balance method)

= ₹ 5,00,000 $(1 – 0.15)^3$ = ₹ 3,07,062.50

Depreciation to be charged in year 2012-13

= (₹ 3,65,000 – ₹ 3,07,062.50) + 15% of ₹ 3,07,062.50

₹ 57,937.50 + ₹ 46,059.38 = ₹ 1,03,997 (approx.)

As per AS 5 'Net profit or loss for the period, Prior Period Items and Changes in Accounting Policies' the revision of remaining useful life is change in accounting estimate, and adoption of reducing balance method of depreciation instead of the straight-line method is change in accounting policy. Since it is difficult to segregate impact of these two changes, the entire amount of difference between depreciation at old rate and depreciation charged in 2012-13 (₹ 1,03,997- ₹ 45,000 = ₹ 58,997) is regarded as an effect of change in accounting estimate as per provisions of the standard. The effect of this change in accounting estimate should be properly disclosed in the financial statements of the company for the year ended 31st March, 2013.

(c) As per AS 11 (Revised) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as an expense in the period in which they arise. However, Ministry of Corporate Affairs has recently amended AS 11 through a notification. As per the notification, exchange difference arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset. The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020. Thus the company can capitalize the exchange differences arising due to long term loans linked with the acquisition of fixed assets.

Transaction 1: Calculation of exchange difference on fixed assets

Foreign Exchange Liability = $\frac{5,000}{50}$ = US $ 100 lakhs

Exchange Difference = US $ 100 lakhs x (₹ 54.98 – ₹ 50) = ₹ 498 lakhs.

Loss due to exchange difference amounting ₹ 498 lakhs will be capitalised and added in the carrying value of fixed assets. Depreciation on the unamortised amount will be provided in the remaining years

Transaction 2: Soft loan exchange difference (US $ 1 lakh i.e ₹ 50 lakhs)

Value of loan 31.3.13 → US $ 1 lakh x 54.98 = ₹ 54,98,000

AS 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) and should be written off over the useful life of such long-term liability, by recognition as income or expenses in each of such periods.

Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2013 = US$1.00 lakh X ₹ (54.98 – 50) = ₹ 4.98 lakh.

Loan account is to be increased to 54.98 lakh and FCMITD account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual instalments, ₹ 4.98 lakh/3 = ₹ 1.66 lakh is to be charged in Profit and Loss Account for the year ended 31st March, 2013 and balance in FCMITD A/c ₹ (4.98 lakh – 1.66 lakh) = ₹ 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance Sheet as a negative figure under the head 'Reserve and Surplus' as a separate line item.

Note: The above answer is given on the basis that the company has availed the option under para 46A of AS 11

Question 38

(a) *Classify the following into either operating or finance lease:*

(i) *Lessee has option to purchase the asset at lower than fair value, at the end of lease term;*

(ii) *Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of the lease term;*

(iii) *Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee;*

(iv) *Present value (PV) of Minimum lease payment (MLP) = "X". Fair value of the asset is "Y".*

(b) *Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakh on research during first 5 months of the financial year 2012-13. The* *development of the process began on 1st September, 2012 and upto 31st March, 2013, a sum of ₹ 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.*

From 1st April, 2013, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakh per annum for next five years.

The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.

Decide the treatment of Research and Development Cost of the project as per AS 26.

(c) *Raj & Co. has taken a loan of US$ 20,000 at the beginning of the financial year for a specific project at an interest rate of 6% per annum, payable annually. On the day of taking loan, the exchange rate between currencies was ₹ 48 per 1 US$. The exchange rate at the closing of the financial year was ₹ 50 per 1 US$. The corresponding amount could have been borrowed by the company in Indian Rupee at an interest rate of 11 % per annum. Determine the treatment of borrowing cost in the books of accounts.*

(4 Marks each, November 2013) (IPCC)

Answer

(a) (i) If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it is a Finance Lease.

(ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.

(iii) Since the asset is procured only for the use of lessee, it is a finance lease.

(iv) The lease is a finance lease if X = Y, or where X substantially equals Y.

(b) Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2012-13. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2013 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	₹ 2 lakhs p.a.
Company's cost of capital	10 %
Annuity factor @ 10% for 5 years	3.7908
Present value of net cash flows (₹ 2 lakhs x 3.7908)	₹ 7.582 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 7.582 lakhs.

The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2012-13.

Amortisation - The company can amortise ₹ 7.582 lakhs over a period of five years by charging ₹ 1.516 lakhs per annum from the financial year 2013-2014 onwards.

(c) The following computations would be made to determine the amount of borrowing costs for the purpose of AS 16 ‘ Borrowing Costs’:

Interest for the period = US $ 20,000 × ₹ 50 per US $ × 6% = ₹ 60,000.

Increase in the liability towards the principal amount

= US$ 20,000 × ₹ (50-48) = ₹ 40,000.(A)

Interest that would have resulted if the loan was taken in Indian Currency

= US $ 20,000 × 48 × 11% = ₹ 1,05,600

Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 1,05,600 – ₹ 60,000 = ₹ 45,600 (B)

In the above case, ₹ 40,000 (A) is less than ₹ 45,600 (B), therefore the entire exchange difference of ₹ 40,000 would be considered as borrowing costs. The total borrowing cost would be ₹ 1,00,000 (₹ 60,000+ ₹ 40,000)

Question 39

Answer the following questions:

(a) *In its Final Accounts for the year ended 31st March, 2014, Z Ltd. made a provision of 3% of its total debtors. On 10th March, 2014, a debtor of ₹ 5 lakhs suffered a heavy loss and became insolvent in April 2014. The loss was not insured.*

State giving reasons, if the company may provide for the full loss in its accounts for the year ended 31st March, 2014.

(b) *Suhana Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.05.2013, to be utilized as under:*

Particulars	*Amount (₹ in lakhs)*
Construction of factory building	*40*
Purchase of Machinery	*35*
Working Capital	*25*

In March 2014, construction of the factory building was completed and machinery was installed and ready for it's intended use. Total interest on debentures for the financial year ended 31.03.2014 was ₹ 11,00,000. During the year 2013-14, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

(c) What do you understand by the term "Interest rate implicit on lease"?

Calculate the interest rate implicit on lease from the following details:

Annual Lease Rent	*₹ 80,000 at the end of each year*
Lease Period	*5 Years*
Guaranteed Residual Value	*₹ 40,000*
Unguaranteed Residual Value	*₹ 24,000*
Fair Value at the inception of the lease	*₹ 3,20,000*

Discounted rates for the first 5 years are as below:

At 10% 0.909, 0.826, 0.751, 0.683, 0621

At 14% 0.877, 0.769, 0.675, 0.592, 0.519

(d) The following information is available for AB Ltd. for the accounting year 2012-13 and 2013-14:

Net profit for		*₹*
Year	*2012-13*	*22,00,000*
Year	*2013-14*	*30,00,000*

No of shares outstanding prior to right issue 10,00,000 shares.

Right issue: One new share for each five shares outstanding i.e. 2,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise right 31st July, 2013

Fair value of one equity share immediately prior to exercise of rights on 31.07.2013 is ₹ 32.

You are required to compute:

(i) Basic earnings per share for the year 2012-13.

(ii) Restated basic earnings per share for the year 2012-13 for right issue.

(iii) Basic earnings per share for the year 2013-14. *(5 Marks each, IPCC May, 2014)*

Answer

(a) According to para 8.2 of Accounting Standard 4 "Contingencies and Events Occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, though the debtor became insolvent after balance sheet date, yet he had suffered heavy loss (not covered by the insurance), before the balance sheet date and this loss was the cause of the insolvency of the debtor. Therefore, the company must make full provision for bad debts amounting ₹ 5 lakhs in its final accounts for the year ended 31st March, 2014.

(b) According to para 6 of AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also para 10 of AS 16 "Borrowing Costs" states that 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.

Thus, eligible borrowing cost

= ₹ 11,00,000 – ₹ 2,00,000 = ₹ 9,00,000

Sr. No.	*Particulars*	*Nature of assets*	*Interest to be Capitalized (₹)*	*Interest to be charged to Profit & Loss Account (₹)*
i	Construction of factory building	Qualifying Asset*	9,00,000x40/100 = ₹ 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	9,00,000x35/100 = ₹ 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

* A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

(c) As per para 3 of AS 19 ' Leases' the interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(b) any unguaranteed residual value accruing to the lessor,

to be equal to the fair value of the leased asset.

Present value at discount rate of 10%

Year	*Lease Payments (₹)*	*Disc. Factor (10%)*	*Present Value (₹)*
1	80,000	0.909	72,720
2	80,000	0.826	66,080
3	80,000	0.751	60,080
4	80,000	0.683	54,640
5	80,000	0.621	49,680
5	40,000	0.621	24,840
5	24,000	0.621	14,904
	Total		3,42,944

Present value at discount rate of 14%

Year	*Lease Payments (₹)*	*Disc. Factor (10%)*	*Present Value (₹)*
1	80,000	0.877	70,160
2	80,000	0.769	61,520
3	80,000	0.675	54,000
4	80,000	0.592	47,360
5	80,000	0.519	41,520
5	40,000	0.519	20,760
5	24,000	0.519	12,456
	Total		3,07,776

Interest Rate Implicit on Lease = $10\% + \dfrac{14\% - 10\%}{3{,}42{,}944 - 3{,}07{,}776} \times (3{,}42{,}944 - 3{,}20{,}000)$

$= 10\% + 2.609\% = 12.609\%$ or say 12.61%

(d) Computation of Basic Earnings per Share

		Year 2012-13 (₹)	*Year 2013-14 (₹)*
(i)	EPS for the year 2012-13 as originally reported		

	= Net profit for the year attributable to equity share holder / weighted average number of equity shares outstanding during the year $\dfrac{₹\ 22,00,000}{10,00,000 \text{ shares}}$	2.20	
(ii)	EPS for the year 2012-13 restated for the right issue $\dfrac{₹\ 22,00,000}{10,00,000 \text{ shares} \times 1.04}$	2.12	
(iii)	EPS for the year 2013-14 (including effect of right issue) $\dfrac{₹\ 30,00,000}{(10,00,000 \times 1.04 \times 4/12) + (12,00,000 \times 8/12)}$		2.62

Working Notes:

1. Computation of theoretical ex-rights fair value per share =

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights+total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$\frac{(₹\ 32 \times 10,00,000) + (₹\ 25 \times 2,00,000)}{10,00,000 + 2,00,000}$$

= ₹ 30.83

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

$$= \frac{₹\ 32}{₹\ 30.83} = 1.04 \text{ (approx.)}$$

Question 40

Explain in brief the treatment of Refund of Government Grants in line with AS 12 in the following three situations:

(a) When Government Grant is related to revenue,

(b) When Government Grant is related to specific fixed assets,

(c) When Government Grant is in the nature of Promoter's contribution. (4 Marks, IPCC May, 2014)

Answer

As per AS 12, refund of Government Grant is treated in the following manner:

(a) When Government Grant is related to Revenue:

(i) The amount of refund is first adjusted against any unamortized deferred credit balance still remaining in respect of the Grant

(ii) Any excess refund over such deferred credit balance or where no deferred credit exists, is immediately charged to Profit & Loss Account.

(b) When Government Grant is related to specific Fixed Asset:

(i) The amount of refund will increase the Book Value of the Asset, if at the time of receipt of Grant, the cost of asset was reduced by the amount of Grant.

(ii) If at the time of receipt, the Grant amount was credited to Deferred Grant Account, then the amount of refund will first reduce the unamortized balance of Deferred Grant Account, any excess refund will reduce the Capital Reserve.

(c) When the Government Grant is in the nature of Promoter's Contribution:

Capital Reserve will be reduced by the amount of refund.

Question 41

Answer the following questions:

(a) A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is ₹ 70,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 4th year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4th year at 10% rate of interest is 0.683.

State with reasons whether the lease constitutes finance lease and also compute the unearned finance income.

(b) A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.2013. This asset was acquired for ₹ 120 lakhs on 01.04.2009 and the same was available for use from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant Accounting Standard.

(c) Stem Ltd. purchased a Plant for US$ 30,000 on 30th November, 2013 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 62.15 per dollar. On 30th November, 2013, the exchange rate was ₹ 60.75 per dollar.

How will you recognise the profit or loss on forward contract in the books of Stem Ltd. for the year ended 31st March, 2014 ?

(d) WZW Ltd. is in dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 1000 Lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the Annual Accounts of the company?

(5 Marks each, IPCC November, 2014)

Answer

(a) (i) Determination of nature of lease

Fair value of asset is ₹ 7,00,000 and Unguaranteed residual value is ₹ 70,000

Present value of residual value at the end of 4th Year = ₹ 70,000 x 0.683 = ₹ 47,810

Present value of lease payment recoverable = ₹ 7,00,000 - ₹ 47,810

= ₹ 6,52,190

The percentage of present value of lease payment to fair value of the asset is

= (₹ 6,52,190/₹7,00,000)x100

= 93.17%

Since it substantially covers the major portion of lease payments and life of the asset, the lease constitutes a finance lease.

(ii) Calculation of Unearned finance income

Annual lease payment = ₹ 6,52,190 / 3.169

= ₹ 2,05,803 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value = (₹ 2,05,803 x 4) + ₹70000

= ₹ 8,23,212 + ₹70,000

= ₹ 8,93,212

Unearned finance income = Gross investment – Present value of minimum lease payment and unguaranteed residual value.

= ₹ 8,93,212 – ₹ 7,00,000 (₹ 6,52,190 + ₹ 47,810)

= ₹ 1,93,212

(b) As per para 63 of AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use.

Company has been following the policy of amortisation of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2013 at ₹ 72 lakhs i.e. ₹ 120 lakhs less ₹ 48 lakhs*.

The difference of ₹ 16 Lakhs (₹ 88 lakhs – ₹ 72 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 72 lakhs will be amortised over remaining 6 years by amortising ₹ 12 lakhs per year.

(c) Calculation of Profit or Loss on forward contract to be recognised in the book of Stem Ltd.

Forward contract rate	₹ 62.15 per dollar
Less: Spot Rate	₹ 60.75 per dollar
Loss	₹ 1.40 per dollar
Forward Contract Amount	US$ 30000
Total Loss on entering into forward contract	= US$ 30,000 x ₹ 1.40
	= ₹ 42,000
Contract Period	6 Months

Out of total contract period of 6 months, 4 months are falling in the financial year 2013-14.

Loss for the period from 1st Dec.2013 to 31st March, 2014= (₹ 42,000/6) x 4 = ₹ 28,000.

Thus the loss amounting to ₹ 28,000 for the period is to be recognised in the year ended 31st March, 2014.

(d) As per para 14 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

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

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

(iii) A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits seems to be remote in the given situation, since the directors of WZW Ltd. are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability.

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* $\left(\frac{₹ 120\ \text{Lakhs}}{10\ \text{years}} \times 4\ \text{years} = 48\ \text{Lakhs}\right)$

However, following note in this regard may be given in annual accounts of the company:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 1,000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

Question 42

Answer any **four** *of the following:*

(a) *Give* **two** *examples of each of the following items:*

  (i) *Change in Accounting Policy*

  (ii) *Change in Accounting Estimate*

  (iii) *Extra Ordinary Items,*

  (iv) *Prior Period Item*

(b) *What are the indicators of Non-Integral Foreign Operation (NFO)?*

(c) *In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:*

  (i) *Equity Shares issued in exchange of cash,*

  (ii) *Equity Shares issued as a result of conversion of a debt instrument,*

  (iii) *Equity Shares issued in exchange for the settlement of a liability of the enterprise,*

  (iv) *Equity Shares issued for rendering of services to the enterprise,*

  (v) *Equity Shares issued in lieu of interest and/or principal of an other financial instrument,*

  (vi) *Equity Shares issued as consideration for the acquisition of an asset other than in cash.*

Also define Potential Equity Share. *(4 Marks each, IPCC November, 2014)*

Answer

(a) (i) Examples of Change in Accounting Policy

  (a) Change in depreciation method from WDV to SLM or vice-versa;

  (b) Change in cost formula in measuring the cost of inventories.

(ii) Examples of Change in Accounting Estimate:

  (a) Change in estimate of provision for doubtful debts on sundry debtors;

  (b) Change in estimate of useful life of fixed assets.

(iii) Examples of Extra Ordinary Items

  (a) Loss due to earthquakes / fire / strike;

(b) Attachment of property of the enterprises by government.

(iv) Examples of Prior Period Item

(a) Applying incorrect rate of depreciation in one for more prior periods;

(b) Omission to account for income or expenditure in one or more prior period.

(b) The following are the important indicators of Non-Integral Foreign Operations (NFO):

(i) While the reporting enterprise may control the foreign operation, the activities of foreign operation's are carried independently without much dependence on reporting enterprise.

(ii) Transactions with the reporting enterprise are not a high proportion of the foreign operation's activities.

(iii) Activities of foreign operation are mainly financed by its operations or from local borrowings.

(iv) Foreign operation's sales are mainly in currencies other than reporting currency.

(v) Cash flow of the reporting enterprises is independent of the day to day activities of the foreign operation.

(vi) Sales price of the foreign operations are not affected by the day-to-day changes in exchange rate of the reporting currency but determined more by local competition or local government regulations.

(vii) There is an active local sales market for the foreign operation's product, although there may be significant amount of exports.

(viii) Costs of labour, material and other components of foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency.

(c) The following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given situations:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles, or may entitle its holder to equity shares.