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CLASSES
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Foundation → Intermediate → Final CA

CA INTER
Advanced Accounting
Accounting Standards - Part 1

Head Office

Shraddha, 4th Floor, Old Nagardas Road,
Near Chinai College, Andheri (E), Mumbai - 400 069.

022 - 2683 66 66

/officialjksc jkshahclasses.com

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INTRODUCTION TO ACCOUNTING STANDARDS

1. What are Accounting Standards?

Accounting Standards are written policy documents, covering guidelines relating to Issues in Financial Reporting.

2. Which Issues are Covered by AS?

AS deals with the following issues:-

(a) Recognition; (when to recognise a transaction in Books of Accounts)

(b) Measurement; (At what Value to recognise transactions in Books of Accounts)

(c) Presentation; (How to present the transactions in the Financial Statements)

(d) Disclosure;

3. WHY AS?

AS are introduced so that there can be:-

(a) **Uniformity;**

(b) **Comparability;**

(c) **Better Decision Making;**

4. How Many AS?

At Intermediate Level there are 22 AS to be studied, Off which:-

- AS 1,2,3,10,11,12,13,16 are covered in Paper 1 Accounting;
- AS 4,5,7,9,14,17,18,19,20,21,22,24,26,29 are covered in Paper 5 Advanced Accounting.

5. To Whom AS are Applicable?

AS are applicable to ALL Business entities. AS are not applicable to entities engaged in solely Charitable Activities. (e.g. an organisation collecting donations and giving them to flood affected people)

Business Entities are classified as:-

- Corporate entities; (Companies)
- Non-Corporate Entities; (Other than Companies)

HOMEWORK SECTION

Question 1

What are the issues, with which Accounting Standards deal?

Covered with Classwork Section

Question 2

List the criteria to be applied for rating a non-corporate entity as Level-I entity for the purpose of compliance of Accounting Standards in India.

Covered with Classwork Section

Question 3

List the criteria to be applied for rating a non-corporate entity as Level-II entity for the purpose of compliance of Accounting Standards in India.

Covered with Classwork Section

PAST PAPER SECTION

Question 4

Please explain briefly two benefits and two limitations of Accounting Standards for an accountant. **(May'19)**

Question 5

List the Criteria for classification of non-corporate entities as level I Entities for the purpose of application of Accounting Standards as per the Institute of Chartered Accountants of India.

Question 6

List the Criteria for classification of non-corporate entities as level I Entities for the purpose of application of Accounting Standards as per the Institute of Chartered Accountants of India. **(Jan' 21)**

Question 7

What is meant by 'Measurement'? What are the bases of measurement of Elements of Financial Statements? Explain the brief. **(Dec' 21)**

AS 1 - DISCLOSURE OF ACCOUNTING POLICIES

1. WHAT ARE ACCOUNTING POLICIES?

Accounting policies are rules or principles and methods to adopt such principles in financial accounts for true and fair recording and presentation of financial statements.

2. EXAMPLES OF DIFFERENT ACCOUNTING POLICIES:

- Methods of Amortization (AS26)
- Valuation of Inventories (AS 2)
- Valuation of Investments (AS 13)
- Valuation of Fixed Assets (AS10)
- Treatment of Government Grants (AS 12)
- Treatment of Contingent liabilities (AS29)
- Conversion of Foreign currency items (AS 11), etc.

3. WHY AS 1?

There is no single list of accounting policies which are applicable in all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

If every entity follows separate method to comply with principle then even if they follow the correct accounting policy but still books are not comparable, so there is need for disclosure.

4. DISCLOSURE REQUIREMENT :

- **SIGNIFICANT ACCOUNTING POLICIES:**

  All significant accounting policies adopted in preparation and presentation of financial statements should be disclosed.

  Significant accounting policies means those accounting policies which deals with material items of assets, liabilities, incomes and expenses.

  Such disclosure should form part of financial statements.

  These significant accounting policies should be disclosed at one place.

- **INSIGNIFICANT ACCOUNTING POLICIES:**

  All accounting policies relating to immaterial items of assets, liabilities, incomes and expenses need not be disclosed.

- **FUNDAMENTAL ACCOUNTING ASSUMPTIONS:**

  Fundamental accounting assumptions form the basis for preparations and presentation of financial statements.

  They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

The following are generally accepted fundamental accounting assumptions:

- **Going concern**

  The enterprise is normally viewed as going concern, that is, as continuing in operations for foreseeable future.

  It is assumed that enterprise neither has any need nor any will to shut down business in near future. (As per SA 570 going concern issued by the ICAI suggests that foreseeable future means 12 months from the date of financial statements)

- **Consistency:**

  It is assumed that accounting policies are consistent from one period to another. However, Consistency is not an excuse to adopt/ continue to adopt inappropriate accounting policies.

- **Accrual:**

  It is assumed that revenues and costs are: Recognized as they are earned/ incurred rather than as and when money is received /paid.

  Recorded in financial statements of the period to which they relate.

5. FACTORS TO BE CONSIDERED WHILE CHOOSING AN ACCOUNTING POLICIES:

The primary consideration in selection of accounting policies by an enterprise is that financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of state of affairs of enterprise as at balance sheet date and profit/loss for the period ended on that date.

Secondary consideration governing selection and application of accounting policies are:

- **Prudence:**

  Anticipated profits should not be recorded, anticipated losses are to be recorded.

- **Substance over form:**

  The accounting treatment and presentation in financial statements of transaction and events should be governed by their substance and not merely by legal form. Substance refers to economic reality.

- **Materiality:**

  Financial statements should disclose all material items i.e. items the knowledge of which might influence the decisions of the user of financial statements. Determination of materiality is a matter of professional judgement.

6. CHANGES IN ACCOUNTING POLICIES:

Accounting policies can be changed if such change is required by

- Law
- AS
- Management, if they can justify better presentation and preparation of financial statements. Any change that has material effect should be disclosed.

  The amount by which any item in GPFS is affected by such change should be disclosed. Where such amount is not ascertainable, wholly/ in part, the fact should be indicated.

CLASSWORK QUESTIONS

Question 1

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to ₹ 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹ 1,95,000. Discuss disclosure requirement of change in accounting policy as per AS1.

Question 2

X Ltd. sold its building to mini Ltd. For ₹ 60 Lakhs on 30.09.2010 and gave possession of the property to mini Ltd. However, documentation and legal formalities are pending. Due to this, the company has not recorded the sale and has shown the amount received as an advance. The book value of the building is ₹ 25 lakhs as on 31st March, 2011.

Do you agree with this treatment? If you do not agree, explain the reasons with reference to the accounting standard.

Question 3

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.

(v) There is no single list of accounting policies which are applicable to all circumstances.

Question 4

Summarised Balance Sheet of Cloth Trader as on 31.03.2017 is given below:

Liabilities	Amount (₹)	Assets	Amount (₹)
Proprietor's Capital	3,00,000	Fixed Assets	3,60,000
Profit & Loss Account	1,25,000	Closing Stock	1,50,000
10% Loan Account	2,10,000	Sundry Debtors	1,00,000
Sundry Creditors	50,000	Deferred Expenses	50,000
		Cash & Bank	25,000
	6,85,000		**6,85,000**

Additional Information is as follows :

(1) The remaining life of fixed assets is 8 years. The pattern of use of the asset is even. The net realisable value of fixed assets on 31.03.2018 was ₹ 3,25,000.

(2) Purchases and Sales in 2017-18 amounted to ₹ 22,50,000 and ₹ 27,50,000 respectively.

(3) The cost and net realizable value of stock on 31.03.2018 were ₹ 2,00,000 and ₹ 2,50,000 respectively.

(4) Expenses for the year amounted to ₹ 78,000.

(5) Deferred Expenses are amortized equally over 5 years.

(6) Sundry Debtors on 31.03.2018 are ₹ 1,50,000 of which ₹ 5,000 is doubtful. Collection of another ₹ 25,000 depends on successful re-installation of certain product supplied to the customer;

(7) Closing Sundry Creditors are ₹ 75,000, likely to be settled at 10% discount.

(8) Cash balance as on 31.03.2018 is ₹ 4,22,000.

(9) There is an early repayment penalty for the loan of ₹ 25,000.

You are required to prepare: (Not assuming going concern)

(1) Profit & Loss Account for the year 2017-18.

(2) Balance Sheet as on 31st March, 2018.

CLASSWORK SOLUTIONS

Answer 1

As per para 22 of AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014 -15, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

Answer 2

As per AS 1, "Disclosure of accounting policies", the main consideration in selection of accounting policy is the presentation of a true and fair picture of the state of affairs & performance of the enterprise. To ensure true and fair view, principles of prudence, substance over form and materiality should be considered.

In this case, the economic reality and substance of the transaction is that the rights and beneficial interest in the property has been transferred although legal title has not been transferred.

Hence, X Ltd. In its financial statements for the year ended 31.3.2011, should record the sale and recognize the profit of ₹ 35 lakhs (60 Lakhs - 25 Lakhs) in its Profit & Loss Account statement and building should be derecognized from the balance sheet of X Ltd. Therefore, the treatment given by the company is not correct.

Answer 3

(i) False; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

(ii) False; As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(iii) True; To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed at one place.

(iv) False; Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

(v) True; As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

HOMEWORK SECTION

Question 5

What are the three fundamental accounting assumptions recognized by Accounting Standard (AS) 1? Briefly describe each one of them.

Question 6

Mention few areas in which different accounting policies are followed by companies.

Question 7

Please explain briefly two limitations of Accounting Standards for an accountant.

Question 8

Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

Question 9

Shankar started a business on 1st April, 2017 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2018, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Shankar in the year 2017-18 if Financial **Capital is maintained at Historical cost.**

Question 10

What are the bases of measurement of Elements of Financial Statements? Explain in brief.

Question 11

"One of the characteristic of the financial statement is neutrality. "Do you agree with this statement? Explain in brief.

Question 12

Following is the Balance Sheet of M/s. S Traders as on 31st March, 2019:

Liabilities	(₹)	Assets	(₹)
Capital	1,50,000	Fixed Assets	1,05,000
11% Bank loan	80,000	Closing stock	76,000
Trade payables	52,000	Debtors	68,000
Profit & loss A/c	56,000	Deferred Expenditure	24,000
		Cash & bank	65,000
	3,38,000		**3,38,000**

Additional information:

(i) Remaining life Fixed Assets is 6 years with even use. The net realizable value of fixed Assets as on 31st March, 2020 is ₹ 90,000.

(ii) Firm's Sales & Purchases for the year ending 31st March, 2020 amounted to ₹7,80,000 and ₹ 6,25,000 respectively.

(iii) The cost & net realizable value of the stock as on 31st March, 2020 was ₹ 60,000 and ₹ 66,000.

(iv) General expenses (including interest on loan) for the year 2019-20 were ₹ 53,800.

(v) Deferred expenditure is normally amortised equally over 5 years starting from the financial year 2018-19 i.e. ₹6,000 per year.

(vi) Debtors on 31st March, 2020 is ₹65,000 of which ₹5,000 is doubtful. Collection of another ₹10,000 debtors depends on successful re-installation of certain products supplied to the customer.

(vii) Closing trade payable ₹48,000, which is likely to be settled at 5% discount.

(viii) There is a prepayment penalty of ₹4,000 for bank loan outstanding.

(ix) Cash & bank balances as on 31st March, 2020 is ₹1,65,200.

Prepare profit & loss Account and Balance sheet for the year ended 31st March, 2020 assuming the firm is not a going concern.

(Nov' 20)

Question 13

In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹ 1,75,000 (valued on the basis of FIFO method).

The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹ 1,59,000. Realizable value of the inventory as on 31.03.2020 amounts to ₹ 2,07,000.

Discuss disclosure requirements of changes in accounting policy as per AS 1.

(Nov' 20)

Question 14

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'. (May' 19)

Question 15

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.

(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.

(iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements. .

(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the facts need not to be indicated.

(May' 22)

Question 16

(i) ABC Ltd. was previously making provision for non-moving stocks based on stocks not issued for the last 12 months up to 31.03.2020. Now, the company wants to make provisions based on technical evaluation during the year ending 31.03.2021.

Total value of stock ₹ 133.75 lakhs

Provision required based on technical evaluation ₹ 4.00 lakhs Provision required based on 12 months not issued ₹ 5.00 lakhs.

(ii) In the Books of Kay Ltd., Closing stock as on 31st March, 2021 amounts to ₹ 1,24,000 (on the basis of FIFO method)

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2020-2021. On the basis of weighted average method, closing stock as on 31st March, 2021 amounts to ₹ 1,15,000. Realisable value of the inventory as on 31st March, 2021 amounts to ₹ 1,54,000.

Discuss Disclosure Requirements of change in accounting policy in above cases as per AS 1.

(Dec' 21)

AS 2 - VALUATION OF INVENTORY

1. WHY VALUATION OF INVENTORY IS REQUIRED ?

To know correct Financial Performance (net profit or loss)

And

To know True & fair Financial Position

Since, Appropriate / In-appropriate valuation of inventory affects both the profit / loss from operations & financial position as reflected in the Balance Sheet.

2. MEANING / DEFINITION OF INVENTORY As Per AS-2 :

According to AS 2, Inventories are assets

(a) held for sale in the ordinary course of business or

(b) in the process of production for such sale or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services

3. INVENTORIES INCLUDES :

Thus, Inventory consists of :

(a) Goods purchased & held for re-sale

(b) Finished goods produced for sale

(c) Work in progress

(d) Stores, spares, loose tools etc. awaiting use in production process (of goods meant for sale)

4. AS 2 DOES NOT COVER :

(a) Financial instruments such as shares, debentures etc. held as stock

(b) Work in progress under construction contracts

(c) Work in progress arising in the ordinary course of business of service providers

(d) Live stock, agricultural & forest products, mineral oils (for whose valuation certain established practices may exist)

5. VALUATION :

Inventories are valued at COST or NRV, whichever is less.

6. COST INCLUDES :

- Cost = Purchase cost + conversion cost + other costs incurred to bring the inventory to its present location & condition
- Purchase cost = purchase price + duties & taxes + freight inward + other directly attributable expenses (like in-transit insurance) – (duties & taxes recoverable + trade discount & rebates etc.).
- Conversion cost = Direct labour + variable production overheads (calculated on actual production) + fixed production overheads (calculated on normal capacity)
- In case of joint products, the conversion cost is allocated on rational & consistent basis (e.g. : sales).
- In case of by products, the NRV of by product is deducted from the conversion cost
- Inventory Cost does not include : Administration cost, Selling & distribution cost, abnormal wastage, storage costs etc.
- Normal capacity means the production expected to be achieved on an average over a number of periods under normal conditions. Fixed production overheads per unit will be revised if actual production exceeds normal capacity so that inventories are not measured above their cost.
- Interest & other borrowing costs are usually not included in inventory valuation. However, they can be included if time plays a major factor in bringing about a change in the condition of inventories.

7. METHODS OF INVENTORY VALUATION :

(a) Inventory not ordinarily interchangeable: specific identification method : Specific identification method tracks the actual physical flow of goods. It is also called the actual cost method because specific job bears the actual cost of materials bought for the job. This method is suited for antique shops, expensive jewellery, custom-made merchandise etc.

(b) Inventory ordinarily interchangeable: FIFO or weighted avg. method

- Other methods allowed are standard cost method or retail price method if it were to result in estimation of value of inventory that approximates the actual cost. Standard cost is a pre-determined cost based on attainable efficiency standard for a given volume of output. Retail price method is generally adopted by retail stores having numerous low unit cost items. Cost is measured by deducting gross margin from retail prices of year end inventory.

8. NRV :

NRV = estimated selling price in the ordinary course of business – estimated cost of completion – estimated costs necessary to make the sale. Considerations governing estimation of NRV are :

(a) Most reliable evidence available at the time estimates are made as to amounts that inventories are expected to realize &

(b) Fluctuations of prices or costs directly relating to events occurring after the Balance Sheet date, to the extent that such events confirm the conditions existing at the Balance Sheet date.

9. VALUATION OF MATERIAL :

Materials & other supplies held for use in production are not written down below the cost if finished goods in which they will be used are expected to be sold at or above cost. When finished goods are not expected to fetch the cost & there is a decline in process of material & other supplies then the materials & other supplies are written down to their NRV. In such a case, the replacement cost is the NRV.

10. DISCLOSURES REQUIRED :

(a) Accounting policy applied in measuring inventories including cost formula

(b) Carrying amount of inventory classified appropriately e.g. finished goods, work in progress, raw material, spare parts, loose tools etc.

(c) Any changes in accounting policy with respect to valuation of inventory & its effect on the financial statements.

CLASSWORK QUESTIONS

Question 1

The following are Cost and NRV value of five inventory items

	Cost (₹)	NRV (₹)
A	15,000	5,000
B	27,000	52,000
C	54,000	74,000
D	1,10,000	85,000
E	68,000	62,000
	2,74,000	**2,78,000**

Find out the value of inventories of

(a) Individual items are distinct items,

(b) Individual items are not distinct items and should be taken as a group.

Question 2

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

Question 3

Calculate the value of raw materials and closing stock based on the following information:

Raw material X	
Closing balance	500 units
	₹ per unit
Cost price including excise duty	200
Excise duty (Cenvat credit is receivable on the excise duty paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150
Finished goods Y	
Closing Balance	1200 units

	₹ per unit
Material consumed	220
Direct labour	60
Direct overhead	40

Total Fixed overhead for the year was ₹ 2,00,000 on normal capacity of 20,000 units.

Calculate the value of the closing stock, when

(i) Net realizable value of the finished goods Y is ₹ 400

(ii) Net Realizable value of the finished goods Y is ₹ 300

Question 4

Cost of a partly finished unit at the end of 2004-05 is ₹ 150. The unit can be finished next year by a further expenditure of ₹ 100. The finished unit can be sold at ₹ 250, subject to payment of 4% brokerage on selling price. Determine the value of inventory.

Question 5

The Company X Ltd., has to pay for delay in cotton clearing charges. The company up to 31.3.2014 has included such charges in the valuation of closing stock. This being in the nature of interest, X Ltd. decided to exclude such charges from closing stock for the year 2014-15. This would result in decrease in profit by ₹ 5 lakhs. Comment.

Question 6

SM Enterprises is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. For the end month of June 2021 following information is available :

(i) Sales for the month of June 2021 was ₹ 30,40,000.

(ii) General overheads cost ₹ 4,00,000.

(iii) Inventory at beginning 10,000 litres @ ₹ 92 per litre.

(iv) Purchases - June 1 2021, 20,000 litres @ ₹ 90 per litre, June 30 2021, 10,000 litres @ ₹ 95 per litre.

(v) Closing inventory 13,000 litres.

You are required to compute the following by FIFO method as per AS 2:

(i) Value of Inventory on 30th June, 2021.

(ii) Amount of cost of goods sold for June, 2021.

(iii) Profit/Loss for the month of June, 2021.

(May ' 22)

Question 7

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2019. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ Rs. 120). Replacement cost of raw material A as on 31-3-2019 is Rs. 90 per unit.

(ii) 500 units of partly finished goods in the process of producing X and cost incurred till date Rs. 260 per unit. These units can be finished next year by incurring additional cost of Rs. 60 per unit.

(iii) 1500 units of finished Product X and total cost incurred Rs. 320 per unit. Expected selling price of Product X is Rs. 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2019. Also calculate the value of total inventory as on 31-3-2019.

Question 8

Raw materials inventory of a company includes certain material purchased at ₹ 100 per kg. The price of the material is on decline and replacement cost of the inventory at the year-end is ₹ 75 per kg. It is possible to convert the material into finished product at conversion cost of ₹ 125.

Decide whether to make the product or not to make the product, if selling price is (i) ₹ 175 and (ii) ₹ 225. Also find out the value of inventory each case. **(May'10)**

Answer 5

According to AS - 2 “valuation of inventories” Cost of inventories generally doesn’t include interest & other borrowing cost. Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition.

Interests and other borrowing costs however are taken as part of inventory costs where the inventory necessarily takes substantial period of time for getting ready for intended sale. Example of such inventory is wine.

Here, X Ltd. has decided to exclude delay in clearing charges from closing stock for the year 2014-15 this would result in decrease in profit by ₹ 5 lakhs.
So the contention of X Ltd. for not to include such delay in clearing charges is correct.

HOMEWORK SECTION

Question 9

The Company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2014-15, the Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

Items	Historical Cost (₹ in lakhs)	Net Realizable Value (₹ in lakhs)
A	40	28
B	32	32
C	16	24

Question 10

Capital Cables Ltd., has a normal wastage of 4% in the production process. During the year 2013-14 the Company used 12,000 MT of raw material costing ₹ 150 per MT. At the end of the year 630 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books. Explain in the context of AS 2 the treatment of normal loss and abnormal loss and also find out the amount of abnormal loss if any.

Question 11

Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2015. His factory produces Product X using Raw material A.

(i) 600 units of raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2015 is ₹ 90 per unit.

(i) 500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.

(ii) 1500 units of finished Product X and total cost incurred ₹ 320 per unit. Expected selling price of Product X is ₹ 300 perunit.

Determine how each item of inventory will be valued as on 31-3-2015. Also calculate the value of total inventory as on 31-3-2015.

Question 12

Materials costing ₹ 12,000 bought for processing and assembly for a profitable special order. Since buying these items, the cost price has fallen to ₹ 10,000. How will you deal in the valuation of raw material if the finished product is sold above the cost? Suppose the finished product is likely to be sold less than the cost, what value will it be reasonable to be assigned for the raw material?

Question 13

You are required to value the inventory per kg of finished goods consisting of :

(a) Material Cost ₹ 200 per Kg.

(b) Direct Labour ₹ 40 Per Kg.

(c) Direct Variable Overhead ₹ 20 Per Kg.

Fixed production charges for the year on normal working capacity of 2 lakh kg. is ₹ 20 lakhs. 4,000 Kgs. of finished goods are in stock at the year end.

PAST PAPER SECTION

Question 14

In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred. Provide example of such costs as per AS-2 Valuation of Inventories. **(May' 12)**

Question 15

Z Limited ordered 13,000 kg. of chemicals at ₹ 90 per kg. The purchase price includes GST of ₹ 5 per kg, in respect of which full credit is admissible. Freight incurred amounted to ₹ 30,000. Normal transit loss is 4%. The company actually received 12,400 kg and consumed 10,000 kg. The company has received trade discount in the form of cash amounting to ₹ 1 per kg. The chemicals were delivered in containers. The containers were not reusable, hence sold for ₹ 500. The administrative expenses incurred to bring the chemicals were ₹ 10,000.

Compute the value of inventory and allocate the material cost as per AS – 2. **(May'16)**

Question 16

A Limited is engaged in manufacturing of Chemical Y for which Raw Material X is required. The company provides you following information for the year ended 31st March, 2017.

Raw Material X	₹ per unit
Cost price	380
Unloading Charges	20
Freight Inward	40
Replacement cost	300
Chemical Y	**₹ per unit**
Material consumed	440
Direct Labour	120
Variable Overheads	80

Additional Information:

(i) Total fixed overhead for the year was ₹ 4,00,000 on normal capacity of 20,000 units.

(ii) Closing balance of Raw Material X was 1,000 units and Chemical Y was ₹ 2,400 units.

	Qty.	Rate (₹)	Amount (₹)
Raw Material X	1,000	440	4,40,000
Finished Goods Y	2,400	660	15,84,000
Total Value of Closing Stock			20,24,000

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when

(a) Net realizable value of Chemical Y is ₹ 800 per unit

(b) Net realizable value of Chemical Y is ₹ 600 per unit **(Nov'17)**

Question 17

Wooden Plywood Limited has a normal wastage of 5% in the production process. During the year 2017-18, the Company used 16,000 MT of Raw material costing ₹ 190 per MT. At the end of the year, 950 MT of wastage was in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to:

(1) Calculate the amount of abnormal loss.

(2) Explain the treatment of normal loss and abnormal loss. [In the context of AS-2 (Revised)] **(May' 19)**

Question 18

The closing stock of finished goods at cost of a company amounted to ₹ 4,50,000. The following items were included at cost in the total:

(a) 100 coats, which had cost ₹ 2,200 each and normally sold for ₹ 4,000 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal selling price.

(b) 200 skirts, which had cost ₹ 50 each. These too were found to be defective. Remedial work in April cost ₹ 2 per skirt, and selling expenses for the batch totaled ₹ 200. They were sold for ₹ 55 each.

(c) Shirts which had cost ₹ 50,000, their net realizable value at Balance sheet date was ₹ 55,000. Commission @ 10% on sales is payable to agents. What should the inventory value be according to AS 2 after considering the above items? **(May' 19)**

Question 19

Mr. Rakshit gives the following information relating to items forming part of inventory as on 31st March, 2019. His factory produces product X using raw material A.

(i) 800 units of raw material A (purchased @ ₹ 140 per unit). Replacement cost of raw material A as on 31st March, 2019 is ₹ 190 per unit.

(ii) 650 units of partly finished goods in the process of producing X and cost incurred till date ₹ 310 per unit. These units can be finished next year by incurring additional cost of ₹ 50 per unit.

(iii) 1,800 units of finished product X and total cost incurred ₹ 360 per unit. Expected selling price of product X is ₹ 350 per unit.

In the context of AS-2, determine how each item of inventory will be valued as on 31st March, 2019. Also, calculate the value of total inventory as on 31st March, 2019. **(Nov'19)**

Question 20

Mr. Jatin gives the following information relating to the items forming part of the inventory as on 31.03.2019. His enterprise produces product P using Raw Material X.

(i) 900 units of Raw Material X (purchases @ ₹ 100 per unit). Replacement cost of Raw Material X as on 3103.2019 is ₹ 80 per unit

(ii) 400 units of partly finished goods in the process of producing P. Cost incurred till date is ₹ 245 per unit. These units can be finished next year by incurring additional cost of ₹ 50 per unit.

(iii) 800 units of Finished goods P and total cost incurred is ₹ 295 per unit. Expected selling price of product P is ₹280 per unit, subject to a payment of 5% brokerage on selling price.

Determine how each item of inventory will be valued as on 31.03.2019. Also calculate the value of total Inventory as on 31.03.2019. **(Jan' 21)**

Question 21

Joy Ltd. purchased 20,000 kilograms of Raw Material @ ₹ 20 per kilogram during the year 2020-21. They have furnished you with the following further information for the year ended 31st March, 2021:

Particulars	Units	Amount (₹)
Opening Inventory:		
Finished Goods	2,000	1,00,000
Raw Materials	2,200	44,000
Direct Labour		3,06,000
Fixed Overheads		3,00,000
Sales	20,000	11,20,000
Closing Inventory:		
Finished Goods	2,400	
Raw Materials	1,800	

The plant has a capacity to produce 30,000 units of finished product per annum. However, the actual production of finished products during the year 2020-21 was 20,400 units. Due to a fall in the market demand, the price of the finished goods in which the raw material has been utilized is expected to be sold @ ₹ 40 per unit. The replacement cost of the raw material was ₹ 19 per kilogram.

You are required to ascertain the value of closing inventory as at 31st March, 2021 as per AS 2.

(July' 21)

Question 22

Following information of Sarah Limited is given:

Sarah Limited uses Raw Material 'A' for production of Finished Goods 'B'

Closing balance of Raw Material 'A' in units on 31st March, 2022	750
	Price Per Unit in ₹
Cost Price	150
Freight inward	10
Replacement Cost	152
Closing balance of Finished Goods 'B' in units on 31st March, 2011	1600
	Price Per Unit in ₹
Material Consumed	225
Direct Labour	75
Direct variable overhead	60

Total Fixed Overheads amounts to ₹ 1,00,000 on normal capacity of 20,000 units.

You are required to calculate the value of closing Stock of Raw materials and Closing Stock of Finished Goods, as on 31st March, 2022, as per AS 2, when selling price of Finished Goods 'B' is ₹ 360 per unit.

(Nov'22 - 5 Marks)

AS 3 - CASH FLOW STATEMENT

THEORY SECTION

1. Cash Flow Statement shows relationship between Profitability and Cash generating ability and hence the "quality of profits" of the reporting entity.

2. It is mandatory for listed companies and entities with a turnover exceeding ₹ 50 crores.

3. Cash comprises cash on hand & demand deposits with bank.
   Cash equivalents are short term highly liquid investments that are readily convertible into known amounts of cash & which are subject to an insignificant risk.

4. **Classification of Activities:** According to the revised Accounting Standard 3, the cash flow statement should show cash flows during the period classified by operating, investing & financing activities.

   (a) **Operating Activities:** These are principle revenue producing activities of an enterprise other activities which are not investing or financing activities. Cash flows from operating activities generally result from the transactions & other events that determine the net profit or loss of the business. e.g. of cash flows from Opening activities are :
   - (i) Cash receipts from sale of goods & rendering of services.
   - (ii) Cash Receipts from commission, fees, royalties etc.
   - (iii) Cash payments suppliers of goods & services.
   - (iv) Cash payments of operating expenses such as salaries & wages, rent, electricity etc.
   - (v) Cash payments or refund of income tax.

   (b) **Investing Activities:** These are acquisition & disposal of Long-term assets such as land, building, plant, furniture, goodwill, trademarks, copyrights and investments not included in cash equivalents e.g.
   - (i) Cash payments to acquire fixed assets.

(ii) Cash payments relating to capatalisation research & development cost.

(iii) Cash received on disposal of fixed assets.

(iv) Loans made to third parties.

(v) Cash received from repayments of loans made to third parties.

(vi) Interest received on investments / Income from investment.

(c) **Financing Activities:** These are activities that result in changes in the size and composition of owners capital including preference share capital & borrowings of a business e.g.

(i) Cash receipts from issue of shares, debts, bonds, loans & other borrowings.

(ii) Cash repayment of loans taken.

(iii) Cash payment to redeem preference shares.

(iv) Interest and dividend paid.

5. Net basis reporting is allowed in following situations.

(a) Cash Flows reflecting activities of customers rather than those of the reporting entity (e.g. deposits and withdrawals by a bank's customers).

(b) Cash Flows in respect of items in which the taken over is quick and amounts are large and maturities are short (e.g. principal amounts relating to credit card customers).

The AS-3 (Revised) "Cash Flow Statement" has prescribed two formats for the presentation of Cash Flow Statement. These formats are given in Tables.

CASH FLOW STATEMENT [PARAGRAPH 18 (A)] (DIRECT METHOD)

Cash flows from Operating Activities		
Cash receipts from Customers	*****	
Cash paid to suppliers and employees	(*****)	
Cash generated from operations	*****	
Income Tax paid	(*****)	
Cash flow before extraordinary item	*****	
± Extraordinary Items	*****	
Net cash from Operating Activities		*****
Cash flows from Investing Activities		
Purchase of fixed assets	(*****)	
Proceed from sale of equipment	*****	
Interest received	*****	
Dividend received	*****	
Net cash from investing activities	*****	
Cash flows from Financing Activities		
Proceeds from issuance of share capital	*****	
Proceeds from long-term borrowings/short - term borrowings	*****	
Repayments of long - term borrowings	(*****)	
Interest paid	(*****)	
Dividend paid	(*****)	
Net cash from financing activities		*****
Net increase in cash and cash equivalents		*****
Cash and cash equivalents at beginnings of period		*****
Cash and cash equivalents at end of period		*****

CASH FLOW STATEMENT [PARAGRAPH 18 (B)] (INDIRECT METHOD)

Cash flows from Operating Activities		
Net profits before taxation and extraordinary item	*****	
Adjustment for :		
Depreciation	*****	
Interest Income	*****	
Dividend Income	*****	
Interest expense	*****	
Operating profit before working capital changes	*****	
Increase in sundry debtors	(*****)	
Decrease in inventories	*****	
Decrease in sundry creditors	*****	
Cash generated from operations	*****	
Income tax paid	(*****)	
Cash flow before extraordinary items	*****	
± Extraordinary items	*****	
Net cash from operating activities		*****
Cash flow from Investing Activities		
Purchase of fixed assets	(*****)	
Proceeds from sale of equipment	*****	
Interest received	*****	
Dividend received	*****	
Net cash from operating activities		*****
Cash flow from Financing Activities		
Proceeds from issuance of share capital	*****	
Proceeds from long – term borrowings / short – term borrowings	*****	
Repayment of long - term borrowings	(*****)	
Interest paid	(*****)	
Dividend paid	(*****)	
Net cash from financing activities		*****
Net increase in cash and cash equivalents		*****
Cash and cash equivalents at beginning of period		*****
Cash and cash equivalents at end of period		*****

CLASSWORK SECTION

Question 1

From the following information, calculate cash flow from operating activities:

Summary of Cash Account

for the year ended March 31, 20X1

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Trade payables	1,57,000
To Trade receivables	1,75,000	By Office & Selling Expenses	75,000
		By Income Tax	30,000
To Trade Commission	50,000	By Investment	25,000
To Sale of Investment	30,000	By Repayment of Loan	75,000
To Loan from Bank	1,00,000	By Interest on loan	10,000
To Interest & Dividend	1,000	By Balance c/d	1,04,000
	5,96,000		**5,96,000**

Question 2

Prepare cash flow statement of M/s MNT Ltd. for the year ended 31 st March, 20X1 with the help of the following information:

(1) Company sold goods for cash only.

(2) Gross Profit Ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.

(3) Opening inventory was lesser than closing inventory by ₹ 35,000.

(4) Wages paid during the year ₹ 4,92,500.

(5) Office and selling expenses paid during the year ₹ 75,000.

(6) Dividend paid during the year ₹ 30,000.

(7) Bank loan repaid during the year ₹ 2,15,000 (included interest ₹ 15,000).

(8) Trade payables on 31st March, 20X0 exceed the balance on 31st March, 20X1 by ₹ 25,000.

(9) Amount paid to trade payables during the year ₹ 4,60,000.

(10) Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.20X1 ₹ 45,000).

(11) Investments of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.

(12) Depreciation on fixed assets amounts to ₹ 85,000.

(13) Plant and machinery purchased on 15th November, 20X0 for ₹ 2,50,000.

(14) Cash and Cash Equivalents on 31st March, 20X0₹ 2,00,000.

(15) Cash and Cash Equivalents on 31st March, 20X1₹ 6,07,500.

Question 3

Prepare Cash flow for Gamma Ltd., for the year ending 31.3.20X1 from the following information:

(1) Sales for the year amounted to ₹ 135 crores out of which 60% was cash sales.

(2) Purchases for the year amounted to ₹ 55 crores out of which credit purchase was 80%.

(3) Administrative and selling expenses amounted to ₹ 18 crores and salary paid amounted to ₹ 22 crores.

(4) The Company redeemed debentures of ₹ 20 crores at a premium of 10%. Debenture holders were issued equity shares of ₹ 15 crores towards redemption and the balance was paid in cash. Debenture interest paid during the year was₹ 1.5 crores.

(5) Dividend paid during the year amounted to ₹ 11.7 crores.

(6) Investment costing ₹ 12 crores were sold at a profit of ₹ 2.4 crores.

(7) ₹ 8 crores was paid towards income tax during the year.

(8) A new plant costing ₹ 21 crores was purchased in part exchange of an old plant. The book value of the old plant was ₹ 12 crores but the vendor took over the old plant at a value of ₹ 10 crores only. The balance was paid in cash to the vendor.

(9) The following balances are also provided:

	₹ in crores 1.4.20X0	₹ in crores 31.3.20X1
Debtors	45	50
Creditors	21	23
Bank	6	18.2

Question 4

Prepare cash flow from investing activities as per AS 3 of M/s Subham Creative Limited for year ended 31.3.2019.

Particulars	Amount (₹)
Machinery acquired by issue of shares at face value	2,00,000
Claim received for loss of machinery in earthquake	55,000
Unsecured loans given to associates	5,00,000
Interest on loan received from associate company	70,000
Pre-acquisition dividend received on investment made	52,600
Debenture interest paid	1,45,200
Term loan repaid	4,50,000

Interest received on investment (TDS of ₹ 8,200 was deducted on the above interest)	73,800
Purchased debentures of X Ltd., on. 1st December, 2018 which are redeemable within 3 months	3,00,000
Book value of plant & machinery sold (loss incurred ₹ 9,600)	90,000

Question 5

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 2013:

Income Statement

		₹
Sales		6,98,000
Cost of Goods Sold		5,20,000
Gross Margin		1,78,000
Operating Expenses (including Depreciation Exp. of ₹ 37,000)		(1,47,000)
		31,000
Other Income (Expenses)		
Interest Expense paid	(23,000)	
Interest Income received	6,000	
Gain on Sale of Investments	12,000	
Loss on Sale of Plant	(3,000)	(8,000)
		23,000
Income tax		(7,000)
		16,000

Comparative Balance Sheets

	₹	₹
	31st March 2013	31st March 2012
Assets		
Plant Assets	7,15,000	5,05,000
Less: Accumulated Depreciation	(1,03,000)	(68,000)
	6,12,000	4,37,000
Investments (Long - term)	1,15,000	1,27,000
Current Assets		

Inventory	1,44,000	1,10,000
Accounts Receivable	47,000	55,000
Cash	46,000	15,000
Prepaid Expenses	1,000	5,000
	9,65,000	**7,49,000**
Liabilities		
Share Capital	4,65,000	3,15,000
Reserves & Surplus	1,40,000	1,32,000
Bonds	2,95,000	2,45,000
Current Liabilities:		
Accounts Payable	50,000	43,000
Accrued Liabilities	12,000	9,000
Income Taxes Payable	3,000	5,000
	9,65,000	**7,49,000**

Analysis of selected accounts and transactions during 2012-2013 :

1. Purchased investments for ₹ 78,000.
2. Sold investments costing ₹ 90,000.
3. Purchased plant assets for ₹ 1,20,000
4. Sold plant assets that cost ₹ 10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.
5. Issued ₹ 1,00,000 of bonds at face value in a exchange for plant assets on 31st March, 2013.
6. Repaid ₹ 50,000 of bonds at face value at maturity.
7. Issued 15,000 shares of ₹10 each.

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect and direct method.

Question 6

Ms. Jyothi of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 31st March, 2013:

	(₹ in lakhs)
Net profit	25,000
Dividend and corporate dividend tax thereon paid	8,535
Provision for income-tax	5,000
Income-tax paid during the year	4,248
Loss on sale of fixed assets (net)	40
Book value of the fixed assets sold	185

Depreciation charged to Profit & Loss Account	20,000
Amortisation of capital grant	6
Profit on sale of investments	100
Carrying amount of investments sold	27,765
Interest income on investments	2,506
Interest expenses	10,000
Interest paid during the year	10,520
Increase in working capital (excluding cash and bank balances)	56,075
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction, work-in-progress	34,740
Proceeds from calls in arrear	2
Receipt of grant for capital projects	12
Proceeds from long-term borrowings	25,980
Proceeds from short-term borrowings	20,575
Opening cash and Bank balances	5,003
Closing cash and bank balances	6,988

Required:

Prepare the cash flow statement in accordance with AS-3, Cash Flow Statements issued by the Institute of Chartered Accountants of India. Make necessary assumptions.

Question 7

From the following, calculate the Net Profit before tax.

Particulars	31st March 2012	31st March 2013
Equity Share Capital	2,50,000	5,00,000
Securities premium	----	25,000
General Reserve	75,000	1,00,000
Profit and Loss A/c	1,00,000	3,00,000
10% Debentures	2,00,000	2,00,000
Sundry Creditors	10,000	35,000
Provision for Tax	25,000	45,000

During the year, Dividend paid for the year end 31st March, 2012 was ₹ 25,000

Question 8

From the following Balance sheet of Grow More Ltd., prepare Cash Flow Statement for the year ended 31st March, 20X1 :

		Particulars	Notes	31st March, 20X1	31st March, 20X0
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital		10,00,000	8,00,000
	B	Reserves and Surplus	1	3,00,000	2,10,000
2		**Non-current liabilities**			
		Long term borrowings	2	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		7,00,000	8,20,000
	B	Other current liabilities	3	-	1,00,000
	C	Short term provision (provision for tax)		1,00,000	70,000
		Total		**23,00,000**	**20,00,000**
		Assets			
1		Non-current assets			
	A	Property, plant and. Equipment	4	13,00,000	9,00,000
	B	Non-Current Investments		1,00,000	-
2		**Current assets**			
	A	Inventories		4,00,000	2,00,000
	B	Trade receivables		5,00,000	7,00,000
		Cash and Cash equivalents		-	2,00,000
	C	**Total**		**23,00,000**	**20,00,000**

Notes to accounts

No.	Particulars	31st March, 20X1	31st March, 20X0
1	**Reserves and Surplus**		
	Revenue reserve	2,00,000	1,50,000
	Profit and Loss account	1,00,000	60,000
	Total	**3,00,000**	**2,10,000**
2	**Long term borrowings**		
	Debentures	2,00,000	--

3.	**Other current liabilities**		
	Dividend payable	-	1,00,000
4	**Property, plant and equipment**		
	Plant and machinery	7,00,000	5,00,000
	Land and building	6,00,000	4,00,000
	Net carrying value	**13,00,000**	**9,00,000**

(i) Depreciation @ 25% was charged on the opening value of Plant and Machinery.

(ii) At the year end, one old machine costing ₹ 50,000 (WDV ₹ 20,000) was sold for ₹ 35,000. Purchase was also made at the year end.

(iii) ₹ 50,000 was paid towards Income tax during the year.

(iv) Construction of the building got completed on 31.03.20X1 and hence no depreciation may be charged on the same.

Prepare Cash flow Statement.

Question 9

From the following Balance Sheets and information, prepare Cash Flow Statement of Ryan Ltd. by Indirect method for the year ended 31st March, 20X1:

		Particulars	Notes	31st March 20X1 `	31st March 20X0 `
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	6,00,000	7,00,000
	B	Reserves and Surplus	2	4,20,000	3,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	2,00,000	-
3		**Current liabilities**			
	A	Trade Payables		1,15,000	1,10,000
	B	Other current liabilities	4	30,000	80,000
	C	Short term provision (provision for tax)		95,000	60,000
		Total		**14,60,000**	**12,50,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	9,15,000	7,00,000
	B	Non-Current Investments		50,000	80,000
2		**Current assets**			
	A	Inventories		95,000	90,000

	B	Trade receivables		2,50,000	2,25,000
	C	Cash and Cash equivalents		50,000	90,000
	D	Other Current assets		1,00,000	65,000
		Total		**14,60,000**	**12,50,000**

Notes to accounts

No.			31st March, 20X1	31st March, 20X0
1.	**Share capital**			
	Equity share capital		6,00,000	5,00,000
	10% Redeemable Preference share capital		--	2,00,000
	Total		**6,00,000**	**7,00,000**
2	Reserves and Surplus			
	Capital redemption reserve		1,00,000	-
	Capital reserve		70,000	-
	General reserve		1,50,000	2,50,000
	Profit and Loss account		1,00,000	50,000
	Total		**4,20,000**	**3,00,000**
3	**Long term borrowings**			
	9% Debentures		2,00,000	--
4.	**Other current liabilities**			
	Dividend payable		-	60,000
	Liabilities for expenses		30,000	20,000
	Total		**30,000**	**80,000**
5	**Property, plant and equipment**			
	Plant and machinery		7,65,000	5,00,000
	Land and building		1,50,000	2,00,000
	Net carrying value		**9,15,000**	**7,00,000**

Additional Information:

(i) A piece of land has been sold out for ₹1,50,000 (Cost – ₹1,20,000) and the balance land was revalued. Capital Reserve consisted of profit on revaluation of land.

(ii) On 1st April, 20X0 a plant was sold for ₹90,000 (Original Cost – ₹70,000 and W.D.V. – ₹ 50,000) and Debentures worth ₹1 lakh were issued at par as part consideration for plant of ₹4.5 lakhs acquired.

(iii) Part of the investments (Cost – ₹50,000) was sold for ₹70,000.

(iv) Pre-acquisition dividend received ₹5,000 was adjusted against cost of investment.

(v) Interim dividend was declared and paid @ 15% during the current year.

(vi) Income-tax liability for the current year was estimated at ₹1,35,000.

(vii) Depreciation @ 15% has been charged on Plant and Machinery but no depreciation has been charged on Building.

Question 10

The Balance Sheet of New Light Ltd. as at 31st March, 20X1 and 20X0 (for the years ended) are as follows:

			Notes	₹ 31st March 20X0	₹ 31st March 20X1
		Equity and Liabilities			
1		**Shareholders' funds**			
	A	Share capital	1	16,00,000	18,80,000
	B	Reserves and Surplus	2	8,40,000	11,00,000
2		**Non-current liabilities**			
		Long term borrowings	3	4,00,000	2,80,000
3		Current liabilities			
	A	Other current liabilities	4	6,00,000	5,20,000
	B	Short term provision (provision for tax)		3,60,000	3,40,000
		Total		**38,00,000**	**41,20,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	5	22,80,000	26,40,000
	B	Non-Current Investments		4,00,000	3,20,000
2		**Current assets**			
	A	Cash and Cash equivalents		10,000	10,000
	B	Other Current assets		11,10,000	11,50,000
		Total		**38,00,000**	**41,20,000**

Notes to accounts

No.			31st March, 20X0	31st March, 20X1
1.	**Share capital**			
	Equity share capital		12,00,000	16,00,000
	10% Preference share capital		4,00,000	2,80,000
	Total		**16,00,000**	**18,80,000**

2	**Reserves and Surplus**			
	General reserve		6,00,000	7,60,000
	Profit and Loss account		2,40,000	3,40,000
	Total		8,40,000	11,00,000
3	**Long term borrowings**			
	9% Debentures		4,00,000	2,80,000
	Total		4,00,000	2,80,000
4.	Other current liabilities			
	Dividend payable		1,20,000	-
	Current Liabilities		4,80,000	5,20,000
	Total		6,00,000	5,20,000
5	Property, plant and equipment			
	Property, plant and equipment		32,00,000	38,00,000
	Less: Depreciation		(9,20,000)	(11,60,000)
	Net carrying value		22,80,000	26,40,000

Additional information:

(i) The company sold one property, plant and equipment for ₹ 1,00,000, the cost of which was ₹ 2,00,000 and the depreciation provided on it was ₹80,000.

(ii) The company also decided to write off another item of property, plant and equipment costing ₹ 56,000 on which depreciation amounting to ₹ 40,000 has been provided.

(iii) Depreciation on property, plant and equipment provided ₹ 3,60,000.

(iv) Company sold some investment at a profit of ₹ 40,000.

(v) Debentures and preference share capital redeemed at 5% premium.

(vi) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.3.20X0 was ₹ 2,16,000. The inventory on 31.3.20X1 was correctly valued at ₹ 3,00,000.

Prepare Cash Flow Statement as per revised Accounting Standard 3 by indirect method.

Question 11

Following information was extracted from the books of S Ltd. for the year ended 31st March,2020 :

(1) Net profit before talking into account income tax and after talking into account the following items was ₹30 lakhs;

(i) Depreciation on Property, Plant & Equipment ₹7,00,000

(ii) Discount on issue of debentures written off ₹45,000.

(iii) Interest on debentures paid ₹4,35,000

(iv) Investment of Book value ₹3,50,000 sold for ₹3,75,000.

(v) Interest received on Investments ₹70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹10 each at a premium of 20% on 10th April,2019.

(4) 20,000,9% Preference Shares of ₹100 each were redeemed on 31st March, 2020 at a premium of 5%

(5) Dividend paid during the year amounted to ₹11 Lakhs (including dividend distribution tax)

(6) A new Plant costing ₹7 Lakhs was purchased in part exchange of an old plant on 1st January,2020. The book value of the old plant was ₹8 Lakhs but the vendor took over the old plant at a value of ₹6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March,2020.

(7) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.03.2020 was ₹ 14,76,000.

The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April,2019 (₹)	As on 31st March,2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash &Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised).

Question 12

Classify the following activities as (a) Operating activities, (b) Investing activities (c) Financing activities (d) Cash equivalents with reference to AS 3 (Revised).

(a) Brokerage paid on purchase of investments
(b) Underwriting commission paid
(c) Trading commission received
(d) Proceeds from sale of investment
(e) Purchase of goodwill
(f) Redemption of preference shares
(g) Rent received from property held as investment
(h) Interest paid on long-term borrowings
(i) Marketable securities
(j) Refund of income tax received (5 Marks – May 2019 – IPCC)

Question 13

Prepare cash flow for ABC Ltd., using Direct Method for the year 10 ending 31-03-2019 from the following information:

(1) Sales for the year amounted to ₹ 270 Lakh out of which 50% was cash sales.
(2) Purchases for the year amounted to ₹ 60 lakh out of which credit purchases were 80%.
(3) Administrative expenses amounted to ₹ 18 lakh. Salary of ₹ 16 lakh was charged to profit and loss account for the year. Salary of ₹ 4 lakh was outstanding as on 31-03-2019. (Salary does not form part of Administrative expenses)
(4) The company has 15% debentures of ₹ 10 lakh, which it redeemed during the year at a premium of 10% by issue of equity shares of ₹ 9 lakh towards redemption and the balance was paid in cash. Debenture Interest was also paid during the year.
(5) Dividend paid during the year amounted to ₹ 12 lakh (including dividend distribution tax).
(6) Investment costing ₹ 10 lakh were sold at a profit of ₹ 2.50 lakh.
(7) Income tax payable for the year was ₹ 80,000.
(8) Depreciation of 25% is charged by the company on opening balance of Plant and Machinery. At the year end one old plant costing ₹ 5,00,000 (WDV ₹ 2,00,000) was sold for ₹ 3,50,000. The purchases were also made at year end.

(9) The following balances are also provided:

	₹ in Lakh 31-03-2018	₹ in Lakh 31-03-2019
Debtors	40	45
Creditors	20	23
Bank	5	-
Plant & Machinery	50	70
Provision for tax	1	0.7

(10 Marks – Nov 2019 – IPCC)

Question 14

The following figures have been extracted from the books of Manan limited for the year ended on 31.3.2020. You are required to prepare the cash flow statement as per AS 3 using indirect method.

(i) Net profit before taking into account tax and income from law suits but after taking into account the following items was ₹30 lakhs:

(a) Depreciation on Property, Plant & Equipment ₹7.50 lakhs.

(b) Discount on issue of Debentures written off ₹45,000.

(c) Interest on Debentures paid ₹5,25,000.

(d) Book value of investment ₹4.50 lakhs (Sale of investments for ₹4,80,000).

(e) Interest received on investments ₹90,000.

(ii) Compensation received ₹1,35,000 by the company in a suit filed.

(iii) Income tax paid during the year ₹15,75,000

(iv) 22,500, 10% preference shares of ₹ 100 each were redeemed on 02-04-2019 at a premium of 5%.

(v) Further the company issued 75,000 equity shares of ₹10 each at a premium of 20% on 30.3.2020 (Out of 75,000 equity shares, 25,000 equity shares were issued to a supplier of machinery)

(vi) Dividend for FY 2018-19 on preference shares were paid at the time of redemption.

(vii) Dividend on Equity shares paid on 31.01.2020 for the year 2018-2019 ₹7.50 lakhs (including dividend distribution tax) and interim dividend paid ₹2.50 lakhs for the year 2019-2020.

(viii) Land was purchased on 02.4.2019 for ₹3,00,000 for which the company issued 22,000 equity shares of ₹ 10 each at a premium of 20% to the land owner and balance in cash as consideration.

(ix) Current assets and current liabilities in the beginning and at the end of the years were as detailed below:

	As on 01.04.2019	As on 31.3.2020
	(₹)	(₹)
Inventory	18,00,000	19,77,000
Trade receivables	3,87,000	3,79,650
Cash in hand	3,94,450	16,950
Trade payable	3,16,500	3,16,950
Outstanding expenses	1,12,500	1,22,700

(10 Marks – Nov 2020 – Inter)

Question 15

From the following summary cash account of K Ltd., prepare cash flow statement for the year ended 31st March, 2020, in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31-03-2020

Particulars	Amount in (₹) '000	Particulars	Amount in (₹) '000
Balance as on 01.04.2019	100	Payment to suppliers	4,000
Issue of Equity Share	600	Purchase of Fixed Assets	400
Receipts from Customers	5,600	Overhead Expenses	400
Sale of Fixed Assets	200	Wages and Salaries	200
		Taxation	500
		Dividend	100
		Repayment of bank loan	600
		Balance as on 31.03.2020	300
	6,500		**6,500**

(8 Marks – Nov 2020 – IPCC)

Question 16

Following are extracts of the Balance Sheets of Ajay Ltd.:

	Particulars	Notes	31.3.20X1 ₹	31.3.20X2 ₹
	Equity and Liabilities			
	Shareholder's funds			
(a)	Share capital	1	5,00,000	5,00,000
(b)	Reserve & surplus	2	50,000	90,000

	Non-current liabilities			
(a)	Long-term borrowings	3	5,00,000	7,50,000
	Current liabilities			
(a)	Other current liabilities	4	---	5,000
	Assets			
	Non-current assets			
(a)	Intangible assets	5	2,05,000	1,80,000

Notes to accounts

		31.3.20X1 ₹	31.3.20X2 ₹
1	**Share Capital**		
	50,000 Equity Shares of ₹10 each	5,00,000	5,00,000
2	**Reserve & surplus**		
	Profit & Loss A/c	50,000	90,000
3	**Long-term borrowings**		
	10% Debentures	5,00,000	7,50,000
4	**Other current liabilities**		
	Unpaid interest	---	5,000
5	**Intangible assets**		
	Goodwill	2,05,000	1,80,000

You are required to show related items in cash flow statement.

Question 17

ABC Ltd. gives you the Balance sheets as at 31st March 20X0 and 31st March 20X1. You are required to prepare Cash Flow Statement by using indirect method as per AS 3 for the year ended 31st March 20X1:

		Particulars	Notes	₹ 31st March 20X0	₹ 31st March 20X1
1		Equity and Liabilities Shareholders' funds			
	A	Share capital		50,00,000	50,00,000
2	B	Reserves and Surplus		26,50,000	36,90,000
		Non-current liabilities			
3		Long term borrowings	1	-	9,00,000
		Current liabilities			
	A	Short-term borrowings (Bank loan)		1,50,000	3,00,000
	B	Trade payables		8,80,000	8,20,000
	C	Other current liabilities	2	4,80,000	2,70,000
		Total		**91,60,000**	**1,09,80,000**
		Assets			
1		**Non-current assets**			
	A	Property, plant and Equipment	3	21,20,000	32,80,000
2		**Current assets**			
	A	Current Investments Inventory		11,80,000	15,00,000
	B	Trade receivables		20,10,000	19,20,000
	C	Cash and Cash equivalents	4	22,40,000	26,40,000
	D	Other Current assets (Prepaid expenses)		15,20,000	15,20,000
	E			90,000	1,20,000
		Total		**91,60,000**	**1,09,80,000**

Notes to accounts

No.			₹20X0	20X1
1	**Long term borrowings**			
	9% Debentures		-	9,00,000
	Total		-	**9,00,000**
2.	**Other current liabilities**			
	Dividend payable		1,50,000	-
	Liabilities for expenses		3,30,000	2,70,000
	Total		**4,80,000**	**2,70,000**
3	**Property, plant and equipment**			
	Plant and machinery		27,30,000	40,70,000
	Less: Depreciation		(6,10,000)	(7,90,000)
	Net carrying value		**21,20,000**	**32,80,000**
4	**Trade receivables**			
	Gross amount		23,90,000	28,30,000
	Less: Provision for doubtful debts		(1,50,000)	(1,90,000)
	Total		**22,40,000**	**26,40,000**

Additional Information:

(i) Net profit for the year ended 31st March, 20X1, after charging depreciation ₹ 1,80,000 is ₹ 10,40,000.

(ii) Trade receivables of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account during the year.

Question 18

The following information was provided by PQR Ltd. for the year ended 31st March, 2019 :

(1) Gross Profit Ratio was 25% for the year, which amounts to ₹ 3,75,000.

(2) Company sold goods for cash only.

(3) Opening inventory was lesser than closing inventory by ₹ 25,000.

(4) Wages paid during the year ₹ 5,55,000.

(5) Office expenses paid during the year ₹ 35,000.

(6) Selling expenses paid during the year ₹ 15,000.

(7) Dividend paid during the year ₹ 40,000 (including dividend distribution tax).

(8) Bank Loan repaid during the year ₹ 2,05,000 (included interest ₹ 5,000)

(9) Trade Payables on 31st March, 2018 were ₹ 50,000 and on 31st March, 2019 were ₹ 35,000.

(10) Amount paid to Trade payables during the year ₹ 6,10,000

(11) Income Tax paid during the year amounts to ₹ 55,000 (Provision for taxation as on 31st March, 2019 ₹ 30,000)·

(12) Investments of ₹ 8,20,000 sold during the year at a profit of ₹ 20,000.

(13) Depreciation on furniture amounts to ₹ 40,000.

(14) Depreciation on other tangible assets amounts to ₹ 20,000.

(15) Plant and Machinery purchased on 15th November, 2018 for ₹ 3,50,000.

(16) On 31st March, 2019 ₹ 2,00,000, 7% Debentures were issued at face value in an exchange for a plant.

(17) Cash and Cash equivalents on 31st March, 2018 ₹ 2,25,000.

(A) Prepare cash flow statement using direct method

(B) Calculate cash flow from operating activities, using indirect method.

Question 19

Following information was extracted from the books of S Ltd. for the year ended 31st March,2020 :

(1) Net profit before talking into account income tax and after talking into account the following items was ₹ 30 lakhs;

(i) Depreciation on Property, Plant & Equipment ₹ 7,00,000

(ii) Discount on issue of debentures written off ₹ 45,000.

(iii) Interest on debentures paid ₹ 4,35,000

(iv) Investment of Book value ₹ 3,50,000 sold for ₹ 3,75,000.

(v) Interest received on Investments ₹ 70,000

(2) Income tax paid during the year ₹ 12,80,000

(3) Company issued 60,000 Equity Shares of ₹ 10 each at a premium of 20% on 10th April,2019.

(4) 20,000,9% Preference Shares of ₹ 100 each were redeemed on 31st March, 2020 at a premium of 5%.

(5) Dividend paid during the year amounted to ₹ 11 Lakhs (including dividend distribution tax)

(6) A new Plant costing ₹ 7 Lakhs was purchased in part exchange of an old plant on 1st January,2020. The book value of the old plant was ₹ 8 Lakhs but the vendor took over the old plant at a value of ₹ 6 Lakhs only. The balance amount was paid to vendor through cheque on 30th March,2020.

(7) Company decided to value inventory at cost, whereas previously the practice was to value inventory at cost less 10%. The inventory according to books on 31.03.2020 was ₹ 14,76,000.

The inventory on 31.03.2019 was correctly valued at ₹ 13,50,000.

(8) Current Assets and Current Liabilities in the beginning and at the end of year 2019-2020 were as:

	As on 1st April,2019 (₹)	As on 31st March,2020 (₹)
Inventory	13,50,000	14,76,000
Trade Receivables	3,27,000	3,13,200
Cash &Bank Balances	2,40,700	3,70,500
Trade Payables	2,84,700	2,87,300
Outstanding Expenses	97,000	1,01,400

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2020 as per AS 3 (revised) using the indirect method. **(Jan' 21)**

Question 20

Prepare cash flow statement of Gama Limited for the year ended 31st March, 2021 in accordance with AS-3(Revised) from the following cash account summary :

Cash summary Account

Inflows	₹ ('000)	Outflows	₹ ('000)
Opening Balance	945	Payment to suppliers	54,918
Receipts from Customers	74,682	Purchase of Investments	351
Sale of Investments (Cost ₹ 4,05,000)	459	Property, plant and equipment acquired	6,210
Issue of Shares	8,100	Wages and salaries	1,863
Sale of Property, Plant and equipment	3,456	Payment of overheads	3,105
		Taxation	6,561
		Dividends	2,160
		Repayment of Bank Overdraft	6,750
		Interest paidon Bank Overdraft	1,350
		Closing Balance	4,374
	87,642		**87,642**

(July' 21)

Question 21

Following are the extracts from the Balance Sheet of ABC Ltd.

Liabilities	31.3.2020 (₹)	31.3.2021 (₹)
Equity Share Capital	25,00,0000	35,60,000
10% Preference Share Capital	7,00,000	6,00,000
Securities Premium Account	5,00,000	5,50,000
Profit & Loss A/c	20,00,000	28,00,000

Equity Share Capital for the year ended 31st March, 2021 includes ₹ 60,000 of equity shares issued to Grey Ltd. at par for supply of Machinery of ₹ 60,000.

Profit & Loss account on 31st March, 2021 includes ₹ 50,000 of dividend received on Equity shares invested in X Ltd.

Show how the related items will appear in the Cash Flow Statement of ABC Ltd. as per AS-3 (Revised) **(Dec' 21)**

Question 22

Given below are the relevant extracts of the Balance Sheet and the Statement of Profit and Loss of ABC Ltd. along with additional information:

Extract of Balance sheet

		Particulars	Notes	31.3.20X1 (₹ in lakhs)	31.3.20X0 (₹ in lakhs)
		Equity and Liabilities			
1		**Current liabilities**			
	(a)	Trade Payables		250	230
	(b)	Short term Provisions	1	200	180
	(c)	Other current liabilities	2	70	50
		Assets			
1		**Current assets**			
	(a)	Inventories		200	180
	(b)	Trade Receivables		400	250
	(c)	Other current assets	3	195	180

Statement of Profit and Loss of ABC Ltd. for the year ended 31st March, 20X1

	Particulars	Notes	₹ in lakhs
I	Revenue from operations		4,150
II	Other income	4	100
III	Total Revenue (I + II)		4,250
	Expenses:		
	Purchases of Stock-in-Trade		2,400
	Change in inventories of finished goods		(20)
	Employee benefits expense		800
	Depreciation expense		100
	Finance cost	5	60
	Other expenses		200
IV	**Total expenses**		3,540
V	Profit before tax (III – IV)		710
VI	Tax expense: Current tax		200
VII	Profit for the year from continuing operations		510

Appropriations

Balance of Profit and Loss account brought forward	50
Transfer to general reserve	200
Dividend paid	330

Notes to accounts:

		20X1 (₹ in lakhs)	20X0 (₹ in lakhs)
1	Short term Provisions:		
	Provision for Tax	200	180
2	Other current liabilities:		
	Outstanding wages	50	40
	Outstanding expenses	20	10
	Total	70	50
3	Other current assets:		
	Advance tax	195	180
4	Other income:		
	Interest and dividend	100	
5	Finance cost:		
	Interest	60	

Compute cash flow from operating activities using both direct and indirect method.

Question 23

From the following information of XYZ Limited, calculate cash and cash equivalent as on 31-03-2019 as per AS-3.

Particulars	Amount (₹)
Balance as per the Bank Statement	25,000
Cheque issued but not presented in the Bank	15,000
Short Term Investment in liquid equity shares of ABC Limited	50,000
Fixed Deposit created on 01-11-2018 and maturing on15-04-2019	75,000
Short Term Investment in highly liquid Sovereign Debt Mutual fund on 01-03-2019	1,00,000
Bank Balance in a Foreign Currency Account in India (Conversion Rate: On the day of deposit ₹ 69/USD As on 31-03-2019 ₹ 70/USD)	$ 1,000

Question 24

Ridgeway Limited, a Non – Financial company has the following activities:

(i) Dividend paid for the year.

(ii) TDS on interest income earned on investments made.

(iii) Loans and advances given to suppliers and interest earned from them.

(iv) Deposit with bank for a term of two years.

(v) Highly liquid Marketable Securities (without risk of change in value).

(vi) Investments made and dividends earned on them.

(vii) Insurance claims received against loss of stock or loss of profits.

(viii) Loans and advances given to subsidiaries and interest earned from them.

(ix) Issue of Bonus Shares.

(x) Term loan repaid

You are required to classify the above activities in Cash Flow Statement as per 'AS – 3'.

(Nov'22 - 5 Marks)

AS 4 - CONTINGENCIES & EVENTS OCCURRING AFTER BALANCE SHEET DATE

1. **MEANING:**

Post Balance Sheet events are those that occur between Balance Sheet date & the date on which the financial statements are approved.

2. **Events occurring after Balance Sheet date fall under 2 categories :**

(a) Events that require adjustment of Assets & Liabilities (Adjusting event)

(b) Other events, financial impact of which requires a disclosure (Non Adjusting event).

3. **ADJUSTING EVENTS :**

(a) Adjusting events provide additional evidence that assist in estimation of amounts relating to conditions existing on the Balance Sheet date. For e.g.:

Elements constituting the principle	Example
1. Condition already existing on the Balance Sheet date	non-payment by a debtor
2. Additional evidence surfacing after Balance Sheet date	debtor declared insolvent by court
3. Post balance sheet event	Insolvency of debtor
4. Quantification of amount	Debts due less likely recovery
5. Adjustment to be made	Provision for bad debts

(b) Adjusting events may provide evidence that the Fundamental Accounting Assumption of going concern is not appropriate.

4. **NON-ADJUSTING EVENTS:**

Non-adjusting events do not affect Balance Sheet figures but the impact of these events have to be appropriately disclosed (in the Directors' report)

Elements constituting the principle	Example
1. Post Balance sheet event	Amalgamation
2. Financial impact of event	Material changes in commitments affecting the financial position
3. Quantification of amount	Estimate the amount where possible
4. Disclosure to be made	In the Director's report
5. Contents of disclosure	Nature of event & estimate of financial effect (or an explicit statement that the financial impact cannot be quantified)

5. EXAMPLES OF ADJUSTING & NON-ADJUSTING EVENTS :

Adjusting events:

(a) Subsequent determination of proceeds of sale of FAs purchased or sold before year end.

(b) Property valuation that provides evidence of a permanent decrease in value.

(c) Evidence regarding NRV < cost

(d) Retrospective changes in tax rates.

(e) Discovery of error or fraud

Non-adjusting events that occur after year end :

(a) Mergers or acquisitions, investment or reconstruction

(b) Issue of shares

(c) Extension of activities

(d) Changes in exchange rates

CLASSWORK QUESTIONS

Question 1

Which of the following event should be taken into account while finalizing (on 30th September, 2011) the annual accounts for the year ending March 31, 2011

(a) One of the several factories destroyed by fire on July 28, 2011.

(b) A debtor against whom insolvency proceedings were instituted prior to March 31, 2011 is declared insolvent on July 21, 2011.

(c) A theft of cash of ₹ 1 crore by the Cashier in Jan. 2011 was detected on 17th May 2011.

(d) The factory of the entrepreneur is permanently sealed under Supreme Court order since it was polluting industry on September 20, 2011.

(e) A major debtor died on May 13, 2011.

(f) A fire occurred in the godown on April 1 2011, damaging a huge quantity of stocks.

Question 2

What will be the treatment of the following in the financial statement for the year ended 31st March, 2012 of a limited company: "On 15th April, 2012 due to destruction of the factory by fire, Ravi, one of the company's debtors, declared himself insolvent. He owed ₹ 2,00,000 to the company."

Question 3

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2017. The accounting year of the company ended on 31.3.2017. The accounts were approved on 30.6.2017. 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.

Question 4

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

Question 5

Comment on the following:

A company follows April-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 A/c and crediting the Debtors A/c. The Cheques in hand is shown in 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.

Question 6

You are an accountant preparing accounts of A Ltd. as on 31.3.2011. After year end the following events have taken place in April, 2011:

(i) A fire broke out in the premises damaging, uninsured stock worth ₹10 lakhs (Salvage value ₹ 2 lakhs).

(ii) A suit against the company's advertisement was filed by a party claiming damage of ₹ 20 lakhs.

Describe, how above will be dealt with in the accounts of the company for the year ended on 31.3.2011.

Question 7

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, 2011 and sale deed was registered on 30th April, 2011.

You are required to state, with reasons, how this event would be dealt with in the financial statements for the year ended 31st March, 2011.

Question 8

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 2017 was detected only in May, 2017. 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 31.3.2017. Decide.

Question 9

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.

Question 10

MEC Limited could not recover an amount of ₹8 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2011 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2011, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of ₹ 8 lakhs in books of account for the year ended 31-3-2011?

CLASSWORK SOLUTIONS

Answer 1

Events	Accounting Treatment
(a)	Disclosure should be made in the report of the approving authority if the amount of loss is considered material. Such loss should not be recognized in the financial statements for the year 2010-11 since such event does not relate to the conditions existing at the Balance Sheet Date.
(b)	Debtors should be reduced by the amount of bad debts. **Reason:** As per AS 4 Assets and liabilities should be adjusted for event 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.
(c)	Loss due to theft should be recognised. **Reason.** As per 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.
(d)	The financial statements should be prepared by not following the fundamental assumption of going concern. **Reason:** As per AS – 4, assets and liabilities should be adjusted for events occurring after the balance sheet date that indicates that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate
(e)	Disclosure should be made in the report of the approving authority since the amount of loss is material. Such loss should not recognized in the financial statement for the year 2010-11 since such event does not relate to the condition existing at the Balance Sheet Date.
(f)	Disclosure should be made in the report of the approving authority since the amount of loss is material. Such loss should not recognized in the financial statement for the year 2010-11 since such event does not relate to the condition existing at the Balance Sheet Date.

Answer 2

The debtor becomes insolvent on 15th April 2012 i.e. after Balance Sheet date AS 4 requires that assets & liabilities should be adjusted for events occurring after the Balance Sheet date that provides additional evidence to asset the estimation & amount relating to condition existing at the Balance Sheet date.

If the fire has occurred on or before 31st March 2012 then the same should be treated as adjusting event and adequate provision for Bad debt should be created to cover the loss arising out of such insolvency of a customer, which occurs after the Balance Sheet date.

But if fire occurs after the Balance sheet date then it does not reflect conditions existed at the Balance sheet.

Hence, in such case, only disclosure is necessary as regards the recoverability of Sundry Debtors.

Answer 3

AS 4 (Revised) "Contingencies and Events Occurring 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. 31.3.2017. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2016-2017.

However, according to 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. Considering that the going concern assumption is still valid, the fact of earthquake together with an estimated loss of ₹ 30 lakhs should be disclosed in the financial statements for the financial year 2016-2017.

Answer 4

As per Accounting Standard 4, Assets and Liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist estimation of amounts relating to conditions existing at the balance sheet date.

So full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 2017.

It is because earthquake took place before the balance sheet date.

Had the earthquake taken place after 31st March, 2017, then mere disclosure required as per AS 4 (Revised), would have been sufficient.

Answer 5

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on 31st March. Thus the collection of cheques after balance sheet date is not an adjusting event. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise, and so no disclosure of such collections in the Directors' Report is necessary.

It should also be noted that, the Framework for Preparation and Presentation of Financial Statement defines assets as resources controlled by an enterprise as a result of past events from which economic benefits are expected to flow to the enterprise. Since the company acquires custody of the cheques after 31st March, it does not have any control over the cheques on 31st March and hence cheques in hand do not qualify to be recognized as assets on 31st March.

Answer 6

Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed according to para 15 of AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date'. The key point here is whether the impact of the loss is material or not. As the loss has arisen from non-insurance the event becomes very material not merely on account of the current loss but the future vulnerability. Hence, fire accident and loss thereof must be disclosed as also the fact that the stocks of the company are uninsured with a value of the future risk (if possible). Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

Answer 7

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 2011 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2011, 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, 2011.

Answer 8

As per 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 recognise the loss amounting ₹ 5,00,000 and adjust the accounts of the company for the year ended 31st March, 2017.

Answer 9

(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 at 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.

Answer 10

As per para 8 of 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 if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the company was aware that the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2011 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of ₹ 8 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of ₹ 8 lakhs in the books of account for the year ended 31st March, 2011.

HOMEWORK SECTION

Question 11

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 followed 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.

Question 12

In preparing the financial statements of Lotus Limited for the year ended 31st March, 2010 you come across the following information. State with reason, how you would deal with this in the financial statements?

The company invested ₹ 50 lakhs in April, 2010 in the acquisition of another company doing similar business, the negotiations for which had just started.

Question 13

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 Board of Directors of the company?

Question 14

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.

Question 15

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.

Question 16

A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at ₹ 10 crores out of which ₹ 7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.

Question 17

The accounting year of Dee Limited ended on 31st March, 2018 but the accounts were approved on 30th April, 2018. On 15th April, 2018 a fire occurred in the factory and office premises. The loss by fire is of such a magnitude that it was not possible to expect the enterprise Dee Limited to start operation again. State with reasons, whether the loss due to fire is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company in the context of the provisions of AS – 4 (Revised).

(Nov'18)

Question 18

With reference to AS 4 "Contingencies and events occurring after the balance sheet date", state whether the following events will be treated as contingencies, adjusting events or non-adjusting events occurring after balance sheet in case of a company which follows April to March as its financial year.

(i) A major fire has damaged the assets in a factory on 5th April, 5 days after the year end. However, the assets are fully insured and the books have not been approved by the Directors.

(ii) A suit against the company's advertisement was filed by a party on 10th April, 10 days after the year end claiming damages of ₹ 20 lakhs.

(iii) It sends a proposal to purchase an immovable property for ₹ 30 lakhs in March. The book value of the property is ₹ 20 lakhs as on year end date. However, the deed was registered as on 15th April.

(iv) The terms and conditions for acquisition of business of another company have been decided by March end. But the financial resources were arranged in April and amount invested was ₹ 40 lakhs.

(v) Theft of cash of ₹ 2 lakhs by the cashier on 31st March but was detected the next day after the financial statements have been approved by the Directors.

(May'16)

Question 19

The Board of Directors of M/s. New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a divided of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders. Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and Other Statutory Requirements.

(May'19 RTP)

Question 20

The financial statements of PQ Ltd. for the year 2017-18 approved by the Board of Directors on 15th July, 2018. The following information was provided:

(i) A suit against the company's advertisement was filed by a party on 20th April, 2018, claiming damages of ₹ 25 lakhs.

(ii) The terms and conditions for acquisition of business of another company have been decided by March, 2018. But the financial resources were arranged in April, 2018 and amount invested was ₹ 50 lakhs.

(iii) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2018 but was detected on 16th July, 2018.

(iv) Company sent a proposal to sell an immovable property for ₹ 40 lakhs in March, 2018. The book value of the property was ₹ 30 lakhs on 31st March, 2018. However, the deed was registered on 15th April, 2018.

(v) A, major fire has damaged the assets in a factory on 5th April, 2018. However, the assets are fully insured.

With reference to AS-4 "Contingencies and events occurring after the balance sheet date", state whether the above mentioned events will be treated as contingencies, adjusting events or non-adjusting events occurring after the balance sheet date.

(May' 19)

Question 21

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2019 (accounts were approved on 25th July, 2019):

(1) Negotiations with another company for acquisition of its business was started on 21st January, 2019. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2019.

(2) The company made a provision for bad debts @ 4% of its total debtors (as per trend followed from the previous years). In the second week of March 2019, a debtor for ₹ 2,50,000 had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In May, 2019 the debtor became bankrupt.

(3) During the year 2018-2019, Hari Ltd. was sued by a competitor for ₹ 13 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Hari Ltd. provided for a sum of ₹ 8 lakhs in its financial statements for the year ended 31st March, 2019. On 26th May, 2019, the Court decided in favour of the party alleging infringement of the trademark and ordered Hari Ltd. to pay the aggrieved party a sum of ₹ 12 lakhs.

(4) Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2019. However the same comes to the notice of Company management during August, 2019.

(5) Cheques dated 31st March, 2019 collected in the month of April, 2019. All cheques are presented to the bank in the month of April, 2019 and are also realized in the same month in the normal course after deposit in the bank.

Question 22

State with reason, as per AS-4, How the following events would be dealt with in the financial statements of Nisha Limited for the year ended 31st March, 2020. Date of Board meeting for approving the accounts is 25th April, 2020 :

(i) The Board of the directors of the Company has proposed dividend of ₹ 20 lakhs on 4th April, 2020.

(ii) An earthquake destroyed a major warehouse of the Company on April 20, 2020.

(iii) The company has filed a legal suit against one debtor from whom ₹ 25 lakh is recoverable as on 31.3.2020 As per legal opinion received by the counsel on 15th April, 2020, the chances of recovery by way of legal suit are not good.

(iv) The cashier of the Company embezzled cash of ₹ 9 lakhs fraudulently in January, 2020 and returned back ₹ 5 lakhs in February, 2020. The same was detected on 5th April, 2020. **(Nov' 20)**

Question 23

As per the provision of AS 4, you are required to state with reason whether the following transactions are adjusting event or non-adjusting event for the year ended 31.03.2021 in the books of NEW Ltd. (accounts of the company were approved by board of directors on 10.07.2021):

(1) Equity Dividend for the year 2020-21 was declared at the rate of 7% on 15.05.2021.

(2) On 05.03.2021, ₹ 53,000 cash was collected from a customer but not deposited by the cashier. This fraud was detected on 22.06.2021.

(3) One building got damaged due to occurrence of fire on 23.05.221. Loss was estimated to be ₹ 81,00,000. **(Dec' 21)**

Question 24

Surya Limited follows the financial year from April to March. It has provided the following information.

(i) A suit against the Company's Advertisement was filed by a party on 5th April, 2021, claiming damages of ₹ 5 lakhs.

(ii) Company sends a proposal to sell an immovable property for ₹ 45 lakhs in March 2021. The book value of the property is ₹ 30 lakhs as on year end date. However, the Deed was registered on 15th April, 2021.

(iii) The terms and conditions for acquisition of business of another company have been decided by the end of March 2021, but the financial resources were arranged in April 2021. The amount invested was ₹ 50 lakhs.

(iv) Theft of cash amounting to ₹ 4 lakhs was done by the Cashier in the month of March 2021 but was detected on the next day after the Financial Statements have been approved by the Directors.

Keeping in view the provisions of AS-4, you are required to state with reasons whether the above events are to be treated as Contingencies, Adjusting Events or Non-Adjusting Events occurring after Balance Sheet date.

(Jul' 21)

Question 25

MN Limited operates its business into various segments. Its financial year ended on 31st March, 2022 and financial statements were approved by their approving authority on 15th June, 2022. The following material events took place:

(i) On 7th April, 2022, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹15 crores would be fully covered by the insurance company.

(ii) A claim for damage amounting to ₹12 crores for breach of patent had been received by the entity prior to the year end. It is the director' opinion, backed by legal advice that the claim will ultimately prove to be baseless. But it is still estimated that it would involve a considerable expenditure on legal fees.

(iii) A major property was sold (it was included in the balance sheet at ₹37,50,000) for which contracts had been exchanged on 15th March, 2022. The sale was completed on 15th May, 2022 at a price of ₹39,75,000.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of MN Limited for the year ended 31st March, 2022 as per AS – 4.

(Nov'22 - 5 Marks)

AS 5 - NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICY

1. NET PROFIT OR LOSS FOR THE PERIOD INCLUDES :

All items of income and expense including extra ordinary items and effects of changes in accounting estimates which are recognized in a period.

The net profit or loss for the period comprises the following component, each of which should be disclosed on the face of the statement of profit and loss:

- Profit or loss from ordinary activities and
- Profit or loss from extra ordinary activities.

Any activities which are undertaken by an enterprise as a part of its business and Such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

When the items of income and expense 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.

Following are items of income/expense which require separate disclosure:

(a) The write down of inventories to NRV

(b) Disposal of fixed assets

(c) Disposal of long term investments

(d) Litigation settlements, etc.

Profit or loss from extra ordinary activities:

Extra ordinary items are incomes or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to occur frequently. The nature and amount of each extraordinary items should be separately disclosed in the statement of profit or loss in a manner that its impact on profit or loss can be perceived.

Examples of extraordinary items:

(a) Loss due to earthquake

(b) Attachment of property

(c) Government Grants becoming refundable

(d) Loss due to fire

(e) Loss due to enemy attack, etc.

2. CHANGES IN ACCOUNTING ESTIMATES :

As a result of the uncertainties inherent in business activities, many financial statements items cannot be measured with precision but can only be estimated based on the latest information available. Estimates may be required, for example, of bad debts, inventory obsolescence or lives of assets.

The estimates can be revised if-

Changes occur regarding the circumstances on which the estimates are based As a result of new information, more experience or subsequent developments.

NOTE: Revision of accounting estimates is not an extra-ordinary item or a prior period item. Classification of change in accounting estimates:

The effect of a change in an accounting estimate should be classified under the same classification in the statement of profit or loss as was used previously for the estimate.

The effect of a change in an accounting estimate which was previously included in profit or loss from ordinary activities is included in that component of net profit or loss.

The effect of a change in an accounting estimate which was previously included in profit or loss as extra-ordinary item is reported as extra-ordinary item.

3. CHANGES IN ACCOUNTING POLICIES:

Accounting policies can be changed if such change is required by

- Law
- AS
- Management, if they can justify better presentation and preparation of financial statements. Any change that has material effect should be disclosed.

The amount by which any item in GPFS is affected by such change should be disclosed. Where such amount is not ascertainable, wholly/ in part, the fact should be indicated.

The following are not changes in accounting policies:

- The adoption of a new accounting policy for events or transactions that differ in substance from previously occurring events or transactions.
- The adoption of a new accounting policy for events or transactions which did not occur previously or that were material.

4. Prior period items:

Prior period items are incomes or expenses which arises in current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Errors may be occur as a result of:

- Mathematical mistakes,
- Mistakes in applying accounting policies,
- Misinterpretation of facts, or
- Oversight.

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

Examples of prior period item:

(a) Error in calculation of depreciation

(b) Use of incorrect rates of depreciation

(c) Omission to provide depreciation Non provision for bad/doubtful debts, etc

CLASSWORK QUESTIONS

Question 1

Advise B Co. Ltd. about the treatment of the following in the financial statement of accounts for the year ended 31st March 2012:

The company finds that the stock sheets as on 31st March 2011 had included twice an item the cost of which was ₹ 55,000

Question 2

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2010-2011.

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 31.3.2011. 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?

Question 3

X Co. Ltd. signed an agreement with its employees union for revision of wages in June, 2012. The wage revision is with retrospective effect from 1.4.2008. The arrear wages upto 31.3.2012 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2012 to 30.06.2012 (being the date of agreement) amounts to ₹ 7 lakhs.

Decide whether a separate disclosure of arrear wages is required.

Question 4

S.T.B. Ltd. makes provision for expenses worth ₹ 7,00,000 for the year ending March 31, 2011, but the actual expenses during the year ending March 31, 2012 comes to ₹ 9,00,000 against provision made during the last year. State with reasons whether difference of ₹ 2,00,000 is to be treated as prior period item as per AS-5.

Question 5

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.

Question 6

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2015.

The company wants to provide during the year ending 31.3.2015 based on technical evaluation:

Total value of stock	₹ 100 lakhs
Provision required based on 12 months issue	₹ 3.5 lakhs
Provision required based on technical evaluation	₹ 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

Question 7

A company created a provision of ₹ 75,000 for staff welfare while preparing the financial statements for the year 2010 - 11. 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, 2011.

Explain the treatment of such revision in financial statements for the year ended 31st March,2011.

CLASSWORK SOLUTIONS

Answer 1

As per AS – 5 Prior period items are incomes or expenses, which arise in the current period as a result of errors or omissions in the preparation of financial statement of one or more prior periods.

Hence Rectification of Error in opening stock valuation is a prior period item.

The amount of ₹ 55,000 shall be deducted from the opening stock in the profit & loss account for the current year and should also be charged as prior period adjustment in the Profit & Loss account, below the line.

As 5 requires separate disclosure of prior period item with their nature and amount.

Answer 2

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the preparation of financial statements involves 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.

In the given case, a limited company created 2.5% provision for doubtful debts for the year 2010-2011. Subsequently in 2011 the company 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 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 and quantified.

Answer 3

It is given that revision of wages took place in June, 2012 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2012 cannot be taken as an error or omission in the preparation of financial statements of earlier years and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 87 lakhs {from 1.4.2008 to 30.6.2012} 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 do not qualify as an extraordinary item. However, as per AS 5, '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 1.4.2012 to 30.6.2012} amounting ₹ 7 lakhs is not a prior period item hence need not be disclosed separately. This may be shown as current year's wages.

Answer 4

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.

As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. Thus, revision of an estimate by its nature i.e. the difference of ₹2 lakhs, is not a prior period item.

Therefore, in the given case expenses amounting ₹ 2,00,000 (₹9,00,000 – ₹7,00,000) relating to the previous year recorded in the current year, should not be regarded as prior period item

Answer 5

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. 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 items.

Therefore, in the year 2012-13, revision in accounting estimate should also be classified as extra-ordinary items in the profit and loss account and closing stock should he shown excluding the value of damaged stock.

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

		₹
Closing Stock of Normal goods		1,38,000
Stock of Abnormal goods	12,000	
Less: decline in NRV (extra-ordinary item)	(8,000)	4,000

Answer 6

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Requirement to provide for non-moving stocks may be said as accounting policy but the basis for making provision will not constitute accounting policy. It will be considered as an accounting estimate. Further, the method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2014-15: "The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ₹ 1 lakh."

HOMEWORK SECTION

Question 8

(i) During the year 2016-2017, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?

(ii) A company signed an agreement with the Employees Union on 1.9.2016 for revision of wages with retrospective effect from 30.9.2015. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2016-17?

Question 9

Explain whether the following will constitute a change in accounting policy or not as per AS 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organisation.

PAST PAPER QUESTION

Question 10

M/s PQR Ltd. is in the process of finalising its accounts for the year ended 31st March, 2018. The company seeks your advice on the following:

(i) Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, 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 account for the year ended 31st March, 2018.

(ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18. Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. 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 extra ordinary item or prior period item? **(May'18)**

Question 11

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months up to 31.03.2017. The company now wants to make provision based on technical evaluation during the year ending 31.03.2018.

Total value of stock ₹120 lakhs

Provision required based on technical evaluation ₹ 3.00 lakhs Provision required based on 12 months no issues ₹ 4.00 lakhs

You are requested to discuss the following points in the light of Accounting Standard– 1:

(i) Does this amount to change in accounting policy?

(ii) Can the company change the method of accounting? **(Nov'18)**

Question 12

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.

Question 13

Give two examples on each of the following items:

(i) Change in Accounting Estimate

(ii) Extra Ordinary items

(iii) Prior Period Items **(Nov'12)**

Question 14

The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016- 2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories. **(Nov 17)**

Question 15

Shama was working with ABC Ltd. drawing monthly salary of ₹ 25,000 per month. She went on maternity leave with pay for 7 months i.e. from 01-01-2017 to 31-7-17. Her salary for 3 months was not provided for in financial statements for F.Y. 2016-17 due to omission. When she joined after leave period, the whole salary for 7 months was paid to her. You are required to

(i) Pass the necessary journal entries in F.Y. 2017-18 to record the above transaction as per accounting standard – 5 and state reason for thesame.

(ii) Would the treatment have been different, if Shama was terminated on 01- 01- 2017 and was reinstated in service by the court w.e.f. 01-08-2017 with instruction to pay Shama salary for the intervening period i.e. 01-01-2017 to 31-07-2017.

(Nov'17)

Question 16

State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary items / Prior period items / Ordinary Activity :

(i) Actual bad debts turning out to be more than provisions.

(ii) Change from Cost model to Revaluation model for measurement of carrying amount of PPE.

(iii) Government grant receivable as compensation for expenses incurred in previous accounting period.

(iv) Treating operating lease as finance lease.

(v) Capitalisation of borrowing cost on working capital.

(vi) Legislative changes having long term retrospective application.

(vii) Change in the method of depreciation from straight line to WDV.

(viii) Government grant becoming refundable.

(ix) Applying 10% depreciation instead of 15% on furniture.

(x) Change in useful life of fixed assets **(Jan 2021)**

Question 17

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January, 2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to ₹ 30 lakhs. The management asked the Finance manager to charge ₹ 30 lakhs as prior period item while finalizing financial statements for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021-22.

Discuss with reference to applicable Accounting Standards. **(May 22)**

Question 18

The Accountant of Shiva Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policies or change in Accounting Estimates for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of AS – 5:

(i) Provision for doubtful debts was created @ 3% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 4%.

(ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till 31st March, 2020 the furniture was depreciated on straight line basis over a period of 5 years. From the Financial year 2020-2021, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2021, there was change in cost formula in measuring the cost of inventories. **(Nov'22 - 5 Marks)**

AS 7 - CONSTRUCTION CONTRACT

1. APPLICABLITY :

AS 7 addresses the issue of allocation of revenue & costs attributable to contract activity to the accounting period in which construction work is performed.

2. DEFINITION :

A construction contract is defined as a contract specifically negotiated for the construction of an asset or combination of assets that are closely inter-related or inter-dependent in terms of their design, technology & function or their ultimate purpose or use e.g. :- contract for construction of a bridge, building, dam, pipeline, road etc. Construction contracts also include contract for rendering services relating to construction of assets (e.g. :- service of architect) & contracts for destruction or restoration of asset & restoration of environment following demolition of asset.

3. TYPES OF CONSTRUCTION CONTRACTS :

Construction contracts are of the following 2 types:

(a) Fixed price construction contracts : are those in which parties agree to a fixed price or fixed rate per unit & in some cases subject to escalation clause

(b) Cost plus construction contracts : are those which involves reimbursement of defined costs plus a percentage of such cost or a fixed fee.

Cost plus contracts involving a maximum ceiling would bear the characteristics of both the above types.

4. ADDITIONAL ASSET :

Construction contracts may provide for construction of additional asset at the option of the customer. The construction of additional asset should be treated as a separate contract if the asset differs significantly from the asset covered by the original contract & the price of the additional asset is independent of the original contract price.

5. PROFIT OR LOSS ON CONTRACT :

Profit / Loss is to be calculated for each contract separately but when a group of contracts have been negotiated as a single package with an overall profit margin then all such contracts put together would be treated as a singlecontract.

To calculate the contract profit/loss, contract revenue & costs must be calculated.

➢ **Contract revenue consists of :**

(a) Agreed price

(b) Claims arising due to escalation clause

(c) Claims for re-imbursement of costs not included in the contract price

(d) Increase or decrease in revenue due to change or variation in scope of work to be performed

(e) Incentives (additional amounts paid if performance exceeds agreed targets)

➢ **Contract costs consists of the following :**

(a) Direct or specific costs : Direct materials, direct labour & direct expenses

(b) Allocable costs : Insurance, design & technical assistance expenditure etc. specifically chargeable under the contract

➢ **Following costs are excluded from contract costs :**

(a) General administration cost

(b) Selling costs

(c) R & D costs

(d) Depreciation on idle plant & equipment

➢ Costs incurred in securing contracts & pre-contract costs are included in the contract costs if it is probable that contract will be obtained. Otherwise they should be charged to the General P & L A/c.

➢ Interest cost can be included in contract costs if the asset is a qualifying asset as per AS – 16.

6. RECOGNITION OF CONTRACT COST & REVENUE :

When the outcome of the contract can be estimated reliably then contract revenue & related costs are recognized as revenue & costs by reference to the stage of completion of the contract activity at the Balance Sheet date. This is also called Percentage Completion Method (PCM). The stage of completion can be determined in a variety of ways:

(a) Cost to cost method: Compare the total cost incurred to date with the total estimated cost of the contract. Therefore,

$$\% \text{ of completion} = \frac{\text{cost incurred till date}}{(\text{cost incurred till date} + \text{cost likely to be incurred for completion})} \times 100$$

(b) Survey of work performed

(c) Completion of a physical proportion of the contract work.

➢ Contract revenue recognition = (Contract price* % of completion) – Revenue recognized earlier.

7. **PROVISION FOR EXPECTED LOSS :**

When it is probable that total contract costs will exceed total contract revenue, expected loss should be recognized as an expense immediately irrespective of

(a) Whether or not work has commenced

(b) The stage of completion

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

8. When the outcome of a contract cannot be reliably estimated then revenue should be recognized only to the extent of costs incurred & of which recovery is possible. Recognition of revenue & expenditure in construction contracts is based on estimates. Changes in estimates in year- to-year are accounted as a change in accounting estimate as per AS 5. This change will neither be a PPI nor an extra-ordinary item.

9. **DISCLOSURE :**

An enterprise should disclose the method used to determine the stage of completion & method used to determine contract revenue. In addition to the policy disclosure, the following disclosures are also required :

(a) Amount of contract revenue recognized during the period

(b) Contract cost incurred & recognition of profit

(c) Advance received

(d) Gross amount due from (Costs Incurred + Recognised Profit - Recognised Losses - Progressive Due from customer)

(e) Gross amount due to customers (Progressive Billing + Recognised Losses - Recognised Profit - Costs Incurred)

(f) Retentions

CLASSWORK QUESTIONS

Question 1

M/s Highway .Constructions undertook the construction of a highway on 01.04.2013. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.2014 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Question 2

Akar Ltd. Signed on 01/04/16, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/17.

- Materials issued ₹ 75,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Out of material issued, material lying unused at the end of period is ₹ 4,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.17.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS-7.

Question 3

A construction contractor has a fixed price contract for ₹ 9,000 lacs to build a bridge in 3 years' time frame. A summary of some of the financial data is as under:

	(Amount ₹ in lacs)		
	Year 1	Year 2	Year 3
Initial Amount for revenue agreed in contract	9,000	9,000	9,000
Variation in Revenue (+)	-	200	200
Contracts costs incurred up to the reporting date	2,093	6,168*	8,100**
Estimated profit for whole contract	950	1,000	1,000

* Includes ₹ 100 lacs for standard materials stored at the site to be used in year 3 to complete the work.

** Excludes ₹ 100 lacs for standard material brought forward from year 2.

The variation in cost and revenue in year 2 has been approved by customer.

Compute year wise amount of revenue, expenses, contract cost to complete and profit or loss to be recognized in the Statement of Profit and Loss as per AS-7 (revised).

Question 4

Mr. Shyam, a construction contractor undertakes the construction of an industrial complex. He has separate proposals raised for each unit to be constructed in the industrial complex. Since each unit is subject to separate negotiation, he is able to identify the costs and revenues attributable to each unit. Should Mr. Shyam treat construction of each unit as a separate construction contract according to AS 7?

Answer 4

As per AS 7 'Construction Contracts', when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

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

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

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

Therefore, Mr. Shyam is required to treat construction of each unit as a separate construction contract.

HOMEWORK SECTION

Question 5

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹ 3 crore on 1st September, 2014. On 31st March, 2015 the company found that it had already spent ₹ 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2015, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

Question 6

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2014. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at ₹ 53 crores. Can the company provide for the expected loss in the book of account for the year ended 31st March, 2015?

PAST PAPER SECTION

Question 7

An amount of ₹ 9,90,000 was incurred on a contract work up to 31-3-2010. Certificates have been received to date to the value of ₹ 12,00,000 against which ₹ 10,80,000 has been received in cash. The cost of work done but not certified amounted to ₹ 22,500. It is estimated that by spending an additional amount of ₹ 60,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of work is ₹ 12,50,000. Compute a conservative estimate of the profit to be taken to the Profit and Loss Account as per AS-7.

(Nov'10)

Question 8

From the following data, show Profit and Loss A/c (Extract) as would appear in the books of a contractor following Accounting Standard-7:

	(₹ in lakhs)
Contract Price (fixed)	480.00
Cost incurred to date	300.00
Estimated cost to complete	200.00

(Nov'11)

Question 9

M/s Excellent Construction Company Limited undertook a contract to construct a building for ₹ 3 Crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ₹ 1 Crore 80 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 1 Crore 40 Lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

(May'12)

Question 10

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2016 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹ 12 crores with an escalation clause. The costs to complete the whole contract are estimated at ₹ 9.50 crores of rupees. You are given the following information for the year ended 31.03.2016:

Cost incurred up to 31.03.2016 ₹4 crores

Cost estimated to complete the contract ₹6 crores

Escalation in cost by 5% and accordingly the contract price is increased by 5%. You are required to ascertain the state of completion and state the revenue and profit to be recognized for the year as per AS-7. **(May'16)**

Question 11

Akar Ltd. signed on 01/04/16, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/17.

- Materials issued ₹75,00,000
- Labour charges paid ₹36,00,000
- Hire charges of plant ₹10,00,000
- Other contract cost incurred ₹15,00,000
- Out of material issued, material lying unused at the end of period is ₹4,00,000
- Labour charges of ₹2,00,000 are still outstanding on 31.3.17.
- It is estimated that by spending further ₹ 33,50,000 the work can be completed in all respect.

You are required to compute profit/loss to be taken to Profit & Loss Account and additional provision for foreseeable loss as per AS – 7. **(May'17)**

Question 12

M/s Action Construction Company Ltd. undertook a fixed price construction contract to construct a building within 3 year's time for ₹10,000 lakhs.

A summary of the financial data during the construction period is as follows:

(₹ in lakhs)

	Year 1	Year 2	Year 3
Initial amount for revenue agreed in contract	10,000	10,000	10,000
Variation in Revenue (+)	-	500	1,000
Contract costs incurred up to the reporting date	2,415	6,375	8,500
Estimated profit for whole contract	1,950	2,000	2,500

The variation in cost and revenue in year 2 and 3 has been approved by customer. Determine the stage of completion of contract and amount of revenue, expenses and profit or loss to be recognised in the statement of Profit and Loss for three years as per AS-7 (Revised). **(Nov'18)**

Question 13

Sarita Construction Co obtained a contract for construction of a dam. The following details are available in records of company for the year ended 31st March, 2018:

	₹ in lakhs
Total Contract Price	12,000
Work Certified	6,250
Work not certified	1,250
Estimated further cost to completion	8,750
Progress payment received	5,500
Progress payment to be received	1,500

Applying the provisions of Accounting Standard 7 "Accounting for Construction Contracts" you are required to compute:

(i) Profit/Loss for the year ended 31st March, 2018.

(ii) Contract work in progress as at end of financial year 2017-18.

(iii) Revenue to be recognized out of the total contract value.

(iv) Amount due from/to customers as at the year end.

(May'18)

Question 14

Shyan Limited commenced a construction contract on 01-04-2018. The company expended ₹ 500 crores in 2018-19 for 40% work. The total estimated cost of the project is ₹ 1,250 crores. Compute (i) Revenue, (ii) Expense, (iii) Provision for loss and (iv) Profit or loss to be recognized in the statement of Profit and Loss A/c as per AS-7 for the year ending 31-03-2019 if:

(1) It is fixed price contract of ₹ 1,200 crores.

(2) It is cost plus contract of 20%. **(Nov' 19)**

Question 15

On 1st December, 2019, Mahindra Construction Co. Ltd. undertook a contract to construct a building for ₹ 170 lakhs. On 31st March, 2020, the company found that it had already spent ₹ 1,29,98,000..on the construction. Prudent estimate of additional cost for completion was ₹ 64,02,000. Calculate total estimated loss on contract and what should be charged to statement of profit and loss account as contract revenue and contract cost in the final accounts for the year ended 31st March, 2020, as per provision of Accounting Standard 7 (Revised). **(Nov' 20)**

Question 16

(i) AP Ltd., a construction contractor, undertakes the construction of commercial complex for Kay Ltd. AP Ltd. submitted separate proposals for each of 3 units of commercial complex. A single agreement is entered into between the two parties. The agreement lays down the value of each of the 3 units, i.e. ₹ 50 Lakh ₹ 60 Lakh and ₹ 75 Lakh respectively. Agreement also lays down the completion time for each unit. omment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.

(ii) On 1st December, 2017, GR Construction Co. Ltd. undertook a contract to construct a building for ₹ 45 lakhs. On 31st March, 2018, the company found that it had already spent ₹ 32.50 lakhs on the construction. Additional cost of completion is estimated at ₹ 15.10 lakhs. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2018 as per provisions of AS-7?

Question 17

Rajendra undertook a contract for ₹ 20,00,000 on an arrangement that 80% of the value of work done as certified by the architect of the contractee, should be paid immediately and that the remaining 20% be retained until the Contract was completed.

In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.

In Year 2, the amounts expended were ₹ 4,75,000. Three-fourths of the Contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.

In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.

Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year. **(Nov' 20)**

Question 18

The following data is provided for M/s. Raj Construction Co.

(i) Contract Price - ₹ 85 lakhs

(ii) Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused at the end of the period.

(iii) Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)

(iv) Specific Contract Costs - ₹ 5 Lakhs

(v) Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to sub-contractors - ₹ 4 Lakhs

(vi) Further Cost estimated to be incurred to complete the contract - ₹ 35 Lakhs

You are required to compute the Percentage of Completion, the Contract Revenue and Cost to be recognized as per AS-7. **(July 21)**

Question 19

Grace Ltd., a firm of contractors provided the following information in respect of a contract for the year ended on 31st March, 2022:

Particulars	(₹ in ' 000)
Fixed Contract Price with an escalation clause	35,000
Work Certified	17,500
Work not Certified (includes ₹ 26,25,000 for materials issues, out of which material lying unused at the end of the period is ₹ 1,40,000)	3,815
Estimated further cost to completion	17,325
Progress Payment Received	14,000
Payment to be Received	4,900
Escalation in cost is by 8% and accordingly the contract price is increased by 8%	

From the above information, you are required to:

(i) Compute the contract revenue to be recognised,

(ii) Calculate Profit/Loss for the year ended 31st March, 2022 and additional provision for loss to be made, if any, for the year ended 31st March, 2022.

(May 22)

REVISION QUESTIONS

Question 20

On 1st December, 2016, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 2017, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2017 as per provisions of Accounting Standard 7 (Revised)?

AS 9 - REVENUE RECOGNITION

1. WHY AS 9?

It is basically concerned with the "timing of recognition" in the statement of Profit and Loss. It lays down criteria for recognition of revenue most suited to preparers of FS of enterprises engaged in varied activities.

2. WHAT IS REVENUE?

Revenue means the gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from sale of goods, from the rendering of services and from the use by others of the resources of the enterprise yielding interest, royalties and dividend.

3. COMMON ELEMENTS FOR RECOGNITION OF REVENUE:

To all these three groups aforesaid, there are two common elements. It is imperative to seek answers to two questions.

- No significant uncertainty exists regarding the amount of the consideration that will be derived (MEASURABILITY)
- Are we certain that the amount will be received? (COLLECTABILITY)

NOTE:

(a) If Consideration is not measurable

Consideration receivable for sale of goods or for rendering of services should be determinable. When such consideration is not determinable within reasonable lim- its, revenue recognition will be postponed.

(b) If collectability isuncertain

When there is uncertainty about the collection of revenue even at the time when claim is raised recognition must be postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reason- ably certain that the ultimate collection will be made.

Where there is no uncertainty as to ultimate collection, revenue is recognized at the time of sale or rendering of service even though payments are made by installments.

(c) Effect of postponement

When recognition of revenue is postponed due to the effect of uncertainties, the amount is considered as revenue of the period in which it is properly recognized.

(d) Uncertainty arises later - make a provision(Do not adjust revenue)

When a transaction was concluded initially, the collectability was certain. Revenue, therefore, stood recognized. Subsequent to sale or rendering of the service, and at a much later date, the collectability of consideration is rendered uncertain. In such a situation, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

4. SALE OF GOODS:

Revenue is to be recognized when the following conditions are satisfied:

(a) The seller has transferred to the buyer the property in goods for a consideration, OR

(b) Significant risks and rewards of ownership have been transferred to the buyer AND

(c) No significant uncertainty exists regarding the amount of consideration that will be derived from the sale of goods.

5. RENDERING OF SERVICES :

The Standard prescribes two methods:

(a) COMPLETED SERVICE CONTRACT METHOD:

Performance in a service contract may consist of

(i) one single act

(ii) or more than one act, where services not performed are significant enough in relation to all transaction taken as whole. Under such conditions, performance is not deemed complete and service is not chargeable unless all the transactions are completed.

Revenue is recognized only when the SOLE or FINAL act takes place and the service becomes chargeable.

(b) PROPORTIONATE COMPLETION METHOD:

This method evolved out of accrual concept - is to be applied when performance consists of execution of more than one act. Revenue is to be recognized proportionately by reference to the performance of each act.

Revenue is recognized when EACH independent act takes place and the proportionate service becomes chargeable.

6. OTHER INCOME:

(a) INTEREST:

Revenue must be recognized on time proportion basis.

(b) ROYALTIES:

Revenue is recognized on accrual basis in accordance with the terms of relevant agreement.

(c) DIVIDENDS:

Revenue is to be recognized only when the owner's right to receive payment is established (When dividends are DECLARED)

EXCEPTION: When interest, royalties and dividends are receivable from other countries which requires forex permission, revenue recognition has to be on CASH BASIS.

CLASSWORK QUESTIONS

Question 1

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

Question 2

Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. Received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respectively from Y Co. Ltd. during the year 2005-06. You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd, as per AS-9.

Question 3

X Limited has recognized ₹ 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of ₹ 50 lakhs held by it as at the end of the financial year 31st March, 2003. The dividends on mutual funds were declared at the rate of 20% on 15th April, 2003. The dividend was proposed on 10th March, 2003 by the mutual funds. Whether the treatment is as per the relevant Accounting Standard? You are asked to answer with reference to provisions of Accounting Standard.

Question 4

The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive ₹ 5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

Question 5

A Ltd. entered into a contract with B Ltd. to dispatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. started dispatching goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to dispatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for dispatch. A Ltd. accounted

₹ 50,000 as sales and transferred the balance to advance received against sales. Comment upon the treatment of balance amount with reference to the provisions of accounting standard 9.

Question 6

Arjun Ltd. sold farm equipment's through its dealers. One of the conditions at the time of sale is payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2015, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9?

Answer 1

As per Para 4.1 of AS 9 "Revenue Recognition", revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. In the given case, M/s Prima Co. Ltd. Should record the sales at gross value of ₹ 50,000. Discount of ₹ 8,000 in price and goods returned worth ₹ 7,000 are to be adjusted by suitable provisions. M/s Prime Co. Ltd. might have sent the credit note of ₹ 15,000 to M/s Y & Co. to account for these adjustments. The contention of the accountant to book the sales for ₹ 35,000 is not correct.

Answer 2

As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest & royalties should only be recognised when no significant uncertainty as to measurability or collectability exists.

These revenues are recognised on the following bases:

(1) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.

(2) Royalties: on an accrual basis in accordance with the terms of the relevant agreement.

Answer 3

Paragraph 8.4 and 13 of Accounting Standard 9 on Revenue Recognition states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th March, 2003, while it is declared on 15th April, 2003. Hence, the right to receive payment is established on 15th April, 2003. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by X Ltd. in the financial year ended 31st March, 2004. The recognition of ₹ 10 lakhs on accrual basis in the financial year 2002-2003 is not as per AS 9 'Revenue Recognition'.

Answer 4

As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X

Ltd., of ₹ 5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Answer 5

According to AS- 9, In case of sale of goods, the physical delivery of goods is not important for revenue recognition. What is relevant is transfer of significant risk & reward. Where delivery is delayed at buyer's request and buyer takes title and accepts billing. Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

Here in this case on the request of B Ltd., goods worth ₹ 50,000 ready for dispatch but are held with A Ltd. until further notice is received from B Ltd. for its delivery.

Therefore A Ltd. will recognize ₹ 50,000 as its revenue for that period.

Answer 6

As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made. In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized

HOMEWORK SECTION

Question 7

M/s. Moon Ltd. sold goods worth ₹ 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to ₹ 53,000 and same was agreed to by M/s. Moon Ltd. The sale was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth ₹ 67,000 are defective. Mr. Star returned defective goods to M/s. Moon Ltd. and made payment due amounting to ₹ 5,30,000. The accountant of M/s. Moon Ltd. booked the sale for ₹ 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9.

Question 8

Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2014 issue was made in February 2014. The magazine was published on its scheduled date. It received ₹ 2, 40,000 on 10.3.2014 and ₹ 60,000 on 10.4.2014 for the March 2014 issue. Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2014. What will be the treatment if the publication is delayed till 2.4.2014?

Question 9

Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹ 60,000 were sold on 20-3-2015 but at the request of the buyer these were delivered on 10-4-2015.

(ii) On 15-1-2015 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015.

(iii) ₹ 1, 20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 and no approval or disapproval received for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹ 7, 80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31- 3-2015.

Question 10

According to Accounting Standard – 9, when revenue from sales should be recognised? **(May'10)**

Question 11

M/s. SEA Ltd. recognized ₹ 5.00 lakhs on accrual basis income from dividend during the year 2010-11, on shares of the face value of ₹ 25.00 lakhs held by it in Rock Ltd. as at 31st March, 2011. Rock Ltd. proposed dividend @ 20% on 10th April, 2011. However, dividend was declared on 30th June, 2011. Please state with reference to relevant Accounting Standard, whether the treatment accorded by SEA Ltd. is in order. **(Nov'11)**

Question 12

M/s. Umang Ltd. sold goods through its agent. As per terms of sales, consideration is payable within one month. In the event of delay in payment, interest is chargeable @ 12% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2015 interest due from agent (because of delay in payment) amounts to ₹ 1,72,000. The accountant of M/s Umang Ltd. booked ₹ 1,72,000 as interest income in the year ended 31st March, 2015. Discuss the contention of the accountant with reference to Accounting Standard – 9. **(Nov'15)**

Question 13

A manufacturing company has the following stages of production and sale in manufacturing Fine paper rolls:

Date	Activity	Costs to Date (₹)	Net Realizable Value (₹)
15.1.16	Raw material	1,00,000	80,000
20.1.16	Pulp (WIP 1)	1,20,000	1,20,000
27.1.16	Rough & thick paper (WIP 2)	1,50,000	1,80,000
15.2.16	Fine Paper Rolls	1,80,000	3,50,000
20.2.16	Ready for sale	1,80,000	3,50,000
15.3.16	Sale agreed and invoice raised	2,00,000	3,50,000
02.4.16	Delivered and paid for	2,00,000	3,50,000

Explain the stage on which you think revenue will be generated and state how much would be net profit for year ending 31-3-16 on this product according to AS – 9.**(Nov'16)**

Question 14

Raj Ltd. entered into an agreement with Heena Ltd. to dispatch goods valuing ₹ 5,00,000 every month for next 6 months on receipt of entire payment. Heena Ltd. accordingly made the entire payment of ₹ 30,00,000 and Raj Ltd. started dispatching the goods. In fourth month, due to fire in premise of Heena Ltd., Heena Ltd. requested to Raj Ltd. not to dispatch goods until further notice. Due to this, Raj Ltd. is holding the remaining goods worth ₹ 15,00,000 ready for dispatch. Raj Ltd. accounted ₹ 15,00,000 as sales and transferred the balance to Advance received against Sales account.

Comment upon the above treatment by Raj Ltd. with reference to the provision of AS–9.

(May'17)

Question 15

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information oh 31st March, 2017:

(i) On 15th January, 2017 garments worth ₹ 4,00,000 were sent to Anand on consignment basis of which 25% garments unsold were lying with Anand as on 31st March, 2017.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2017 but at the request of Shine Boutique, these were delivered on 15th April, 2017.

(iii) On 1st November, 2016 garments worth ₹ 2,50,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods up to 31st December, 2016 and no approval or disapproval received for the remaining goods till 31st March, 2017.

You are required to advise the accountant of Fashion Limited, the amount to be recognised as revenue in above cases in the context of AS 9.

Question 16

Goods worth ₹ 6,62,500 were sold on 31.10.2017 by X Ltd. to Y Ltd. Y Ltd. requested for a trade discount of 8 % which was agreed by X Ltd. The sale was effected and goods were dispatched. However, on receipt of the goods, Y Ltd. found that goods worth ₹ 77,500 were damaged. Consequently, Y Ltd. returned the damaged goods to X Ltd. and made the due payment amounting to ₹ 5,32,000, The accountant of X Ltd. booked the sale for ₹ 5,32,000.

Discuss the above treatment by the accountant with reference to applicable Accounting Standard.

(Nov'18)

Question 17

Given the following information of ABC Ltd.

(i) Goods of ₹ 80,000 were sold on 10-03-2019 but at the request of the buyer these were delivered on 10-04-2019.

(ii) On 25-01-2019 goods of ₹ 2,00,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2019.

(iii) ₹ 2,40,000 worth of goods were sold on approval basis on 1-12-2018. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2019 and no approval or disapproval received for the remaining goods till 31-3-2019.

(iv) Apart from the above, the company has made cash sales of ₹ 9,60,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of ABC Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 for the year ending 31-03-2019.

Question 18

Given below are the following informations of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2018 but at the request of the buyer these were delivered on 15-04-2018.

(ii) On 13-01-2018 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2018.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2017. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2018 and no approval or disapproval received for the remaining goods till 31-03-2018.

You are required to advise the accountant of B.S. Ltd., with valid reasons, the amount to be recognized as revenue for the year ended 31st March, 2018 in above cases in the context of AS-9. **(May' 19)**

Question 19

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS-9.

(1) Trade discount and volume rebate received.

(2) Where goods are sold to distributors or others for resale.

(3) Where seller concurrently agrees to repurchase the same goods at a later date.

(4) Insurance agency commission for rendering services.

(5) On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-2019.

Question 20

Given the following information of Rainbow Ltd.

(i) On 15th November, goods worth ₹ 5,00,000 were sold on approval basis. The period of approval was 4 months after which they were considered sold. Buyer sent approval for 75% goods sold upto 31st January and no approval or disapproval received for the remaining goods till 31st March.

(ii) On 31st March, goods worth ₹ 2,40,000 were sold to Bright Ltd. but due to refurnishing of their show-room being underway, on their request, goods were delivered on 10th April.

(iii) Rainbow Ltd. supplied goods worth ₹ 6,00,000 to Shyam Ltd. and concurrently agrees to re-purchase the same goods on 14th April.

(iv) Dew Ltd, used certain assets of Rainbow Ltd. Rainbow Ltd. received ₹ 7.5 lakhs and ₹ 12 as interest and royalties respectively from Dew Ltd. during the year 2020 -21.

(v) On 25th December, goods of ₹ 4,00,000 were sent on consignment basis of which 40% of the goods unsold are lying with the consignee at the year-end on 31st March.

In each of the above cases, you are required to advise, with valid reasons, the amount to be recognized as revenue under the provisions of AS-9.

(Dec 21)

Question 21

Indicate in each case whether revenue can be recognized and when it will be recognized as per AS – 9.

(i) Delivery is delayed at buyer's request but buyer takes title and accepts billing.

(ii) Instalment Sales.

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising commission.

(Nov'22 - 5 Marks)

Question 22

Toy Ltd. is engaged in manufacturing toys. They provide you the following information as on 31st March, 2023:

(i) On 15th January, 2023, Toys worth ₹ 5,00,000 were sent to A Ltd. on consignment basis of which 25% Toys unsold were lying with A Ltd. as on 31st March, 2023.

(ii) Toys worth ₹ 2,25,000 were sold to S Ltd. on 25th March, 2023 but at the request of S Ltd., these were delivered on 15th April, 2023.

(iii) On 1st November, 2022, toys worth ₹ 3,50,000 were sold on approval basis. The period of approval was 4 moths after which they were considered sold. Buyer sent approval for 75% goods upto 31st December, 2022 and no approval or disapproval received for the remaining goods till 31st March, 2023.

You are required to advise the accountant of Toy Ltd, The amount to be recognised as revenue in above cases in the context of AS - 9

AS 10 - PROPERTY, PLANT & EQUIPMENT

1. MEANING :

The Property, Plant and Equipment know as Fixed asset (Tangible Assets)

These tangible assets are asset held with the intention of being used for the purpose of producing or providing goods or services is not held for sale in normal course of business.

Eg: Land, Building, Plant and Machinery, Furniture and fixtures, office equipments etc.

2. AS 10 DOES NOT APPLY :

- Biological assets
  - Living animals
  - Living Plants (Does not include bearer plants)
- Wasting assets
- Asset Covered by another AS

Note: AS is applicable on bearer plants.

3. AT WHAT VALUE SHOULD ANY ASSET BE SHOWN IN BALANCE SHEET ?

- Historic Cost
- Revalued Price

- **Historic Cost**

  Cost Under different circumstances

  - **Purchased**

    Cost of an item of fixed asset comprises of its purchase prices, including non refundable taxes, any directly attributable cost and PV of decommissioning.

  - **Self generated fixed asset**

    Include all directly attributable cost (exclude any internal profits)

  - **Exchange**

    FMV of asset that goes out , if it is more evident otherwise FMV of asset that comes in recd.

  - **Free**

    Record @ Nominal Value

- **Cost of jointly held assets**

  Prorata cost of such jointly owned asset is grouped together with similar fully owned assets.

- **Cost of assets acquired under consolidated basis**

  Cost of each fixed asset @ FMV By component valuation officer.

• **Revalued Price**

- 1st time upward revaluation –RR
- Ist time downward revaluation- P/L
- Present increase is credited to RR if previous revaluation also led to increase
- Present increase is relatable to previous decrease the credit revenue to the extent of previous decrease and remaining increase in RR
- Present decrease is charged to P/L if previous revaluation also led to decrease
- If present decrease is relatable to previous increase then change RR to intent of previous increase & remaining in P/L

Note: Revaluation should be performed for an ENTIRE CLASS of PPE

4. COMPONENT ACCOUNTING :

- An asset may consist of several different and significant physical components.
- If an item of PPE may consist two or More Significant components with substantially different useful life or usage then each component must be recorded and depreciated SEPARATELY

Note: When a significant component is replaced, the old component is de-recognized.

5. SUBSEQUENT EXPENDITURE :

- It is the expenditure, which is incurred after the initial recognition i.e. after the asset is ready to use or being used. Here, we discuss whether subsequent expenditure will go to P&L or will be capitalized along with PPE. It depends on the nature and benefits from the expenditure incurred.

Does the subsequent expenditure increases future economic benefits i.e satisfies the recognition criteria?

YES	NO
Capitalise along with PPE	Charge to P&L statement

- If subsequent expenditure increases the future economic benefits i.e. satisfies recognition criteria then such expense is recognized as a separate component and depreciated over its useful life.
- Costs of day to day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the "repairs and maintenance" of item of PPE and these expenses should be charged to Profit and loss Account.
- If a part of PPE is replaced then it should be capitalized as Component of PPE if it meets recognition criteria given by AS, otherwise, it will be charged to P&L statement.
- A condition of continuing to operate an item of PPE may be performed in regular intervals as major inspection for faults regardless of whether parts of PPE are replaced. When each such major inspections are performed, its cost is capitalized as part of PPE as a replacement if the recognition criteria is satisfied.

6. DEPRECIATION :

- Depreciable amount= Cost-SV
- It is systematic allocation of depreciable amount of an asset over its useful life
- Determinants-Cost-SV-Life-Future Economic benefits
- Methods- SLM, WDV, on basis of future economic benefits
- Changes in methods/ determinant – Change in Accounting estimate, effect prospective as per AS 5

7. RETIREMENT :

Value @ Net Book Value

Or

Net realizable value, whichever is lower

8. DISPOSAL :

- If Entity followed cost model then profit or loss on sale will go to profit or loss account.
- If entity followed revaluation model then profit or loss on sale will go to P/L a/c (after disposal Revaluation reserve will be transferred to general reserve)

9. DISCLOSURE :

- Depreciation method
- Depreciation rate
- Life of PPE
- Measurement basis (cost model or revaluation method)
- **Cost model**
  - In balance sheet show: Gross BV – Accumulated depreciation - Accumulated Impairment loss = Net BV
- **Revaluation Model**
  - In balance sheet show: Gross BV – SUBSEQUENT accumulated depreciation – SUBSEQUENT accumulated impairment loss = Net BV
- **Reconciliation between :**
  - Addition
  - Retirement
  - Disposal
  - Acquisition
  - Revaluation
  - Depreciation
  - Impairment loss
- Contractual commitment for acquisition of PPE
- Existence and restriction on title and PPE pledged as securities
- If the asset is revalued
  - Date of revaluation
  - Valuer is independent or not
  - Methods and assumption of revaluation
  - Revaluation surplus, if any

CLASSWORK QUESTIONS

Question 1

During the current year 2014-15, X Limited made the following expenditure relating to its plant building:

	₹ in lakhs
Routine Repairs	4
Repairing	1
Partial replacement of roof tiles	0.5
Substantial improvements to the electrical wiring system which will increase efficiency	10

What amount should be capitalized?

Question 2

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

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

Advise Z Ltd. on the costs that can be capitalized in accordance with AS – 10.

Question 3

Aman Ltd. Contracted with a supplier to purchase a specific machinery to be installed in Department A in two months time. Special foundations were required for the plant, which were to be prepared within this supply lead time. The cost of site preparation and laying foundations were ₹ 47,290. These activities were supervised by a technician during the entire period who is employed for this purpose of ₹ 15,000 per month. The technician's services were given to department A by department B, which billed the services at ₹ 16,500 per month after adding 10% profit margin. The machine was purchased at ₹ 52,78,000. Sales Tax was charged at 4% on the invoice, ₹ 18,590 transportation charges were incurred to bring the machine to the factory. An architect was engaged at a fee of ₹ 10,000 to supervise machinery installation at the factory premises. Also, payment under the invoice was due in 3 months. However, the company made the payment in 2nd month. The company operates on Bank Overdraft @11%. Ascertain the amount at which the assets should be capitalized under AS 10.

Question 4

M/s. Tiger Ltd. allotted 7,500 equity shares of ₹ 100 each fully paid up to Lion Ltd. in consideration for supply of a special machinery. The shares exchanged for machinery are quoted at National Stock Exchange (NSE) at ₹ 95 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, show how the value of the machinery would be recorded in the books of Tiger Ltd.?

Question 5

B Ltd.owns an asset with an original cost of ' 2,00,000'. On acquisition, management determined that the useful life was 10 years and the residual value would be '20,000'. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value. At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by company. As a result, the residual value will reduce to ₹ 10,000. How would the above changes in estimates be made by B Ltd.?

Question 6

With reference to , classify the items under the following heads:

HEADS

(i) Purchase Price of PPE

(ii) Directly attributable cost of PPE or

(iii) Cost not included in determining the carrying amount of an item of PPE.

ITEMS

(1) Import duties and non-refundable purchase taxes.

(2) Initial delivery and handling costs.

(3) Costs of testing whether the asset is functioning properly, after deducting the net proceeds.

(4) Initial operating losses, such as those incurred while demand for the output of an item builds up.

(5) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.

(6) Trade discounts and rebates.

(7) Costs of relocating or reorganizing part or all of the operations of an enterprise.

(8) Installation and assembly costs.

(9) Cost of site preparation.

(10) Administration and other general overhead costs. **(Nov'19)**

CLASSWORK SOLUTIONS

Answer 1

As per AS 10 property plant and equipment, expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity. Hence, in the given case, Repairs amounting ₹ 5 lakhs and Partial replacement of roof tiles should be charged to profit and loss statement ₹ 10 lakhs incurred for substantial improvement to electrical writing system which will increase efficiency should be capitalized.

Answer 2

Calculation of cost of Plant to be capitalized.

Particulars	₹
Cost of the Plant	25,00,000
(+) Initial Delivery & handling cost	2,00,000
(+) Cost of site preparation	6,00,000
(+) Consultation fees	7,00,000
(+) PV of Dismantling cost	3,00,000
Cost of Plant to be Capitalised	**43,00,000**

Answer 3

Calculation of Cost of Machinery to be Capitalised.

Particulars	₹
Purchase Price	52,78,000
(+) 4% Sales tax	2,11,120
(+) Cost of site preparation & Laying foundations	47,290
(+) Supervisors Salary (15000 p.m. × 2m)	30,000
(+) Transport Charges	18,590
(+) Architect's fees	10,000
Cost of Machinery	**55,95,000**

Notes:

(1) If is assumed that 4% sales tax is not included in the the purchase price, it is not refundable.

(2) Internal profits w.r.t. supervisors salary shall be eliminated.

(3) Interest on O.D. shall not form the cost of machinery.

Answer 4

As per AS 10 "Property, Plant & Equipment", fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more Clearly Evident. Since, in the given situation, the market value of shares exchanged for the asset is more clearly evident, the company should record the value of machinery at ₹ 7,12,500 (i.e. 7,500 shares × ₹ 95 per share) being the market price of the shares issued in exchange.

Answer 6

Heads

(i) Purchase price of PPE

(ii) Directly attributable cost of PPE

(iii) Cost not included in determining the carrying amount of an item of PPE

Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Costs of testing whether the asset is functioning properly, after deducting the net proceeds*	(ii)
4	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
5	Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity.	(iii)
6	Trade discounts and rebates (deducted for computing purchase price)	(i)
7	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
8	Installation and assembly costs	(ii)
9	Costs of site preparation	(ii)

*Considered that this cost of testing is after deducting net proceeds from selling any items produced while bringing the asset to that location and condition otherwise if the net proceeds are after fixing the asset to its location and condition (asset ready for use), it will be classified under category (iii) i.e. Cost not included in determining the carrying amount of an item of PPE.

HOMEWORK SECTION

Question 7

PQR Ltd. constructed a fixed asset and incurred the following expenses on its construction:

	₹
Materials	16,00,000
Direct Expenses	3,00,000
Total Direct Labour	6,00,000
(1/15th of the total labour time was chargeable to the construction)	
Total Office & Administrative Expenses	9,00,000
(4% of office and administrative expenses are specifically attributable to construction of a fixed asset)	
Depreciation on assets used for the construction of this asset	15,000

Question 8

During the year MIs Progressive Company Limited made additions to its factory by using its own workforce, at a cost of ₹ 4,50,000 as wages and materials. The lowest estimate from an outside contractor to carry out the same work was ₹ 6,00,000. The directors contend that, since they are fully entitled to employ an outside contractor, it is reasonable to debit the Factory Building Account with ₹ 6,00,000. Comment Comment whether the directors' c c contention is right in view of AS 10?

Question 9

On 01.04.2010 a machine was acquired at ₹ 4,00,000. The machine was expected to have a useful life of 10 years. The residual value was estimated at 10% of the original cost. At the end of the 3rd year, an attachment was made to the machine at a cost of ₹ 1,80,000 to enhance its capacity. The attachment was expected to have a useful life of 10 years and zero terminal value. During the same time the original machine was revalued upwards by ₹ 90,000 and remaining useful life was reassessed at 9 years and residual value was reassessed at NIL.

Find depreciation for the year, if

(i) Attachment retains its separate identity.

(ii) Attachment becomes integral part of the machine. **(May'14)**

Question 10

Ascertain the value at which various items of Fixed Assets are to be shown in the Financial Statements of Velvet Ltd. and amount to be debited to the Profit and Loss Account in the context of the relevant Accounting Standard.

Narrations for the adjustments made should form part of the answer;

(i) Goodwill was valued at ₹ 1,20,000 by independent valuers and no consideration was paid. The Company has not yet recorded the same.

(ii) Balance of Office Equipment as on 01-04.2013 is ₹ 1,20,000. On 01.04.2013, out of the above office equipment having book value ₹ 20,000 has been retired from use and held for disposal. The net realizable value of the same is ₹ 2,000. Rate of depreciation is 15% p.a. on WDV basis.

(iii) Book Value of Plant and Machinery as on 01.04.2013 was ₹ 7,20,000. On 01.08.2013 an item of machinery was purchased in exchange for 500 equity shares of face value ₹ 10. The Fair Market value of the equity shares on 01.08.2013 was ₹ 120. Rate of depreciation is 10% p.a. on WDV basis.

(May'14)

Question 11

In the books of Optic Fiber Ltd., plant and machinery stood at ₹ 6,32,000 on 1.4.2013. However on scrutiny it was found that machinery worth ₹ 1,20,000 was included in the purchases on 1.6.2013. On 30.6.2013 the company disposed a machine having book value of ₹ 1,89,000 on 1.4.2013 at ₹ 1,75,000 in part exchange of a new machine costing ₹ 2,56,000. The company charges depreciation @ 20% WDV on plant and machinery.

You are required to calculate:

(i) Depreciation to be charged to P/L

(ii) Book value of Plant and Machinery A/c as on 31.3.2014

(iii) Loss on exchange of machinery.

(Nov'14)

Question 12

From the following information state the amount to be capitalized as per AS 10. Give the explanations for your answers.

₹ 5 lakhs as routine repairs and ₹ 1 lakh on partial replacement of a part of a machine.

₹ 10 lakhs on replacement of part of a machinery which will improve the efficiency of a machine. **(Nov'14)**

Question 13

M/s. Versatile Limited purchased machinery for ₹ 4,80,000 (inclusive of excise duty of ₹ 40,000). CENVAT credit is available for 50% of the duty paid. The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	21,000
Total labour charges	66,000
(200 out of the total of 600 men hours worked, were spent for installation of the machinery)	
Spare parts and tools consumed in installation	6,000
Total salary of supervisor	24,000
(time spent for installation was 25% of the total time worked)	
Total administrative expenses	32,000
(1/10 relates to the plant installation)	
Test run and experimental production expenses	23,000
Consultancy charges to architect for plant set up	9,000
Depreciation on assets used for the installation	12,000

The machine was ready for use on 15-1-2015 but was used from 1-2-2015. Due to this delay further expenses of ₹ 19,000 were incurred. Calculate the value at which the plant should be capitalized in the books of M/s. Versatile Limited. **(May'15)**

Question 14

A machinery with a useful life of 6 years was purchased on 1st April, 2012 for ₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost. In the beginning of fourth year the company reassessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of original cost. The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year. **(Nov'15)**

Question 15

Briefly explain the treatment of following items as per relevant accounting standards:

- The accountant of Star Limited valued the Goodwill of the company at ₹ 50 lakhs and showed the same as Fixed Asset in Balance Sheet. The corresponding credit was given to Reserves.
- An expense of ₹ 5 crores were incurred on a Machine towards its Repairs and Maintenance. The accountant wants to capitalize the same considering the significance of amount spent.
- A plant was ready for commercial production on 01.04.2014 but could commence actual production only on 01.06.2014. The company incurred ₹ 50 lakhs as administrative expenditure during the period of which 20% was allocable to the plant. The accountant added ₹ 10 lakhs to cost of plant. **(Nov'15)**

Question 16

Argon Ltd. purchased a shop on 1st January, 2001 as a cost of ₹ 8,50,000. The useful life of the shop is estimated as 30 years with residual value of ₹ 25,000 and depreciation is provided on a straight line basis. The shop was revalued on 30th June, 2015 for ₹ 19,50,000 and the Revaluation was incorporated in the accounts.

Calculate:

(i) The surplus on revaluation;

(ii) Depreciation to be charged in the Profit and Loss account for the year ended on 31st December, 2015. **(May'16)**

Question 17

Hema Ltd. purchased a machinery on 1.04.2008 for ₹ 15,00,000. The company charged straight line depreciation based on 15 years working life estimate and residual value ₹ 3,00,000. At the beginning of the 4th year, the company by way of systematic evaluation revalued the machinery upward by 20% of net book value as on date and also re-estimated the useful life as 7 years and scrap value as nil. The increase in net book value was credited directly to revaluation reserves. Depreciation (on SLM basis) later on was charged to Profit & Loss Account. At the beginning of 8th year the company decided to dispose off the machinery and estimated the realizable value to ₹ 2,00,000.

You are required to ascertain the amount to be charged to Profit & Loss Account at the beginning of 8th year with reference to AS – 10. **(Nov'16)**

Question 18

Explain 'Bearer Plant' & 'Biological Asset' as per AS – 10. **(May'18)**

Question 19

Neon Enterprise operates a major chain of restaurants located in different cities. The company has acquired a new restaurant located at Chandigarh. The new restaurant requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the restaurant will be closed.

Management has prepared the following budget for this period -

Salaries of the staff engaged in preparation of restaurant before its opening	₹ 7,50,000
Construction and remodelling cost of restaurant	₹ 30,00,000

Explain the treatment of these expenditures as per the provisions of AS 10 "Property, Plant and Equipment". **(Nov'18)**

Question 20

Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at ₹ 49,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. ₹ 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹ 30,000 to supervise machinery installation at the factory site.

Also, payment under the invoice was due in 5 months. However, the Company made the payment in 3rd month. The company operates on Bank Overdraft @ 14% p.a.

Ascertain the amount at which the Machinery should be capitalized under AS 10.

(Nov'18)

Question 21

ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹ 4,00,000. As on 31st March, 2016 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd. **(May'17)**

Question 22

A Ltd. had following assets. Calculate depreciation for the year ending 31st March, 2020 for each asset as per AS 10 (Revised)

(i) Machinery purchased for ₹10 lakhs on 1st April; 2015 and residual value after useful life of 5 years, based on 2015 prices is ₹ 10 lakhs.

(ii) Land for₹ 50 lakhs.

(iii) A Machinery is -constructed for ₹ 5,00,000 for its own use (useful life is 10 years). Construction is completed on 1st April, 2019, but the company does not begin using the machine until 31st March, 2020.

(iv) Machinery purchased on 1st April, 2017 for ₹ 50,000 with useful life of 5 years and residual value is NIL. On 1st April, 2019, management decided to use this asset for further 2 years only. **(Nov'20)**

Question 23

XYZ Limited provided you the following information for the year ended 31st March. 2022:-

(i) The carrying amount of a property at the end of the year amounted to ₹ 2,16,000 (cost/value ₹ 2,50,000 and accumulated depreciation ₹ 34,000). On this date the property was revalued and was deemed to have a fair value of ₹ 1,90,000. The balance on the revaluation surplus relating to a previous revaluation gain for this property was ₹ 20,000.

You are required to calculate the revaluation loss as per (Revised) and give its treatment in the books of accounts.

(ii) An asset that originally cost ₹ 76,000 and had accumulated depreciation of ₹ 62,000 was disposed of during the year for ₹ 4,000 cash.
You are required to explain how the disposal should be accounted for in the financial statements as per (Revised). **(MAY' 22)**

Question 24

(i) A Limited has contracted with a supplier to purchase machinery which is to be installed at its new plant in four months time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹ 2,10,000. These activities were supervised by an Architect during the entire period, who is employed for this purpose at a salary of ₹ 35,000 per month. The machinery was purchased for ₹ 1,27,50,000 and a sum of ₹ 2,12,500 was incurred towards transportation charges to bring the machinery to the plant site. An Engineer was appointed at a fees of ₹ 37,500 to supervise the installation of the machinery at the plant site. You are required to ascertain the amount at which the machinery should be capitalized in the books of A Limited.

(ii) B Limited, which operates a major chain of retail stores, has acquired a new store location. The new location requires substantial renovation expenditure. Management expects that the renovation will last for 4 months during which the store will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salary of staff who shall be preparing the store before its opening and related utilities cost. How would such expenditure be treated in the books of B Limited? **(July' 21)**

Question 25

In the books of Topmaker Limited, carrying amount of plant and Machinery as on 1st April, 2022 is ₹ 56,30,000.

On scrutiny, it was found that a purchase of machinery worth ₹ 21,12,000 was included in the purchase of goods on 1st June, 2022.

On 30th June, 2022 the company disposed a Machine having book value of ₹ 9,60,000 (as on 1st April, 2022) for ₹ 8,25,000 in part exchange of a new machine costing ₹ 15,65,000.

The company charges depreciation @ 10% p.a. on written down value method on plant and Machinery.

You are required to compute:

(i) Depreciation to be charged to Profit & Loss Account;

(ii) Book value of plant & Machinery as on 31st March, 2023; and

(iii) Profit /Loss on exchange of Plant & Machinery.

AS 11 - ACCOUNTING FOR EFFECTS FOR CHANGES IN FOREIGN EXCHANGE RATES

1. SCOPE :

AS 11 applies to the following:

(a) Accounting for transactions in foreign currency.

(b) Translating the financial statements of foreign operations for inclusion in Company's financial statements.

(c) Accounting for foreign currency transactions in the nature of forward exchange contracts.

2. DEFINITIONS :

(a) **Reporting Currency:** Currency used in presenting financial statements.

(b) **Foreign Currency:** Currency other than reporting currency of an enterprise.

(c) **Exchange Rate:** It is the ratio for exchange of 2 currencies.

(d) **Average Rate :** It is the mean of the exchange rates in force during a period

(e) **Forward Rate:** It is the agreed exchange rate for exchange of 2 currencies at a specified future date.

(f) **Forward Exchange Contract:** It is an agreement to exchange different currencies at a forward rate.

(g) **Closing Rate:** It is the Exchange Rate at the Balance Sheet date.

(h) **Monetary items:** They are money held & assets & liabilities to be received or paid in fixed or determinable amounts of money. E.g.: Cash, Bank balance, Receivables, Payables etc.

(i) **Non-monetary items:** They are assets & liabilities other than monetary items. E.g.: FAs, Inventories, Investment in equity shares etc.

(j) **Settlement date:** Date on which a receivable is due to be collected / a payable is due to be paid.

(k) **Foreign Operation:** A Subsidiary, Associate, JV or Branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise. Under AS 11, a foreign operation is classified as either 'Integral Foreign Operation' or 'Non-Integral Foreign Operation', based on the way of financing & operation in relation to the reporting enterprise.

(l) **Integral Foreign Operation (IFO) :** Its activities are an integral part of those of the reporting enterprise, its business is carried on as if it was an extension of the reporting enterprise's operations, IFOs generally carry on business in a single foreign currency of the country where it is located, cash flows from operations of the reporting enterprise are directly & immediately affected by a change in the exchange rate between the reporting currency & currency of the IFOs country, change in exchange rate affect individual monetary items held by the IFO rather than the reporting enterprise's investment in IFO etc.

(m) **Non-Integral Foreign Operation (NFO) :** It is a foreign operation that is not an IFO. The business of NFO is carried on in a substantially independent manner in its local currency, NFOs may also enter into business transactions in foreign currencies, including transactions in reporting currency, change in the exchange rate between the reporting currency & local currency has little or no direct effect on the present or future cash flows from operations of the NFO or the reporting enterprise, change in the exchange rate affects the reporting enterprise's net investment in the NFO rather than the individual monetary / non-monetary items held by that NFO.

3. FOREIGN CURRENCY TRANSACTIONS :

(a) Initial Recognition

Transactions involving foreign currencies can be brought under four groups, namely (a) buying or selling of goods and services, (b) borrowing or lending money, (c) acquiring or disposing of assets or incurring and settling liabilities, or (d) by being a party to a forward exchange contract. For initial recognition, the Accounting Standards prescribe that a foreign currency transaction should be **recorded** by applying the **exchange rate** (defined as ratio for exchange for two currencies) between the reporting currency and the foreign currency at the date of the transaction.

(b) Reporting at subsequent Balance Sheet date

For purposes of reporting as at the balance sheet date, items are classified into monetary and non-monetary items, which are carried at either historical cost, or at fair values.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. Examples are cash balances, account receivables and payables. **Non-monetary items** are assets and liabilities other than monetary items. Examples include fixed assets, inventories, and investments in equity shares.

Accounting standards lays down the following principles for translation of foreign currency items.

1. Apply **closing rate** for monetary items

   Monetary items in the balance sheet should be reported using the closing rate.

2. Apply **Transaction-date** rate or the rate that existed on **fair-value estimation date** for non-monetary items.

(c) Recognizing exchange difference

Exchange difference has been defined in Accounting standards as the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

Exchange differences can arise, inter alia, on three counts

- A transaction – either a monetary item, or a non-monetary item – being settled at a rate of different from the rate at which it was initially recorded (initial recognition)
- A transaction being reported at a rate different from the rate at which it was initially recorded (balance sheet reporting)
- A transaction being settled at a rate different from the one taken for reporting in the last financial statement (settlement).

4. TRANSLATION OF FINANCIAL STATEMENT OF FOREIGN OPERATIONS

- Foreign operation is a **subsidiary, associate, joint venture or branch** of the reporting enterprise, the activities of which are based on or conducted in a foreign country.
- It is not necessary that the subsidiary, associate joint venture or branch should be based in foreign country. Its activities must be based or conducted in a foreign country.
- Foreign operation is classified into -

  (a) Integral foreign operation and

  (b) Non-integral foreign operation.

Financial statement of IFO

Accounting standards requires the financial statement to be translated in the same manner as applicable for the enterprises own foreign currency transaction, i.e.

(a) All transactions of foreign operation be translated at the rate prevailing on the date of transaction (spot rate).

(b) Translation at balance sheet date

- (i) Monetary items at closing rate;
- (ii) Non-monetary items which are carried at historical cost at the rate at the date of transaction and
- (iii) Non-monetary items which are carried at fair value like net realizable value at the rate of such date of ascertaining fair valuation.

Note: Accounting standards does not state about conversion of revenue items of such organization because it will automatically get converted at spot rate as per (a) above.

Recognition of Foreign Exchange difference-

Exchange difference arising on reinstatement/settlement of monetary items be recognized in P & L.

Financial Statements of Non-integral Foreign Operation

For incorporating in its financial statement the financial statements of a non-integral foreign operation should be translated in the following manner.

(a) All assets and liabilities monetary as well as non-monetary, translated at closing rate.

(b) Income and expenses items be translated at the rate of the date of transaction. (Average rate of the period if it approximates the actual rate can be used)

Recognition of exchange difference -

- All exchange difference be accumulated and carried in foreign currency translation reserve.
- When the net investment in such non-integral operation in full or in part is disposed of then this reserve will be proportionately recognized to P&L.
- Such reserve can have debit balance as well.

5. FORWARD EXCHANGE CONTRACT :

➢ **When forward contract is for hedging**

(a) The premium or discount (difference between the value at spot rate and forward rate) should be amortized over the life of contract.

(b) Exchange difference (difference between the value of settlement date / reporting date and value at previous reporting date / inception of the contract) be recognized in P & L of the year.

(c) Profit / loss on cancellation / renewal of forward contract be recognized in P & L of the year.

➢ **When forward contract is for Trading / Speculation**

(a) No premium or discount is recognized.

(b) A gain or loss i.e. the difference between the forward rate as per contract/ previous year end valuation rate and the forward rate available at the year end (reporting date) for remaining maturity period should be recognized in the P&L of the period.

6. DISCLOSURES :

An enterprise should disclose :

(a) The amount of exchange differences included in the net profit / loss for the period &

(b) Net exchange difference accumulated in FCTR as a separate component of shareholders' funds & a reconciliation of the amount of such exchange differences at the beginning & end of the period.

CLASSWORK QUESTIONS

Question 1

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

(i) Fixed Assets.

Question 2

DBK Industries Ltd. invoiced goods to West Germany worth US $ 1,00,000 on 10th March, 2005 on which date exchange rate for US $ 1 was ₹ 41.00.

The payment for the same was received as under :-

Date of Receipt	Received	Exchange rate for US $ 1
20-03-2005	US $ 40,000	₹ 42.00
29-03-2005	US $ 35,000	₹ 41.00
15-04-2005	US $ 25,000	₹ 44.00

The company closes its accounting year on 31st March. The exchange rate as on 31-03-2005 was 1 US $ ₹ 45.00. Pass Journal entries of the same.

Question 3

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).

Question 4

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.

Question 5

Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months @ ₹ 48.85 per dollar. On 31st December, 2011, 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, 2012.

Question 6

Rau Ltd. purchased a plant for US$ 1,00,000 on 1st February 2012, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st Feb. was ₹ 48.85. How will you recognize the Profit or Loss on forward contract in the books of Rau Ltd.

Question 7

(i) Jared Limited purchased a Machine for US $20,000 on 31st December, 2021 Payable after four months. It entered into a forward contract for four months @ ₹ 78.85 per US $. On 31st December, 2021 the exchange rate was ₹ 77.50 per US $.

How will you recognize the Profit or Loss on Forward Contract for the year ended 31st March, 2022 in the books of Jared Limited?

(ii) Trade Payables of Jared Limited includes amount due to Sterling Limited ₹ 9,75,000 recorded at the prevailing exchange rate on the date of purchase; transaction recorded at US $ 1 = ₹ 75.00.

The exchange rate on Balance Sheet date (31st March, 2022) was US $ 1 = ₹ 79.00.

The payment was made on 1st May, 2022 when the exchange rate was US $ 1= ₹ 78.30.

You are required to calculate the amount of exchange difference on 31st March, 2022 and 1st May, 2022 and also explain the accounting treatment needed in the above case as AS 11 in the books of Jared Limited.

(Nov'22 - 5 Marks)

Question 8

ABC Builders Limited had borrowed a sum of US $ 15,00,000 at the beginning of Financial year 2020-21 for its residential project at London Interbank Offered Rate (LIBOR) + 4 %. The interest is payable at the end of the Financial Year. At the time of availing the loan, the exchange rate was ₹ 72 per US $ and the rate as on 31st March, 2021 was ₹ 76 per US $. If ABC Builders Limited borrowed the loan in Indian Rupee equivalent, the pricing of loan would have been 9.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2021 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

CLASSWORK SOLUTIONS

Answer 1

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.

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

Answer 3

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 × ₹ 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 × ₹ 5) will he 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.

Answer 4

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. 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 acquisition of depreciable capital asset, can be added to or deducted from cost of asset. 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.

Revised Book Value of Fixed Assets = 5000 + 498 = ₹ 5,498 Lacks

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 installments, ₹ 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.

Answer 6

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss	₹ 30,000
Contract Period	3 Months

Two month of the year 2012- 13; therefore loss to be recognized = ₹ 20,000

Rest ₹ 10,000 will be recognized in the following year.

Answer 8

(i) Interest for the period 2020-21 = US \$ 15 lakhs x 5% × ₹ 76 per US \$ = ₹ 57 lakhs

(ii) Increase in the liability towards the principal amount = US \$ 15 lakhs × ₹ (76 - 72) = ₹ 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency = US \$ 15 lakhs × ₹ 72 x 9.5% = ₹ 102.60 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 102.60 lakhs less ₹ 57 lakhs = ₹ 45.60 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 45.60 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 102.60 lakhs being the aggregate of interest of ₹ 57 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 45.60 lakhs. Hence, ₹ 102.60 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 "Borrowing Costs" and the remaining ₹ 14.4 lakhs (60 - 45.60) would be considered as the exchange difference to be accounted for as per AS 11 "The Effects of Changes in Foreign Exchange Rates".

HOMEWORK SECTIONS

Question 9

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?

Question 10

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3.2015.

Sundry Debtors include amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1= ₹ 58.50.

Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction.

US $ 1 = ₹ 61.20 on 31.3.2015.

Question 11

	Exchange Rate per $
Goods purchased on 1.1.2011 of US $ 10,000	₹ 45
Exchange rate on 31.3.2011	₹ 44
Date of actual payment 7.7.2011	₹ 43

Ascertain the loss/gain for financial years 2010-11 and 2011-12, also give their treatment as per AS 11.

Question 12

Pass Journal entries for the following transactions in foreign currency NSD Ltd. imported raw materials worth US $ 40,000 on 12th December, 2004. The exchange rate for US $ 1 as on 12-12-2004 was ₹ 46.50.

The payment for the above transaction was made as under:-

Date of Receipt	Received	Exchange rate for US $ 1
23-02-2005	US $ 18,000	₹ 47.75
21-03-2005	US $ 12,000	₹ 48.25
10-04-2005	US $ 10,000	₹ 48.50

The accounting year of the company ends on 31st March. The exchange rate as 31st March, 2005 for US $ 1 was ₹ 45.00.

PAST PAPER SECTION

Question 13

ABC Ltd. borrowed US $ 5,00,000 on 01/01/2017, which was repaid as on 31/07/2017. ABC Ltd. prepares financial statement ending on 31/03/2017. Rate of Exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2017	1US$ = ₹ 68.50
31/03/2017	1US$ = ₹ 69.50
31/07/2017	1US$ = ₹ 70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

(May'18)

Question 14

(i) ABC Ltd. a Indian Company obtained long term loan from WWW private Ltd., a U.S. company amounting to ₹ 30,00,000. It was recorded at US $1 = ₹ 60.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹ 62.00.

(ii) Trade receivable includes amount receivable from Preksha Ltd., ₹ 10,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 59.00. The exchange rate on balance sheet date (31.03.2018) was US $1 = ₹ 62.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of ABC Ltd.

(Nov'18)

Question 15

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st January 2018 from an American company M/s M&M Limited. The amount was payable after 6 months. The company entered into a forward contract on 1st January 2018 for five months @ ₹ 62.50 per dollar. The exchange rate per dollar was as follows:

On 1st January, 2018	₹ 60.75 per dollar
On 31st March, 2018	₹ 63.00 per dollar

You are required to state how the profit or loss on forward contract would be recognized in the books of AXE Limited for the year ending 2017 – 18, as per the provisions of AS 11.

(Nov'18)

Question 16

M/s Power Track Ltd. purchased a plant for US $ 50,000 on 31st October, 2015 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2015 the exchange rate was ₹ 61.50 per Dollar.

You are required to recognise the profit or loss on forward contract in the books of the company for the year ended 31st March, 2016.

(May'16)

Question 17

Rahul Ltd. purchased a plant for US$ 2,00,000 on 1st January 2017, payable after 5 months. Company entered into a forward contract for five months @ ₹ 64.75 per dollar. Exchange rate per dollar on 1st January 2017 was ₹ 64.25. How will you recognize the profit or loss on forward contract in the books of Rahul Ltd.?

(Hint: 200,000 * 0.5 = 100,000 loss over the life of the contract).

Question 18

Legal Ltd. is engaged in the manufacturing of rubber. For its plant, it required machineries of latest technology. It usually resorts to Long Term Foreign Currency Borrowings for its fund requirements. On 1st April, 2017, it borrowed US $1 million from International Funding Agency, USA when exchange rate was 1 $ = ₹ 63. The funds were used for acquiring machineries, on the same date, to be used in three different plants. The useful life of the machineries is 10 years and their residual value is ₹ 30,00,000.

Earlier also the company used to purchase machineries out of foreign borrowings. The exchange differences arising on such borrowings were charged to profit and loss account and were not capitalized even though the company had an option to capitalize it as per notified AS 11.

Now for this new purchase of machinery, Legal Ltd, is interested to avail the option of capitalizing the same to the cost of asset. Exchange rate on 31st March, 2018 is 1 US $ = ₹ 62. Assume that on 31st March, 2018, Legal Ltd. is not having any old long term foreign currency borrowings except for the amount borrowed for machinery purchased on 1st April, 2017.

Comment whether Legal Ltd. can capitalize the exchange difference to the cost of asset on 31st March, 2018. If yes, then calculate the depreciation amount on machineries as on 31st March, 2018.

Question 19

Bansal Company Ltd. imported raw material worth US Dollars 12,000 on 15th Jan, 2019 when the exchange rate was ₹ 68 per US Dollar. The payment for the transaction was made on 5th May, 2019 when exchange rate was ₹ 64 per US Dollar. At the year end, 31st March, 2019, the rate of exchange was ₹ 65 per US Dollar. The accountant of the company passed entry on 31st March, 2019 adjusting the cost of raw material consumed for the difference between ₹ 64 and ₹ 68 per US Dollar. Discuss whether this treatment is justified as per the provisions of AS-11 (Revised).

(Nov' 19)

Question 20

(i) PP Ltd. an Indian Company acquired long term finance from WW (P) Ltd. a U.S. company, amounting to ₹ 40,88,952. The transaction was recorded at US $1 = ₹ 72.00, taking exchange rate prevailing at the date of transaction. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60.

(ii) Trade receivables of PP Ltd. include amount receivable from Preksha Ltd., ₹ 20,00,150 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $1 = ₹ 73.40. The exchange rate on balance sheet date (31.03.2021) is US $1 = ₹ 73.60. Exchange rate on 1st April, 2020 is US $1 = ₹ 74.00.

You are required to calculate the amount of exchange difference and also explain the accounting treatment needed in the above two cases as per AS 11 in the books of PP Ltd.

(Dec' 21)

Question 21

Trower Limited is an Indian importer. It imports goods from True View Limited situated at London. Trower Limited has a payable of £ 50,000 to True View Limited as on 31st March, 2023. True View Limited has given Trower Limited the following two options:

(i) Pay immediately with a cash discount of 1% on the payable.

(ii) Pay after 6 months with interest @ 5% p.a. on the payable.

The borrowing rate for Trower Limited in rupees is 15% p.a.

The following are the exchange rates:

Date	₹/£
31st March, 2023	97
30th September, 2023	99

You are required to give your opinion to Trower Limited on which of the above two options to be chosen.

AS 12 - ACCOUNTING FOR GOVERNMENT GRANTS

1. GOVERNMENT:

Government refers to

- government,
- government agencies and
- similar bodies whether local (like Municipal Corporation), national or international (e.g. World Bank, Asian Development Bank).

2. GOVERNMENT GRANTS:

Government grants are –

- assistance by government
- in cash or kind to an enterprise
- for past or future compliance with certain conditions.

The term Government grant excludes

- those forms of government assistance which cannot reasonably have a value placed upon them and
- transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.
- Equity Investment by Government
- Tax Holidays

3. Accounting for Government grants :

Nature of Grant	Description of the grant	At the time of initial recognition - debit to bank/receivable account and	If required to be refunded - credit to bank / payable account and ....
1. Related to specific fixed assets (depreciable fixed assets) (This can also be intangible assets covered under AS– 26)	Grant related to specific fixed assets are government grants whose primary condition is that an enterprise should purchase, construct or otherwise acquire such assets.	a. Credit to that fixed asset A/c (charge depreciation on the reduced value) or b. Credit to govt. grant A/c (show in balance sheet in reserves) (w/off it to P & L A/c over the life of assets in proportion to depreciation)	Debit to that fixed asset A/c (charge depreciation on revised value prospectively) Debit to govt. grant A/c (to the extent of bal.) Debit to P & L a/c (excess if any)
2. Related to Non-depreciable fixed asset	Same as above.	(a) Credit to that fixed asset or	Debit to that fixed asset a/c
		(b) Credit to capital reserve A/c or	Debit to capital reserve a/c (to the extent of bal.) Debit to P & L a/c (excess if any)
		(c) But if it has certain cost then defer it & credit to P & L A/c. in the period in which such cost is being incurred.	Debit to capital reserve a/c (to the extent of bal.) Debit to P & L a/c (excess if any)

3. In the nature of promoters contribution	They are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof.	Credit to capital reserve A/c	Debit to deferred credit a/c (to the extent of bal.) Debit to P & L a/c (excess if any)
4. Grants related to revenue	Grants intended to compensate expenses incurred in the past or to be incurred in the future.	(a) Credit to P & L a/c as other income or reduce it from related expenditure. Or	Debit to P & L a/c.
		(b) Credit to deferred credit (w/off to P & L in the period over which related cost are incurred)	Debit to deferred credit A/c (to the extent of balance) Debit to P & L a/c (excess if any)
5. In lieu of past period cost or with no corresponding cost to be incurred	Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs.	Credit to P & L A/c (as extraordinary item)	Debit to P & L a/c.

6. Non-monetary grant	Grant in kind		In case of default to comply with the terms and conditions of govt. grant (AS is silent on this point). Following can be the possibilities.
(a) Asset given at concessional rate		Account at the actual cost incurred i.e., at concessional rate debiting asset and crediting bank A/c.	If asset is taken over-write off the book value to P & L a/c.
(b) Given free of cost		Account at token value say ₹ 1 or ₹ 100 debiting the asset A/c and crediting P & L A/c	If the concession amount is required to be paid then debit the asset a/c. and credit the bank A/c. depreciate this revised value prospectively.

4. DISCLOSURE :

The following should be disclosed:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

CLASSWORK QUESTIONS

Question 1

Explain the treatment of the following:

(a) a firm acquired a fixed asset for ₹ 250 lakhs on which the government grant received was 40%

(b) Capital Subsidy received (As Promoters contribution) from the central government for setting up a plant in the notified backward region. Cost of the plant ₹ 300 lakhs. Subsidy received ₹ 100 lakhs.

(c) ₹ 50 lakhs received from the state government for the setting up of water treatment plant.

(d) ₹ 25 lakhs received from the local authority for providing medical facilities to the employees.

Question 2

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years on the assumption that Grant is credited to Defers Grant A/c.

Question 3

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.?

Question 4

A Ltd. purchased a machinery for ₹40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

CLASSWORK SOLUTIONS

Answer 1

(a) Receipt of grant of₹100 lakhs can be credited to Depreciable Fixed Asset Account so as to reduce its cost. Alternatively ₹100 lakhs can be credited to Deferred Government Grant Account & amortised over useful life of Fixed Asset in proportion of Depreciation.

(b) The grant received is in the nature of capital subsidy (AS Promoters contribution) and hence to be credited to Capital Reserve A/c.

The Plant should appear at ₹300 lakhs.

(c) The grant received from state government should be deducted from the cost of the asset.

Alternatively it can be credited to Deferred Government Grant Account & amortised over useful life of Plant in proportion of Depreciation.

(d) ₹ 25 lacs received from local authority for providing medical facilities to the employees is to be credited to Profit & Loss A/c.

HOMEWORK SECTION

Question 5

Supriya Ltd. received a grant of ₹2,500 lakhs during the accounting year 2010-11 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However, during the year 2011-12, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12.

Question 6

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.

Question 7

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2007-08 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2010-11, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2010-11 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2007-08 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2010?

Question 8

M/s A Ltd. has set up its business in a designated backward area with an investment of ₹ 200 Lakhs. The Company is eligible for 25% subsidy and has received ₹ 50 Lakhs from the Government. Explain the treatment of the Capital Subsidy received from the Government in the Books of the Company.

PAST PAPER SECTION

Question 9

On 01.04.2014, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 500 lakhs. The grant was received and credited to the cost of the asset. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method.

The company had to refund the entire grant in 2nd April, 2017 due to non- fulfilment of certain conditions which was imposed by the government at the time of approval of grant.

How do you deal with the refund of grant to the government in the books of XYZ Ltd., as per AS 12? **(May'18)**

Question 10

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 company for the first year, treating grant as deferred income. **(May'12)**

Question 11

Explain in brief the treatment of Refund of Government Grants in line with AS 12 in the following three situations: **(May'14)**

Question 12

M/s ABC Ltd. purchased fixed assets for ₹ 50,00,000. Government grant received towards it is 20%. Residual value is ₹ 8,00,000 and useful life is 8 years. Assumed depreciation is on the basis of Straight Line Method. Asset is shown in the Balance Sheet net of grant. After one year, grant becomes refundable to the extent of ₹ 7,00,000 due to non-compliance of certain conditions.

Pass Journal entries for 2nd year in the books of the company. **(May'16)**

Question 13

Ram Ltd. purchased machinery for ₹ 80 lakhs, (useful life 4 years and residual value ₹ 8 lakhs). Government grant received is ₹ 32 lakhs. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if

(i) The grant is credited to Fixed Assets A/c.

(ii) The grant is credited to Deferred Grant A/c. **(May'17)**

Question 14

How would you treat the following in the accounts in accordance with AS-12 'Government Grants'?

(i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.

(ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area.

(iii) ₹ 10 Lakhs Grant received from the Central Government on installation of anti-pollution equipment. **(May' 19)**

Question 15

(a) Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery. Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019& 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

Question 16

(i) Zinga Limited received a 20% Subsidy on ₹ 100 lakhs for investment in designated backward area during 2016-17. The Subsidy received was credited to General Reserve. During 2019-2020, the company paid dividend out of the amount of Subsidy Received for ₹ 10 lakhs. Is the above treatment done for Subsidy received and Dividend paid is correct ? If not, give correct treatment.

(ii) Singha Limited received a specific grant of ₹ 90 lakhs for acquiring a plant of ₹ 250 lakhs (having useful life of 10 years) during 2016-17. The grant received was credited to deferred income in the Balance Sheet, During 2019-2020, the company could not comply some condition laid down for the grant for plant, it had to refund the whole grant for plant to the Government. Balance in the deferred income on that date was ₹ 63 lakhs and written down value of plant was ₹ 175 lakhs.

You are required to state :

(i) What should be the treatment of the refund of grant in 2019-2020?

(ii) What would be the effect on cost of the fixed asset?

(iii) What amount of depreciation should be charged during the Financial year 2019-2020 ? **(Nov' 20)**

Question 17

On 1st April, 2016, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2019 due to non-compliance of certain conditions.

How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2019-20. Pass necessary Journal Entries for the year 2019-20. **(Nov' 20)**

Question 18

Darshan Ltd. purchased a Machinery on 1st April, 2016 for ₹ 130 lakhs (Useful life is 4 Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery. Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income.

Your are required to calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2017,31st March, 2018, 31st March, 2019 & 31st March, 2020.

Darshan Ltd. follows straight line method for charging depreciation.

(Jan' 21)

Question 19

Suraj Limited provides you the following information :

(i) It received a Government Grant @40% towards the acquisition of Machinery worth ₹ 25 Crores.

(ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.

(iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.

iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.

(v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited. **(May ' 22)**

Question 20

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

(i) ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.

(ii) ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.

(iii) ₹ 25 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants". **(July' 21)**

REVISION QUESTIONS

Question 21

X Limited received a grant of ₹ 2 crores from the Central Government for the purpose of a special Machinery during 1998 – 99. The cost of Machinery was ₹ 20 crores and had a useful life of 9 years. During 2002 – 03, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons, the accounting treatment to be followed in the year 2002 -03.

Question 22

Siva Limited received a grant of ₹ 1,500 lakhs during the last accounting year (2009-10) from Government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However during the year 2010-11, it was found that the conditions of the grant were not complied with and the grant had to be refunded to the Government in full. Elucidate the current accounting treatment with reference to the provisions of AS 12.

Answer 22

As per para 11 of AS 12 'Accounting for Government Grants', Government Grant may, sometimes, become refundable if certain conditions are not fulfilled. A government grant that becomes refundable is treated as extra-ordinary item as per AS, 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 unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the given case, the amount of refund of grant of ₹ 1,500 lakhs should be charged to the profit and loss account in the year 2010 – 2011 as an extraordinary item.

AS 13 - ACCOUNTING FOR INVESTMENT

1. WHAT ARE INVESTMENTS?

Investments are:-

- Assets
- Held by an enterprise for earning incomes by way of dividends, interest, and, rentals, for capital appreciation, or for other benefits to the investing enterprise.

Assets held as stock in trade are not 'investments'.

Some investments have no physical existence and are represented merely by certificates or similar documents while others exist in physical form.

2. DETERMINATION OF COST:

- If investments are purchased:

  The cost of an investment includes acquisition charges such as brokerage, fees and duties. Interest, dividends and rentals receivables in connection with an investment are generally regarded as income, being the return on investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. In such case, it should be deducted from the cost.
- If investments are acquired for consideration other than cash:

Sr. no.	Consideration in the form of	Valued at
1.	Shares or securities	Fair value of securities issued
2.	Other assets	Fair value of asset given up or Fair value of asset acquired whichever is known more appropriately.

- **Cost of right shares:**
  - When right shares offered are subscribed for, the cost of right shares is added to the carrying amount of the original holding.
  - If the right shares are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement.

- However, where the investments are acquired on cum cum-right basis and the market value of investments immediately after their becoming ex- right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of right to reduce the carrying amount of such investments to the market value.

3. DETERMINATION OF FAIR VALUE:

Fair value is the amount for which an asset could be exchanged between a knowledge-able, willing buyer and a knowledgeable, willing seller in an arms' length transaction.

4. DETERMINATION OF CARRYING AMOUNT OF INVESTMENTS (VALUATION):

- **Current investments:**

  Current Investments should be carried in the financial statement at lower of cost or fair value. The lower of cost or fair value should not be determined on overall basis. It should be determined-

  (a) On an individual investment basis (More prudent) or

  (b) By category of investment.

  Any reduction to fair value of current investments or any reversal of such reduction should be included in profit or loss account.

- **Long term Investments:**

  Long term investments are usually carried at cost.

  However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognize the decline.

  Such reduction should be determined and made for each long term investments individually.

4. DISPOSAL:

On disposal of an investment, the difference between the carrying amount and disposal proceeds, net of expenses, is recognized in profit or loss account. When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment (i.e. weighted average cost)

5. RECLASSIFICATION OF INVESTMENTS:

From long term investment to current investment.

Transfers are made at the lower of cost and carrying amount on the date of transfer

From current investment to long term investment.

Transfers are made at the lower of cost and fair value on date of transfer.

6. DISCLOSURE:

- The accounting policies for determination of carrying amount of investments.
- An Enterprise should disclose current Investments and long term investments separately.
- As per Schedule III of Companies Act, 2013 further classification should disclose investments in:
  - (a) Government securities
  - (b) Shares, Debentures or bonds
  - (c) Investment properties
  - (d) Others-Specifying nature.
- The amounts included in profit or loss statement for:
  - (a) Interest, dividends and rentals on investments showing separately such in- come from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes paid.
  - (b) Profit or loss on disposal of current investments and changes in the carrying amount of such investments.
  - (c) Profit or loss on disposal of Long term investments and changes in the carrying amount of such investments.
- Significant restrictions on the rights of ownership, realisability of investments or the remittance of income and proceeds of the disposal.

CLASSWORK QUESTIONS

Question 1

Albert Ltd. has made the following investments:

(i) Purchased the following equity shares from stock exchange on 1st June, 2010:

Cost	₹
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

(ii) Purchased gold of ₹ 3,00,000 on 1st April, 2007.

(iii) Invested in mutual funds at a cost of ₹ 6,00,000 on 31st March, 2010.

(iv) Purchased government securities at a cost of ₹ 5,00,000 on 1st April, 2010.

How will you treat these investments as per applicable AS in the books of the company for the year ended on 31st March, 2011, if the values of these investments are as follows:

Shares	₹	₹
Scrip X	1,90,000	
Scrip Y	70,000	
Scrip Z	40,000	3,00,000
Gold		5,00,000
Mutual funds		4,50,000
Government securities		7,00,000

Also explain is it possible to set of diminution in investment in mutual funds against appreciation of the value of investment in government securities?

Question 2

An unquoted long-term investment is carried in the books at a cost of ₹ 2 lakhs. The published accounts of the unlisted company received in May, 2012 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 20,000. Financial statement of 31st March, 2012 of investor are yet to be completed and approved by the Board of Directors.

Question 3

Bharat Ltd. wants to re-classify its investments in accordance with AS 13. Decide on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for ₹ 20 lakhs, to be re - classified as Long - term investments, as the company has decided to retain them. The market value as on the date of balance sheet was ₹ 25 lakhs.

(2) Another portion of current investments purchased for ₹ 15 lakhs, to be re- classified as long-term investments. The market value of these investments as on the date of balance sheet was ₹ 6.5 lakhs.

(3) Certain Long-term investments no longer considered for holding purposes, to be re-classified as current investments. The original Cost of these were ₹ 18 lakhs but had been written down to ₹ 12 lakhs to recognize permanent decline as per AS 13.

Question 4

Sabka Bank has classified its total investment on 31-3-2017 into three categories (a) held to maturity (b) available for sale (c) held for trading. 'Held to maturity' investments are carried at acquisition cost less amortised amount. 'Available for sale' investments are carried at marked to market. 'Held for trading' investments are valued at weekly intervals at market rates or as per the prices declared by FIMMDA. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. Comment whether the policy of the bank is in accordance with AS 13?

Question 5

Following is the Investment made by Ranka Ltd. as on 31.03.2005.

Type of Share	Quantity	Cost	Market Value
(i) Equity Shares:			
X Ltd.	250	124	175
Y Ltd.	400	106	156
Z Ltd.	200	97	95
(ii) Preference Shares:			
F Ltd.	400	102	88
M Ltd.	10	115	149
R Ltd.	55	116	121

Value the investments as per Global/Category/Individual method.

CLASSWORK SOLUTIONS

Answer 1

1. As per As 13, "Accounting for Investment", for investment in shares – if the investment is purchased with an intention to hold for short-term period then it will be shown at the lower of cost or realizable value of as on 31st March, 2011.

   Scrip X ₹ 1,80,000 (cost)

   Scrip Y ₹ 50,000 (cost)

   Scrip Z ₹ 40,000 (NRV)

   If equity shares are acquired with an intention to hold for long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, if other than temporary, in the value of the investments.

2. As Per the standard, investment acquired for long term period shall be shown at cost. Gold is generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in Gold (Purchased on 1st April, 2007) shall continue to be shown at cost as on 31st March, 2011, i.e. ₹ 3,00,000 though their realizable values have been increased.

3. Investments in mutual funds are treated as long-term, then they will be valued at its cost ₹ 6.00.000 unless there is a permanent reduction in its value. However, provision for diminution shall be made to recognize a decline, if other than temporary, in the value of the investment.

4. Investment in Govt. securities, are treated as long-term, then they will be valued at its cost ₹ 5,00,000, though it's realizable value is greater than its cost.

   It is not possible to set of diminution in investment in mutual funds against appreciation of the value of investment in government securities, as the gain is unrealized on govt. securities which will not be recorded in the books where as if the reduction in value of mutual fund is of permanent nature then the loss only will be recognized in the statement of Profit & Loss.

Answer 2

As it is stated in the question that financial statement for the year ended 31st March, 2012 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

As per AS 13, Accounting for investment, long term investment should be valued at cost unless reduction is other than temporary. Here, cost of unquoted long term investment was ₹ 2,00,000, however, fair value of this investment is ₹ 20,000 only and this reduction is due to cash losses suffered by company with declining market share, which is other than temporary in nature.

On this basis, the facts of the given case clearly suggest that the provision for diminution of ₹ 1,80,000 (₹ 2,00,000 - ₹ 20,000) should be made to reduce the carrying amount of long term investment to ₹ 20,000 in the financial statements as on 31st March, 2012.

Answer 3

As per As 13, where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

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

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

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

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

Answer 4

As per para 2(d) of AS 13 'Accounting for Investments', the accounting standard is not applicable to Bank, Insurance Company, Mutual Funds. In this case Sabka Bank is a bank, therefore, AS 13 does not apply to it. For banks, the RBI has issued guidelines for classification and valuation of its investment and Sabka Bank should comply with those RBI Guidelines/Norms. Therefore, though Sabka Bank has not followed the provisions of AS 13, yet it would not be said as non-compliance since, it is complying with the norms stipulated by the RBI.

HOMEWORK SECTION

Question 6

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13. State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing ₹ 8.5 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹ 6.5 lakhs to recognize a permanent decline in value. The fair value on date of transfer is ₹ 6.8 lakhs.

(ii) Long term investments in Company B, costing ₹ 7 lakhs are to be re-classified as current. The fair value on date of transfer is ₹ 8 lakhs and book value is ₹ 7 lakhs.

(iii) Current investment in Company C, costing ₹ 10 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹ 12 lakhs.

(iv) Current investment in Company D, costing ₹ 15 lakhs are to be re-classified as long term. The market value on date of transfer is ₹ 14 Lakhs.

Question 7

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2014 at a cost of ₹ 2,50,000. It also earlier purchased Gold of ₹ 4,00,000 and silver of ₹ 2,00,000 on 1st March, 2012. Market value as on 31st March, 2015 of above investments are as follows:

	₹
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2015 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Question 8

A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of ₹ 5,00,000. It also purchased Gold of ₹ 2,00,000 and Silver of ₹ 1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable

AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	₹
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

PAST PAPER SECTION

Question 9

M/s. Active Builders Ltd. invested in the shares of another company on 31st October, 2015 at a cost of ₹ 4,50,000. It also earlier purchased Gold of ₹ 5,00,000 and Silver of ₹ 2,25,000 on 31st March, 2013. Market values as on 31st March, 2016 of the above investment are as follows:

Shares ₹ 3,75,000; Gold ₹ 7,50,000 and Silver ₹ 4,35,000

How will the above investments be shown in the books of accounts of M/s. Active Builders Ltd. for the year ending 31st March, 2016 as per the provision of AS – 13?

(May'16)

Question 10

How you will deal with following in the financial statement of the Paridhi Electronics Ltd. as on 31.3.16 with reference to AS – 13?

(i) Paridhi Electronics Ltd. invested in the shares of another unlisted company on 1st May 2012 at a cost of ₹ 3,00,000 with the intention of holding more than a year. The published accounts of unlisted company received in Jan 2016 reveals that the company has incurred cash losses with decline market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹ 45,000.

(ii) Also Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹ 5 lakhs, which the company wants to reclassify as long term investment. The market value of these investments as on date of Balance Sheet was ₹ 2.5 lakhs.

(Nov'16)

Question 11

Sun Ltd. wants to re-classify its investments in accordance with AS-13.

State the values at which the investments have to be re-classified as per AS-13 in the following cases:

(1) Current investments in Company Fine Ltd., costing ₹ 39,000 are to be re- classified as long term investments. The fair value on the date of transfer is ₹ 37,000.

(2) Long term investments in Company Bold Ltd., costing ₹ 16 lakhs are to be re-classified as current investments. The fair value on the date of transfer is ₹ 15 lakhs and book value is ₹ 16 lakhs. **(May'18)**

Question 12

The Investment portfolio of XYZ Ltd. as on 31.03.2018 consisted of the following:

(₹ in lakhs)

	Current Investments	Cost	Fair Value as on 31.03.2018
1	1000 Equity Shares of A Ltd. 500	5	7
2	Equity Shares of B Ltd.	10	15
3	1000 Equity Shares of C Ltd.	15	12
	Total	30	34

Give your comments on below:

(i) The company wants to value the above portfolio at ₹ 30 lakhs being lower of cost or fair market value.

(ii) Company wants to transfer 1000 Equity Shares of C Ltd. from current investments to long term investments on 31.03.2018 at cost of ₹ 15 lakhs.

(Hint: i) Value at 30 Lakhs; (ii) Reclassified at 12 Lakhs.

Question 13

On 15th June, 2018, Y limited wants to re-classify its investments in accordance with AS 13 (revised). Decide and state the amount of transfer, based on the following information:

(1) A portion of long term investments purchased on 1st March, 2017 are to be re-classified as current investments. The original cost of these investments was ₹ 14 lakhs but had been written down by ₹ 2 lakhs (to recognise 'other than temporary' decline in value). The market value of these investments on 15th June, 2018 was ₹ 11 lakhs.

(2) Another portion of long term investments purchased on 15th January, 2017 are to be re-classified as current investments. The original cost of these investments was ₹ 7 lakhs but had been written down to ₹ 5 lakhs (to recognise 'other than temporary' decline in value). The fair value of these investments on 15th June, 2018 was ₹ 4.5 lakhs.

(3) A portion of current investments purchased on 15th March, 2018 for ₹ 7 lakhs are to be re-classified as long term investments, as the company has decided to retain them. The market value of these investments on 31st March, 2018 was ₹ 6 lakhs and fair value on 15th June 2018 was ₹ 8.5 lakhs,

(4) Another portion of current investments purchased on 7th December, 2017 for ₹ 4 lakhs are to be re-classified as long term investments. The market value of these investments was:

on 31st March, 2018 ₹ 3.5 lakhs

on 15th June, 2018 ₹ 3.8 lakhs **(May'19)**

Question 14

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

(1) As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period.

(2) As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve.

(3) As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price.

(4) As per the provisions of AS-13, a current investment is an investment, that by its nature, is readily realisable and is intended to be held for not more than six months from the date on which such investment is made.

(5) As per the provisions of AS-4, a contingency is a condition or situation, the ultimate outcome of which (gain or loss) will be known or

Determined only on the occurrence of one or more uncertain future events.

(May'19)

Question 15

Mother Mart Ltd., wants to re-classify its investment in accordance with AS 13. Decide the treatment to be given in each of the following cases assuming that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller:

(i) A portion of current investments purchased for ₹ 25 lakhs to be reclassified as long- term investments, as the company has decided to retain them. The market value as on the date of balance sheet was ₹ 30 lakhs.

(ii) Another portion of current investments purchased for ₹ 20 lakhs has to be re-classified as long-term investments. The market value of these investments as on the date of the balance sheet was ₹ 12.5 lakhs.

(iii) One portion of long-term investments, no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ₹ 15 lakhs, but had been written down to ₹ 11 lakhs to recognize permanent decline as per AS 13.

(May'19)

Question 16

PQR Investments Ltd., wants to re-classify its investments in accordance with AS 13. State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investments in Company A, costing ₹ 10 lakhs are to be re-classified as current. The company had reduced the value of these investments to ₹ 8 lakhs to recognize a permanent decline in value. The fair value on date of transfer is ₹ 8.50 lakhs.

(ii) Long term investments in Company B, costing ₹ 5 lakhs are to be re-classified as current. The fair value on date of transfer is ₹ 6 lakhs and book value is ₹ 5 lakhs.

(iii) Current investment in Company C costing ₹ 8 lakhs are to be re-classified as long term as the company wants to retain them. The market value on date of transfer is ₹ 9 lakhs.

(iv) Current investment in Company D, costing ₹ 12 lakhs are to be re-classified as long term. The market value on date of transfer is ₹ 11 Lakhs.

You are required to advise PQR Investments Ltd., the correct treatment in light of relevant accounting standard.

Question 17

A Limited invested in the shares of XYZ Ltd. on 1st December, 2019 at a cost of ₹ 50,000. Out of these shares ₹ 25,000'shares were purchased with an intention to hold for 6 months and ₹ 25,000 shares were purchased with an intention to hold as long-term Investment. A Limited also earlier purchased Gold of ₹ 1,00,000 and Silver of ₹ 30,00,000 on 1st April, 2019. Market value as on 31st March, 2020 of above investments are as follows:

Shares	₹ 47,500 (Decline in the value of shires is temporary.)
Gold	₹ 1,80,000
Silver	₹ 30,55,000

How above investments will be shown in the books of accounts of M/s A Limited for the year ending 31st March, 2020 as per the provisions of AS 13 (Revised)?

(Nov'20)

Question 18

M/s. Gowtham Limited invested in shares of another company (with the intention to hold the shares for short-term period) on 30th November, 2019 at a cost of ₹ 4,25,000. It also earlier purchased Gold of ₹ 8,00,000 and Silver of ₹ 3,50,000 on 31st March, 2017.

Market values as on 31st March, 2020, of the above investments are as follows :

Shares	₹ 3,50,000
Gold	₹ 10,25,000
Silver	₹ 5,10,000

You are required to explain how will the above investments be shown (individually and in total) in the books of account of M/s. Gowtham Limited for the year ending 31st March, 2020 as per the provisions of As 13. **(Nov' 20)**

Question 19

Kunal Securities Ltd. wants to reclassify its investments in accordance with AS-13 (Revised). State the values, at which the investments have to be reclassified in the following cases:

(i) Long term investment in Company A, costing ₹ 10.5 lakhs is to be re-classified as current investment. The company had reduced the value of these investments to ₹ 9 lakhs to recognize a permanent decline in value. The fair value on the date of reclassification is ₹ 9.3 lakhs.

(ii) Long term investment in Company B, costing ₹ 14 lakhs is to be re-classified as current investment The fair value on the date of reclassification is ₹ 16 lakhs and book value is ₹ 14 lakhs.

(iii) Current investment in Company C, costing ₹12 lakhs is to be re-classified as long term investment as the company wants to retain them. The market value on the date of reclassification is ₹ 13.5 lakhs.

(iv) Current investment in Company D, costing ₹ 18 lakhs is to be re-classified as long term investment. The market value on the date of reclassification is ₹ 16.5 lakhs.

Question 20

Mr. Mohan has invested some money in various Mutual funds. Following information in this regard is given:

Mutual Funds	Date of purchase	Purchase cost (₹)	Brokerage Cost (₹)	Stamp duty (₹)	Market value as on 31.03.2021 (₹)
A	01.05.2017	50,000	200	20	48,225
B	05.08.2020	25,000	150	25	24,220
C	01.01.2021	75,000	300	75	78,190
D	07.05.2020	70,000	275	50	65,880

You are required to:

1. Classify his investment in accordance with AS-13 (revised).
2. Value of Investment in mutual fund as on 31.03.2021 **(Dec' 21)**

AS 16 - BORROWING COST

1. BORROWING COST :

Borrowing Cost includes interest and other costs incurred in connection with borrowed funds.

Elements of borrowing costs generally include:

(1) Interest and commitment charges on bank borrowings

(2) Discounts and premiums on borrowings to the extent amortized

(3) Other ancillary costs for arranging borrowings to the extent amortized

(4) Finance charges in respect of assets under Finance lease, Hire purchase

(5) Exchange rate differences relatable to foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

2. QUALIFYING ASSET :

Qualifying Asset Is an asset that necessarily takes substantial period of time to get ready for its:

- **Intended** use [Fixed Assets or Investment properties], OR
- Sale [Inventory]

Note:

Ordinarily a period of 12 months is considered substantial period unless a shorter or longer period can be justified.

The following are, however, not qualifying assets:

- Inventories routinely manufactured
- Inventories produced in large quantities on repetitive basis over short period
- Assets ready for intended use at the time of acquisition

3. ACCOUNTING FOR BORROWING COSTS :

Accounting Treatment - Borrowing Costs

Sr. No.	Nature of borrowing costs	Accounting treatment prescribed by AS-16	Remarks
1.	Borrowing costs that are directly attributable to the acquisition construction or production of a qualifying asset	Capitalize as part of the cost of that asset (i.e. include in the cost of that assets)	Amount to be capitalized period for which capitalization should be done to be determined as per AS-16.
2.	Other borrowing costs	To be expensed in the period in which they are incurred -	-

From the above table, it is clear that borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of cost of that asset.

4. SPECIFIC AND GENERAL BORROWINGS :

Borrowing costs can be related to either specific borrowings, or general borrowings.

(i) **Specific Borrowings:**

As a general rule, specific borrowings are those which could have been avoided, but for expenditure on Qualifying Asset. In this case, capitalisation rate is done for the "actual borrowing costs" incurred.

Income on temporary investment of funds forming part of specific borrowings alone should be deducted from borrowing cost & ONLY net amount should be capitalized.

(ii) **General Borrowings:**

Under this category, falls more than one type of borrowing (loans, debentures ICDs, working capital borrowings, etc) used – either wholly or partly for expenditure on Qualifying Asset. In this case, capitalisation rate will be "weighted average of the borrowing costs outstanding" during the relevant period

(iii) **Capitalisation ceiling:**

Borrowing cost capitalized should not exceed borrowing cost actually incurred during the period. This situation will arise in the case of general borrowings.

1. CAPITALISATION CRITERIA :

A. Commencement of Capitalisation:

The borrowing cost incurred on qualifying asset is to be capitalized only if all the three following conditions are fulfilled

- Expenditure on Qualifying Asset is being incurred
- Borrowing Costs are incurred
- Activities are in progress; such activities include technical/administrative work also. However, it does not include those, which do not result in a change in the condition of the asset.

It follows, therefore, that there would be circumstances in which capitalisation of borrowing costs are either to be suspended or stopped.

B. Suspension of capitalization:

It is possible that after commencement of capitalisation of Borrowing Cost, one or more of the three conditions (stated above) may not subsequently be fulfilled. Activities could stand suspended for **(i) avoidable reasons, or (ii) for unavoidable reasons.**

Suspension of activity for avoidable reasons (do not capitalise)

Where activity necessary to prepare the asset for its intended use or sale stands suspended.

- Over extended periods, and
- Active development is interrupted

Borrowing Cost incurred during such periods of suspension represents cost of holding incomplete asset and hence **should** not be capitalized.

Suspension of activity for unavoidable reasons (can continue to capitalise subject to prudence)

The suspension which is in the nature of temporary delay and where such delay is necessary for getting asset ready, e.g., maintaining of inventory (wine) and high water level for bridge construction, the borrowing cost should be capitalized.

C. Cessation of capitalization – stoppage

Capitalization of borrowing costs should cease when:

- All activities necessary for making assets ready for intended use/sale are substantially complete

- Items of administrative work or finishing touches to be completed happen to be minor in nature
- Where an asset is completed "in parts", and completed part is capable of use, when work on others is in progress, capitalization for completed part should be stopped.

2. DISCLOSURE REQUIREMENTS:

1. The accounting policy followed for treatment of borrowing costs
2. The amount of borrowing costs capitalized during the period

CLASSWORK QUESTIONS

Question 1

Paras Ltd. has the following borrowings during a year in respect of capital expansion.

Plant	Cost of Asset (₹)	Remarks
Plant P	100 lakhs	No Specific Borrowings
Plant Q	125 lakhs	Bank loan of ₹ 65 lakhs at 10%
Plant R	175 lakhs	9% Debentures of ₹ 125 lakhs were issued.

In addition to the specific borrowings stated above, the company had obtained term loans from banks (1) ₹ 100 lakhs at 10% from corporation Bank and (2) ₹ 110 lakhs at 11.5% from State Bank of India to meet its capital expansion requirements. Determine the amount of borrowing costs to be capitalized in each of the above plants, as per AS 16.

Question 2

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit & loss account. Comment on the accounting treatment done by the company in context of the relevant AS.

Question 3

Axe Limited began construction of a new plant on 1st April, 2011 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, 2011	5,00,000
1st August, 2011	12,00,000
1st January, 2012	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, 2012. 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.

Question 4

Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2014-15 for its residential project at LIBOR + 3 %. The interest is payable at the end of the Financial Year. At the time of availment, exchange rate was ₹ 56 per US $ and the rate as on 31st March, 2015 ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

Compute Borrowing Cost and exchange difference for the year ending 31st March, 2015 as per applicable Accounting Standards. (Applicable LIBOR is 1%).

Question 5

On 1st April, 2011, 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, 2012	₹ 80,00,000

Show the treatment of interest by Amazing Construction Ltd.

Answer 2

The Accounting Standard Board (ASB) has opinioned that investments other than investment properties are not qualifying assets as per AS 16 Borrowing Costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale.

Also, where the investment properties meet the definition of 'qualifying asset', for the capitalization of borrowing costs, the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS16 have to be complied with.

HOMEWORK SECTION

Question 6

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 wasinstalled 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.

Question 7

M/s. Ayush Ltd. began construction of a new building on 1st January, 2014. It obtained ₹3 lakh special loan to finance the construction of the building on 1st January, 2014 at an interest rate of 12% p.a. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11% p.a.
₹ 11,00,000	13% p.a.

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

Amount	(₹)
January, 2014	3,00,000
April, 2014	3,50,000
July, 2014	5,50,000
December, 2014	1,50,000

Building was completed on 31st December, 2014. Following the principles prescribed in AS 16 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal entry for capitalizing the cost and borrowing in respect of the building.

Question 8

GHI Limited obtained a loan for ₹70 lakhs on 15th April, 2010 from JKL Bank, to be utilized as under:

	₹ in lakhs
Construction of Factory shed	25
Purchase of Machinery	20
Working capital	15
Advance for purchase of Truck	10

In March 2011, construction of the factory shed was completed and machinery, which was ready for its intended use, was installed. Delivery of Truck was received in the next financial year. Total interest of ₹ 9,10,000 was charged by the bank for the financial year ending 31-03-2011.

Question 9

On 20.4.2003 JLC Ltd. obtained a loan from the Bank for ₹ 50 lakhs to be utilized 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.

Question 10

Rohini Limited has obtained loan from an Institution for ₹ 500 Lakhs for modernization and renovating its plant and machinery. The installation of and ₹ 50 lakhs advanced to supplier of additional assets and the balance of ₹ 130 lakhs has been utilized for working capital requirements. Total interest paid for the above loan amounted to ₹ 65 lakhs during 2008 – 09. You are required to state how the interest on institutional loan is to be accounted for in the year 2008 – 09. **(May'10)**

Question 11

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

	₹ In lakhs
Instruction 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 inter under Accounting Standard – 16.

(Nov' 11)

Question 12

Write short note on 'Suspension of Capitalisation' in context of Accounting Standard 16.

(May'16)

Question 13

M/s. Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath: (work was held up totally for a month during the year due to heavy rain which are common in the geographic region involved)	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores

(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ 1 crores
(v)	Advances for tools / cranes etc.	₹ 1 crores
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2016	₹ 1.6 crores

Show the treatment of Interest according to Accounting Standard by M/s. Zen Bridge Construction Limited. **(Nov'16)**

Question 14

First Ltd. began construction of a new factory building on 1st April, 2017. It obtained ₹ 2,00,000 as a special loan to finance the construction of the factory building on 1st April, 2017 at an interest rate of 8% per annum. Further, expenditure on construction of the factory building was financed through other non-specific loans. Details of other outstanding non-specific loans were:

Amount (₹)	Rate of Interest per annum
4,00,000	9%
5,00,000	12%
3,00,000	14%

The expenditures that were made on the factory building construction were as follows:

Date	Amount (₹)
1st April, 2017	3,00,000
31st May, 2017	2,40,000
1st August, 2017	4,00,000
31st December, 2017	3,60,000

The construction of factory building was completed by 31st March, 2018. As per the provisions of AS 16, you are required to:

(1) Calculate the amount of interest to be capitalized.

(2) Pass Journal entry for capitalizing the cost and borrowing cost in respect of the factory building.

(May' 19)

Question 15

On 15th April, 2019 RBM ltd. obtained a Term Loan from the Bank for 320 lakhs to be utilized as under:

	₹ in (Lakhs)
Construction for factory shed	240
Purchase of Machinery	30
Working capital	24
Purchase of vehicles	12
Advance for tools/cranes etc.	8
Purchase of technical know how	6

In March, 2020 construction of shed was completed and machinery was installed. Total interest charged by the bank for the year ending 31St March, 2020 was 40 lakhs. In the context of provisions of AS 16 'Borrowing Costs', show the treatment of interest and also explain the nature of Assets. **(Nov' 20)**

Question 16

Expert Limited issued 12% secured debentures of ₹ 100 lakhs on 01.06.2019. Money raised from debentures to be Utilized as under :

Intended Purpose	Amount ₹ in lakhs
Construction of factory building	40
Working Capital	30
Purchase of Machinery	15
Purchase of Furniture	2
Purchase of truck	13

Additional Information:

(i) Interest on debentures for the Financial Year 2019-2020 was paid by the Company.

(ii) During the year, the company invested idle fund of ₹ 5 lakhs (out of the money raised from debentures) in Bank's fixed deposit and earned interest of ₹ 50,000.

(iii) In March, 2020 construction of factory building was not completed (it is expected that it will take another 6 months).

(iv) In March 2020, Machinery was installed and ready for its intended use.

(v) Furniture was put to use at the end of March 2020.

(vi) Truck is going to be received in April, 2020.

You are required to show the treatment of interest as per AS 16 in respect of borrowing cost for the year ended 31st March, 2020 in the Books of Expert Limited.

(Nov' 20)

Question 17

Zebra Limited began construction of a new plant on 1st April, 2021 and obtained a special loan of ₹ 20,00,000 to finance the construction of the plant. The rate of interest on loan was 10%.

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

	₹
1st April, 2021	10,00,000
1st August, 2021	24,00,000
1st January, 2022	4,00,000

The company's other outstanding non-specific loan was ₹ 46,00,000 at an interest rate of 12%.

The construction of the plant completed on 31st March, 2022.

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. **(MAY' 22)**

Question 18

On 1st April, 2022 Workhouse Limited took a loan from a Finanacial Institution for ₹ 25,00,000 for the construction of Building. The rate of interest is 12%.

In addition to above loan, the company has taken multiple borrowings as follows:

(i)	8% Debentures	₹ 15,00,000
(ii)	15% Term Loan	₹ 30,00,000
(iii)	10% Other Loans	₹ 18,00,000

The company has utilised the above funds in construction/ purchase of the following assets:

(i)	Building	₹ 70,00,000
(ii)	Furniture	₹ 22,00,000
(iii)	Plant & Machinery	₹ 90,00,000
(iv)	Factory Shed	₹ 43,00,000

The construction of Building, Plant & Machinery and Factory Shed was completed on 31st March 2023. Readymade Furniture was purchased directly from the market. The factory was ready for production on 1st April 2023.

You are required to calculate the borrowing cost for both qualifying and non - qualifying assets.

AS 17 - SEGMENT REPORTING

1. MEANING :

- An enterprise deals in multiple Products/Services and operates in different Geographical areas, which expose to **Significantly different risk and rewards/returns.**
- **Information** about Multiple Products/Services and operations in different Geographical areas is called **Segment Information.**
- **Disclosure** of such information is called segment reporting.

2. SEGMENT REPORTING HELPS USERS OF FINANCIAL STATEMENTS :

(1) To better understand the **PERFORMANCE** of the enterprise;

(2) To better assess the **RISKS AND RETURNS** of the enterprise;

(3) To make more informed judgements about the enterprise as a whole.

3. SEGMENT REPORTING :

The segment report is made as per Accounting Standard - 17 which is mandatory and is effective for the accounting periods starting on or after 1.04.2003. The Accounting Standard is mandatory for listed companies or companies intending to be listed or whose turnover exceeds 50 crores.

4. TYEPS OF SEGMENT :

Segmentation can be done on the basis of products on services or a group of related products & services. Segmentation can also be geographical. Whether segmentation should be primarily product wise or geographical depends on whether primary risk is due to products or services or due to geographical area. To identify the primary risk the internal organisation & management structure & its system of reporting to the Board of Directors or CEO of the company should be considered.

5. BUSINESS SEGMENT :

A business segment is a distinguishable component of an enterprise which is engaged in providing an individual product or service or a group of related products or services and that is subject to risks & returns which are different from those of other segments. Factors which would be considered in determining whether products or service are related includes :

(a) Nature of products or services

(b) Nature of production process

(c) Type of or class of customers for products or services

(d) The methods used to distribute the products or provide the services

(e) Nature of regulatory environment.

6. GEOGRAPHICAL SEGMENT :

A geographical segment is a distinguishable component of an enterprise which is engaged in providing products or services within a particular economic environment and it is subject to risks and returns that are different from those of other segments operating in other economic environment. It includes:

(a) Similarity of economic & political conditions.

(b) Relationship between operations

(c) Proximity of operations

(d) Special Risks

(e) Exchange Control Regulations

(f) Underlying Currency Risks

The risks & returns of an enterprise are categorised by geographical location of its assets and location of its customers.

NOTE:

Determining the composition of a business or geographical segment involves a certain amount of judgment.

7. REPORTABLE SEGMENT :

It is a business or geographical is identified on the basis of the foregoing definition for which segment information is required to be disclosed by the financial statements.

(i) Para 27 a of Accounting Standard - 17 states that i f total revenue (External + Intersegment) of a segment is 10% or more of total revenue of all segment then those segments are reportable.

(ii) Para 27 b states that if the result i.e. profit or loss of any segment is 10% or more of combined profit / combined loss of all segments in absolute terms then that segment is reportable.

(iii) Para 27 c states that if assets of any segment is 10% or more than the total assets of all segments then that segment is reportable.

(iv) Para 28 states that management may designate any segment as reportable even if it doesn't satisfy above mentioned criteria.

(v) Para 29 requires that if the total external revenue of reportable segments identified as per para 27 & 28 is less than 75% of total enterprise revenue, additional segments should be identified as reportable till limit of 75% is reached.

8. DISCLOSURE :

Accounting Standard - 17 is a reporting standard. Hence " disclosures" is its core element. The intensity of disclosures is high in case of primary segments and low for secondary segments.

For each Primary segment the following disclose have to be made.

(a) Segment Revenue (External + Internal segment)

(b) Segment Result

(c) Segment Assets.

(e) Segment Liabilities

(f) Capital expense incurred during the period

(g) Depreciation charge for the period

(h) Other non-cash expenses during the period.

Disclosure required for secondary segments.

If Business segments are primary then geographical segments are secondary. Disclose:

- Revenue from external customers by geographical location (10% Test)
- Assets by geographical location of assets (10% Test)
- Fixed Asset acquired during the period.

If Geographical segs are primary then Business segs are secondary. If a business seg's external sales are ≥ 10% of total external revenue or Business segment assets are ≥ 10% of total assets of all business segs, then disclose for those business segments:

- Segments revenue from external customers.
- Segments assets
- Fixed assets acquired during the period.

Also if the primary geographic segments are based on location of customers, also make the following disclosures:

- Assets located in each geographic segment (10 % Test)
- Additions to fixed assets during the period.

If the Primary geographic segments are based on location of assets, also make the following disclosure:

- Sales to external customers for each customer based geographical segment (10% Test).

CLASSWORK QUESTIONS

Question 1

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

₹in lakhs

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	(190)	10	10	(10)	30	(100)
Segment Revenue	300	620	80	60	80	60	1,200

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

Question 2

M/s XYZ Ltd. has three segments namely X, Y, Z. The total Assets of the Company are ₹ 10.00 crores. Segment X has ₹ 2.00 crores, segment Y has ₹ 3.00 crores and segment Z has ₹ 5.00 crores. Deferred tax assets included in the assets of each segments are X - ₹ 0.50 crores, Y - ₹ 0.40 crores and Z - ₹ 0.30 crores.

The accountant contends that all the three segments are reportable segments. Comment.

CLASSWORK SOLUTIONS

Answer 1

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

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

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

- The combined result of all segments in profit; or
- The combined result of all segments in loss,

whichever is greater in absolute amount; or its segment assets are 10% or more of the total assets of all segments.

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

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

On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of ₹ 200 lakhs).

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

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

Answer 2

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

PAST PAPER SECTION

Question 3

The accountant of Parag Limited has furnished you with the following data related to its Business Divisions:

(₹ in lacs)

Division	A	B	C	D	Total
Segment Revenue	100	300	200	400	1000
Segment Result	45	-70	80	-10	45
Segment Assets	39	51	48	12	150

You are required to identify the reportable segments in accordance with criteria laid down in AS 17.

Question 4

The Senior Accountant of AMF Ltd. gives the following data regarding its five segments:

Particulars	P	Q	R	S	T	Total
	(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
Segment Assets	80	30	20	20	10	160
Segment Results	(190)	10	10	(10)	30	(150)
Segment Revenue	620	80	60	80	60	900

The Senior Accountant is of the opinion that segment "P" alone should be reported. Is he justified in his view? Examine his opinion in the light of provision of AS-17 'Segment Reporting'. **(Jan'21)**

Question 5

XYZ Ltd. has 5 business segments. Profit / Loss of each of the segments for the year ended 31st March, 2022 has been provided below. You are required to identify from the following whether reportable segments or not reportable segments, on the basis of "profitability test" as per AS-17.

Segment	Profit (Loss) ₹ in lakhs
A	225
B	25
C	(175)
D	(20)
E	(105)

(May' 22)

Question 6

The Accountant of X. Ltd. provides the following data regarding its five segments:

Particulars	A	B	C	D	E	Total (₹ in Crore)
Segment Assets	50	20	15	10	5	100
Segment Results	(85)	10	10	(15)	5	(75)
Segment Revenue	250	50	40	60	30	430

The accountant is of the opinion that segment 'A' alone should be reported.

Is he justified in his view? Examine his opinion in the light of provisions of AS - 17 Segment Reporting.

AS 18 - RELATED PARTY DISCLOSURES

Disclosure Requirement

- Related Party Relationship
- Related Party Transactions

1. RELATED PARTY :

Any party that Controls or can significantly influence the management or operating policies of the company during the reporting period.

➢ Control

One party has the ability to control the other party in following ways.

- Control by Ownership (directly or indirectly) more than 50% of Voting Power.
- Control over Composition of Board of Direction or other Governing body.
- Control of Substantial interest in the Voting Power and power to direct the Financial and operating policies.

➢ SIGNIFICANT INFLUENCE :

It refers to Power to Participate in the Financial and/or Operating Policy decisions of an enterprise but not control of those policies.

Significant influence may be gained by

- Ownership [Generally 20% or more interest in Voting Power]
- Statute
- Agreement.

2. Related Party Relationships :

AS 18 deals with the Following related party relationships only :

(i) Enterprises that directly, or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, the reporting enterprise (This includes Holding Companies, Subsidiaries and Fellow Subsidiaries).

(ii) Associates and joint ventures of the reporting enterprise.

(iii) Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual.

Relative Means:

- Spouse
- Son
- Daughter
- Brother
- Sister
- Father
- Mother

(iv) Key management personnel and relatives of such personnel.

Key Managerial Personnel: Who has authority and responsibility for Planning, Directing and controlling the activities of reporting enterprise.

(v) Enterprises over which individual or KMP (define above) is able to exercise significant influence.

[This includes enterprises owned by directors or major shareholders of the reporting enterprise]

3. EXCEPTION OF RELATED PARTY RELATIONSHIP :

Following relationship will be deemed not as related party:

- Two companies have a common director but director is not able to influence the Mutual dealing between companies.
- A single customer or supplier or franchiser or distributor or general agent with whom enterprise transactions are in significant Volume.
- Providers of finance
- Trade unions
- Government departments and Agencies

4. EXEMPTION FROM DISCLOSURE REQUIREMENT OF AS 18

If disclosure would conflict with the reporting enterprise statutory duties of Confidentiality.

For Example

Banks are obliged by law to maintain confidentiality in respect of their customers transactions.

5. Related Party Transactions:

It means a transfer of resource or obligations between related Parties regardless of whether or not a price is charged.

Examples:

- Purchase or Sale of Goods [Finished or unfinished]
- Purchase or Sale of Fixed Assets
- Rendering or receiving of services
- Leasing or Hire purchase arrangement
- Transfer of Research and Development
- License Agreements
- Finance [including loan and Equity contribution]
- Guarantees

6. DISCLOSURE:

➢ If Related Party Relationship is based on control, disclosure about relationship [i.e. Name and nature of relationship] be given even if there is no transaction with the related party.

➢ If Related Party Relationship is based on significant influence, disclosure need to be given only if transactions are there with the related party.

CLASSWORK QUESTIONS

Question 1

Identify the related parties in the following cases as per AS 18

A Ltd. holds 51% of B Ltd.

B Ltd holds 51% of O Ltd.

Z Ltd holds 49% of O Ltd.

Question 2

Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3 2017. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?

Question 3

Mr. Raj a relative of key management personnel received remuneration of ₹ 2,50,000 for his services in the company for the period from 1.4.2016 to 30.6.2016. On 1.7.2016, he left the service.

Should the relative e identified as at the closing date i.e. on 31.3.2017 for the purposes of AS 18?

CLASSWORK SOLUTIONS

Answer 1

Reporting entity- A Ltd.

- B Ltd. (subsidiary) is a related party
- O Ltd.(subsidiary) is a related party

Reporting entity- B Ltd.

- A Ltd. (holding company) is a related party
- O Ltd. (subsidiary) is a related party

Reporting entity- O Ltd.

- A Ltd. (holding company) is a related party
- B Ltd. (holding company) is a related party
- Z Ltd. (investor/ investing party) is a related party

Reporting entity- Z Ltd.

- O Ltd. (associate) is a related party

Answer 2

As per AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

Answer 3

As per AS18, key management personnel and relative of such personnel are those who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. Therefore the KMP and relative of such KMP are related to the enterprise.

In the given case Mr Raj received remuneration from the enterprise for the services rendered, as he is the relative of KMP, Mr Raj is related party to the enterprise. Therefore the enterprise has to report this transaction as a related party transaction as per AS 18 on 31.03.2017, even if he left services as on 1st July 2016.

HOMEWORK SECTION

Question 4

A Ltd. sold to B Ltd. goods having a sales value of ₹ 50 lakhs during the financial year ended 31.3.2009. Mr. X, the Managing Director and Chief Executive of A Ltd. owns nearly 100% of the capital of B Ltd. The sales were made to B Ltd. at the normal selling price of A Ltd. The chief accountant of A Ltd. does not consider that these sales should be treated any differently from any other sale made by the company despite being made to a controlled company, because the sales were made at normal and that too, at arm's length prices. Discuss the above issue from the view point AS - 18.

Question 5

Identify the related parties in the following cases as per AS-18

(i) Maya Ltd. holds 61 % shares of Sheetal Ltd. Sheetal Ltd. holds 51 % shares of Fair Ltd. Care Ltd. holds 49% shares of Fair Ltd.
(Give your answer - Reporting Entity wise for Maya Ltd., Sheetal Ltd., Care Ltd. and Fair Ltd.)

(ii) Mr. Subhash Kumar is Managing Director of A Ltd. and also holds 72% capital of B Ltd.

(5 Marks – May 2019 – Inter)

PAST PAPER SECTION

Question 6

Following transactions are disclosed as on 31st March, 2018:

(i) Mr. Sumit, a relative of Managing Director, received remuneration of ₹ 2,10,000 for his services in the company for the period from 1st April, 2017 to 30th June, 2017. He left the service on 1st July, 2017.

Should the relative be identified as on closing date i.e. on 31-3-2018 for the purpose of AS – 18.

(ii) Goods sold amounting to ₹ 50 lakhs to associate company during the 1st quarter ended on 30th June, 2017. After that related party relationship ceased to exist. However, goods were supplied as was supplied to any other ordinary customer. Decide whether transactions of the entire year, have to be disclosed as related party transactions. **(Nov'18)**

Question 7

(i) Khushi Limited enter into an agreement with Mr. Happy for running a business for a fixed amount payable to the later every year. The contract states that the day-to-day management of the business will be handled by Mr. Happy, while all financial and operating policy decisions are taken by the Board of Directors of the Company. Mr. Happy does not own any voting power in Khushi Limited.

(ii) Shri Bhanu a relative of key management personnel received remuneration of ₹ 3,50,000 for his services in the company for the period from 1st April, 2020 to 30th June, 2020. On 1st July, 2020, he left the service.

You are required to suggest how the above transactions will be treated as at the closing date i.e. on 31st March, 2021 for the purposes of AS 18- Related Party Disclosures.

(Jul' 21)

Question 8

Answer the following with respect to AS - 18:

(i) ABC Ltd. sold goods of ₹ 2,00,000 to its associate company for the 1st quarter ending 30.06.2022. After that the related party relationship ceased to exist. However, goods were supplied to any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

(ii) If the majority of directors of Arjun Ltd. constitute the majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?

(iii) Asha Ltd. sells all the manufactured furniture of ₹ 1,00,00,000 to Sasha Ltd. as per agreement. Sasha Ltd. is the only customer to Asha Ltd. In the financial statements, Asha Ltd. wants to present Sasha company as a related party. Comment on the disclosure requirement.

AS 19 - LEASES

1. INTRODUCTION:

(a) OBJECTIVE:

The objective of AS 19 is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

(b) DEFINATION:

A Lease is an agreement whereby the Lessor (legal owner of an asset) conveys to the Lessee (another party) in return for a payment or series of periodic payments (Lease rents), the right to use an asset for an agreed period of time.

(c) Applicability of AS 19:

The standard applies to all leases other than:

(a) lease agreements to explore for or use of natural resources, such as oil, gas, timber metals and other mineral rights; and

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands

(d) agreements that are contracts for services, that do not transfer right to use assets from one contracting party to the other.

2. TYPE OF LEASE :

For the purpose of accounting the lease is classified into two categories as follows

(a) Finance lease

(b) Operating lease.

Finance lease: It is a lease which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. In following situations, the lease transactions are called finance lease:

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value on the date on which option will be exercised.

- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
- The asset given on lease to lessee is of specialized nature and can be used by the lessee without major modification.

Operating lease : It is a lease which does not transfer substantially all the risks and rewards incidental to ownership.

It is a lease other than financial lease.

3. ACCOUNTING FOR FINANCE LEASE – IN THE BOOKS OF LESSEE :

Following is the accounting treatment of Finance Leases in the books of Lessee:

(i) On the date of inception of Lease, Lessee should show it as an asset and corresponding liability at lower of:

- Fair value of leased asset at the inception of the lease
- Present value of minimum lease payments from the standpoint of the lessee (present value to be calculated with discount rate equal to interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used)

(ii) Lease payments to be apportioned between the finance charge and the reduction of the outstanding liability.

(iii) Finance charges to be allocated to periods during the lease term so as to produce a constant rate of interest on the remaining balance of liability for each period.

(iv) A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in AS 10 (Revised), Property, Plant and Equipment. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

(v) Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

In the lessee book lease Asset is capitalised –

Asset A/c Dr.

To lease liability A/c

4. ACCOUNTING FOR FINANCE LEASES (BOOKS OF LESSOR) :

The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

In a finance lease, the lessor recognises the net investment in lease (which is usually equal to fair value, i.e. usual market price of the asset, as shown below) as receivable by **debiting the Lease Rental A/c and Crediting Asset A/c.**

Gross investment in Lease (GIL)

= Minimum Lease Payments (MLP) + Unguaranteed Residual value (UGR)

Net investment in Lease (NIL) = Gross investment in Lease (GIL) – Unearned Finance Income (UFI).

Unearned finance income (UFI) = GIL – (PV of MLP + PV of UGR)

The discounting rate for the above purpose is the rate of interest implicit in the lease.

5. ACCOUNTING FOR OPERATING LEASES :

- **Accounting treatment in the Books of lessee**

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

  Lease payments may be tailor made to suit the payment capacity of the lessee. For example, a lease term may provide for low initial rents and high terminal rent. Such payment patterns do not reflect the pattern of benefit derived by the lessee from the use of leased asset. To have better matching between revenue and costs, AS 19 requires lessees to recognise operating lease payments as expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

- **Accounting treatment in the books of lessor**

  (i) The lessor should present an asset given under operating lease as fixed assets in its balance sheets.

  (ii) Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

(iii) Depreciation should be recognised in the books of lessor. The depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 10.

(iv) The impairment losses on assets given on operating leases are determined and treated as per AS 28.

6. SALE AND LEASEBACK:

The basis of a sale and leaseback agreement is simply that one sells an asset for cash and then leases it back from the buyer. The asset subject to such sale and leaseback agreement is generally property. Under such an agreement the property owner agrees to sell the property at an agreed valuation and lease it back from the buyer. The lessee or seller receives cash immediately and makes periodic payment in form of lease rents for right to use the property. The lease payments and the sale price are generally interdependent as they are negotiated as a package. The accounting treatment of a sale and lease back depends upon the type of lease involved. Accounting treatment of profits / losses on sale of asset, as required by the standard in respect of sale and lease-back transactions, are summarised below.

- **Where sale and leaseback results in finance lease**

  The excess or deficiency of sales proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

- **Where sale and leaseback results in operating lease**

  Case 1: Sale price = Fair Value

  Profit or loss should be recognised immediately.

  Case 2: Sale Price < Fair Value

  Profit should be recognised immediately. The loss should also be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.

  Case 3: Sale Price > Fair Value

  The excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

7. DISCLOSURE :

The following disclosures in financial statements of the lessee and lessor should be made as regards lease.

Disclosure in operating lease by lessor –

- General description of significant leasing arrangements
- Accounting policy for initial direct payment
- Future lease payments in aggregate classified as :
  - not later than one year;
  - later than one year but not later than five years;
  - later than five years;

Disclosure in operating lease by the lessee-

- General description of significant leasing arrangements.
- Total of future minimum lease payments in following period :
  - not later than one year;
  - later than one year but not later than five years;
  - later than five years;
- lease payments recognized in Profit & Loss A/c for the period.

Disclosure in finance lease by the lessor -

- General description of the significant leasing arrangement.
- Accounting policy for initial direct cost.
- Reconciliation of total gross investment in lease with present value of MLP receivable on balance sheet date.
- Minimum lease payment (MLP) receivable in following categories :
  - not later than one year;
  - later than one year but not later than five years;
  - later than five years;

Disclosure in finance lease by the lessee -

- Asset under finance lease segregated from an asset owned.
- Reconciliation of total MLP with its present value on balance sheet date.
- MLP in following categories on balance sheet date :
  - not later than one year;
  - later than one year but not later than five years;
  - later than five years;

CLASSWORK QUESTIONS

Question 1

AD Softex Ltd. has taken the assets on lease from ACS Impex Ltd. the information is given below:

Lease term	= 4 years
Fair value at inception of lease	= ₹ 16,00,000
Lease Rent	= ₹ 5,00,000 p.a. at the end of year
Guaranteed Residual Value	= ₹ 1,00,000
Expected Residual Value	= ₹ 3,00,000
Implicit Interest Rate	= 14.97%

Do the accounting in the books of lessee & lessor.

Question 2

Prakash Limited leased a machine to Badal Limited on the following terms:

		(₹ in lakhs)
(i)	Fair value of the machine	40.00
(ii)	Lease term	5 years
(iii)	Lease rental per annum	8.00
(iv)	Guaranteed residual value	1.60
(v)	Expected residual value	3.00
(vi)	Internal rate of return	15%

Discounted rates for 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively.

Ascertain Unearned Finance Income.

Question 3

Annual lease rents = ₹ 50,000 at the end of each year.

Lease period	= 5 years;
Guaranteed residual value	= ₹ 25,000
Unguaranteed residual value (UGR)	= ₹ 15,000
Fair Value at the inception (beginning) of lease	= ₹ 2,00,000

Calculate Interest rate implicit on lease:

Question 4

NDA Ltd. availed a lease from Induga Ltd. on following terms :

- A lease for a tenor of 3 years, in the beginning of year 2001 for equipment costing ₹ 7,00,000 and which has an expected useful life of 5 years. The fair market value is also ₹ 7,00,000.
- 3 equal annual payments are made at end of each year.
- The property reverts back to the lessor on termination of the lease.
- The unguaranteed residual value is estimated at ₹ 75,000 at the end of year 2003
- IRR = 10%
- The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513
- The present value of annuity of Re. 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868
  - (i) State with reason whether the lease constitute finance lease.
  - (ii) Calculate unearned finance income

Question 5

A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. Comment if –

(a) Sale price of ₹ 50 lakhs is equal to fair value.

(b) Fair value is ₹ 60 lakhs.

(c) Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.

(d) Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.

(e) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

(f) Fair value is ₹ 35 lakhs and sale price is ₹ 39 lakhs.

Question 6

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

Lease term = 4 years

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

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

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

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

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

HOMEWORK SECTION

Question 7

Write short note on Sale and Lease Back Transactions as per Accounting Standard19.

As per AS 19 on 'Leases', a sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the asset back to the vendor. The lease payments and the sale price are usually interdependent, as they are negotiated as a package. The accounting treatment of a sale and lease back transaction depends upon the type of lease involved.

Question 8

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 2010, 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 2012

(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.

Question 9

X Ltd. sold JCB Machine having WDV of ₹ 50 Lakhs to Y Ltd for ₹ 60 Lakhs and thesame 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

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

Question 10

Explain the types of lease as per AS 19.

For the purpose of accounting AS 19 'Leases' classify the lease into two categories as follows:

(i) Finance Lease

(ii) Operating Lease

Question 11

Define the term Finance Lease. State any three situations when a lease would beclassified as finance lease.

Question 12

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 installments 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 is10%. 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.

Question 13

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.

Question 14

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

Question 15

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.

Question 16

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, 0.621

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

(May'14)

Question 17

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹ 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹ 3,50,000. The lessee has guaranteed a residual value of ₹ 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residual value of the machinery will be ₹ 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

(May'17)

Question 18

A Ltd. sold JCB having WDV of ₹ 20 lakhs to B Ltd. for ₹ 24 lakhs and the same JCB was leased back by B Ltd. to A Ltd. The lease is operating lease. In context of Accounting Standard 19 "Leases" explain the accounting treatment of profit or loss in the books of A Ltd. if

(i) Sale price of ₹ 24 lakhs is equal to fair value.

(ii) Fair value is ₹ 20 lakhs and sale price is ₹ 24 lakhs.

(iii) Fair value is ₹ 22 lakhs and sale price is ₹ 25 lakhs.

(iv) Fair value is ₹ 25 lakhs and sale price is ₹ 18 lakhs.

(v) Fair value is ₹ 18 lakhs and sale price is ₹ 19 lakhs. **(May'18)**

Question 19

Ram Ltd. sold a machine having WDV of ₹ 125 lakhs to Shyam Ltd. for ₹ 150 lakhs and the same machine was leased back by Shyam Ltd. to X Ltd. under Operating lease system : Comment according to relevant Accounting Standard if:

(i) Sale price of ₹ 150 lakhs is equal to fair value.

(ii) Fair value is ₹ 125 lakhs and Sale price is ₹ 112.50 lakhs.

(iii) Fair value is ₹ 137.50 lakhs and Sale price is ₹ 155 lakhs.

(iv) Fair value is ₹ 112.50 lakhs and Sale price is ₹ 120 lakhs.

(May'18)

Question 20

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost ₹ 1,50,000. Economic life of the machine is 5 years and outputs from the machine are estimated as 40,000 units, 50,000 units, 60,000 units, 80,000 units and 70,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. Compute the following:

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years of lease.

(Nov'18)

Question 21

Jaya Ltd. took a machine on lease from Deluxe Ltd., the fair value being ₹ 11,50,000. Economic life of the machine as well as lease term is 4 years. At the end of each year, lessee pays ₹ 3,50,000 to lessor. Jaya Ltd. has guaranteed a residual value of ₹ 70,000 on expiry of the lease to Deluxe Ltd., however Deluxe Ltd. estimates that residual value will be only ₹ 25,000. The implicit rate of return is 10% p.a. and present value factors at 10% are: 0.909, 0.826, 0.751 and 0.683 at the end of 1st, 2nd, 3rd and 4th year respectively.

Calculate the value of machinery to be considered by Jaya Ltd. and the value of the lease liability as per AS-19.

(May' 19)

Question 22

Sun Limited leased a machine to Moon Limited on the following terms:

	(Amount in ₹)
Fair value at inception of lease	50,00,000
Lease Term	4 Years
Lease Rental per annum	16,00,000
Guaranteed residual value	3,00,000
Expected residual value	4,50,000
Implicit Interest rate	15%

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

Calculate the value of Lease Liability and ascertain Unearned Finance Income as per AS- 19.

Question 23

Classify the following into either operating lease or finance lease with reason:

(1) Economic life of asset is 10 years, lease term is 9 years, but asset is not acquired at the end of lease term.

(2) Lessee has option to purchase the asset at lower than fair value at the end of lease term.

(3) Lease payments should be recognized as an expense in the statement of Profit & Loss of a lessee.

(4) Present Value (PV) of Minimum Lease Payment (MLP) = "X". Fair value of the asset is "Y". And X = Y.

(5) Economic life of the asset is 5 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.

(Nov' 19)

Question 24

From the following information, compute unearned finance income as per AS-19.

Fair value of Machine	₹ 65 lakh
Lease Term	5 years
Lease Rent	₹ 10 lakh per annum
Guaranteed Residual Value	₹ 1.4 lakh
Expected Residual Value	₹ 2.3 lakh
Internal Rate of Return	10%

Discount rates from 1st to 5th year are 0.909, 0.826, 0.751, 0.683 and 0.621 respectively. (Nov' 19)

Question 25

A machine was given on 3 years operating lease by a dealer of the machine for equal annual lease rentals to yield 30% profit margin on cost of ₹ 2,25,000. Economic life of the machine is 5 years and output from the machine is estimated as 60,000 units, 75,000 units, 90,000 units, 1,20,000 units and 1,05,000 units consecutively for 5 years. Straight line depreciation in proportion of output is considered appropriate. You are required to compute the following as per AS-19.

(i) Annual Lease Rent

(ii) Lease Rent income to be recognized in each operating year and

(iii) Depreciation for 3 years lease **(Dec' 21)**

Question 26

X Ltd. sold machinery having WDV of ₹ 300 lakhs to Y Ltd. for ₹ 400 lakhs and the same machinery was leased back by Y Ltd. to X Ltd. The lease back arrangement is operating lease. Give your comments in the following situations:

(i) Sale price of ₹ 400 lakhs is equal to fair value.

(ii) Fair value is ₹ 450 lakhs.

(iii) Fair value is ₹ 350 lakhs and the sale price is ₹ 250 lakhs.

(iv) Fair value is ₹ 300 lakhs and sale price is ₹ 400 lakhs.

(v) Fair value is ₹ 250 lakhs and sale price is ₹ 290 lakhs.

(Jan' 21)

Question 27

What are the disclosures requirements for operating leases by the lessee as per AS-19?

(May' 22)

AS 20 - EARNINGS PER SHARE

1. INTRODUCTION :

The objective of AS 20 is to describe principles for determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise.

Earnings per share (EPS) is a financial ratio indicating the amount of profit or loss for the period attributable to each equity share and AS 20 gives computational methodology for determination and presentation of basic and diluted earnings per share.

2. TYPES OF EPS :

There are two types of earning per share (EPS), which are to be reported by an enterprise on the face of the statement of profit and loss:

- Basic EPS
- Diluted EPS

3. BASIC EPS:

Basic EPS is calculated as under

$$\text{Basic Earning Per Share} = \frac{\text{Net profit / loss for the period attributable to equity shareholder.}}{\text{Weighted average number of equity shares outstanding during the period.}}$$

4. Calculation of Net Profit / Loss for the period attributable to equity shareholders.

➢ Calculate the net profit / loss for the period including prior period items and extraordinary items as per AS-5 and also deduct tax expense (Current tax + Deferred tax) unless the AS-5 requires otherwise.

➢ Deduct the amount of preference dividend and any attributable tax on preference dividend from the figure calculated above. Dividend on non-cumulative preference share is deducted if dividend is provided. However, in case of cumulative preference share, dividend of current year is deducted even if not provided in accounts. Dividend paid during the current year in respect of previous periods is to be excluded.

5. Per Share - Basic

The number of shares used in the denominator for basic EPS should be the weighted average number of equity shares outstanding during the period.

The weighted average number of equity shares outstanding during the period is the number of shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by a time-weighting factor.

6. EFFECTIVE DATES :

List of shares issued, which are to be adjusted	Weight to be considered from
➢ Equity shares issued in exchange of cash.	Date of cash receivable
➢ Equity shares against conversion of debt instrument	Date of conversion
➢ Equity shares against interest or principal of any financial instrument	Date when interest ceases to accrue.
➢ Equity shares issued in exchange for the settlement of a liability of the enterprise.	Date on which settlement becomes effective.
➢ Equity shares issued in consideration of acquisition of assets other than cash.	Date on which acquisition is recognised.
➢ Equity shares issued against services rendered.	When service is rendered
➢ Partly paid up share	Partly paid up equity should be counted as fraction of equity shares in ratio of amount paid up to the total face value of the share. Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.
➢ Right issue.	Adjusted with Right Factor.
➢ Equity shares issued as consideration in amalgamation by way of:	

(i) Merger	Shares included in the calculation of weighted average from the beginning of the reporting period.
(ii) Purchase	Included in the weighted average from the date of acquisition.
➢ Bonus share	Shares included in weighted average from the beginning of the reporting period.

7. IMPACT OF BONUS ISSUE:

Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

(a) A bonus issue;

(b) A bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;

(c) A share split; and

(d) A reverse share split (consolidation of shares).

In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported. For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

8. RIGHT ISSUE:

Right issue is generally made at a price lower than fair value of share. Therefore, a right issue usually includes a bonus element. Since right issue includes a bonus element, the number of equity shares to be used in calcu0lating basic EPS for all periods prior to right issue is the number of equity shares outstanding prior to the issue multiplied by right factor which is calculated as under:

$$\text{Right Factor} = \frac{\text{Fair value per share immediately prior to right issue}}{\text{Theoretical Ex-Right fair value per share}}$$

Theoretical Ex-Right fair value:

$$\frac{\text{Aggregate fair value of share immediately prior to the exercise of the rights} + \text{Proceeds from exercise of the rights}}{\text{Number of shares outstanding immediately after the right issue}}$$

Computation of WANES

$$\left(\text{No. of shares outstanding at the beginning of the year} \times \text{RF} \times \frac{\text{No. of Months upto Rights}}{12}\right) +$$

$$\left(\text{Total No of shares after rights} \times \frac{\text{No. of remaining Months}}{12}\right)$$

9. DILUTED EARNING PER SHARE :

Diluted earning per share is calculated when there are potential equity shares in capital structure of the enterprise. A potential equity share is that financial instrument which entitles the holder the right of equity shares like convertible debentures, convertible preference shares, options, warrants, etc.

Diluted Earning Per Share

$$= \frac{\text{Net profit attributable to equity shareholders (after adjustment for diluted earnings)}}{\text{Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity shares)}}$$

➢ **Diluted Earning**

- Compute net profit or loss for the period attributable to existing equity shareholder.
- Add back dividend along with distribution tax on convertible preference shares previously deducted.
- Add back interest net of tax effect charged on convertible debenture or loans.

10. PRESENTATION:

An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented. AS 20 requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).

CLASSWORK QUESTIONS

Question 1

Date	Particulars	Purchased	Sold	Balance
1st January	Balance at beginning of year	1,800	-	1,800
31st May	Issue of shares for cash	600	-	2,400
1st November	Buy Back of shares	-	300	2,100

Calculate Weighted Number of Shares.

Question 2

Net profit for the year 31.3.2016 ₹ 18,00,000

Net profit for the year 31.3.2017 ₹ 60,00,000

No. of equity shares outstanding until 31.3.2016 ₹ 20,00,000

Bonus issue 1st October 2016 was 2 equity shares for each equity share outstanding at 31.3.2016.

Calculate Basic Earnings Per Share and Adjusted Earnings Per Share.

Question 3

Given below is the information regarding the capital of a company 40,00,000 equity shares @ 3.50 = 1,40,00,000

9 months later the Company had issued 1 share for 4 shares held given rights to existing shareholder @ 2.80.

Find out bonus element in right issue and WANES.

Question 4

Net profit for the year 2016 ₹ 11,00,000

Net profit for the year 2017 ₹ 15,00,000

No. of shares outstanding prior to rights issue 5,00,000 shares

Rights issue price ₹ 15.00

Last date to exercise rights 1st March 2017

Rights issue is one new share for each five outstanding (i.e. 1,00,000 new shares)

Fair value of one equity share immediately prior to exercise of rights on 1st March 2017 was ₹ 21.00. Compute Basic Earnings per share of 2016 & 2017. Also calculate restated EPS of 2016.

Question 5

Net profit for the current year	₹ 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	₹ 2.00
No. of 12% convertible debentures of 100 each	1,00,000
Each debenture is convertible into 10 equity shares	
Interest expense for the current year	₹ 12,00,000
Tax relating to interest expense (30%)	₹ 3,60,000

Compute Diluted Earnings Per Share.

Question 6

From the following information pertaining to A Ltd., compute BEPS and DEPS

Profit available for equity shareholders = 20,00,000

Equity Share Capital of ₹ 10 each = 8,00,000

Convertible 12% Preference share of ₹ 100 = 16,00,000

Each preference share is convertible into 2 equity shares.

Question 7

Net profit for the year 2017	12,00,000
Weighted average number of equity shares outstanding during the year 2017	5,00,000 shares
Average fair value of one equity share during the year 2017	20.00
Weighted average number of shares under option during the year 2017	1,00,000 shares
Exercise price for shares under option during the year 2017	15.00

Compute Basic and Diluted Earnings Per Share.

Question 8

"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.

Question 9

"While calculating diluted earning per share, effect is given to all dilutive potential equity shares that were outstanding during that period." Explain. Also calculate the diluted earnings per share from the following information:

Net profit for the current year ₹ 85,50,000

No. of equity shares outstanding 20,00,000

No. of 8% convertible debentures of ₹ 100 each 1,00,000

Each debenture is convertible into 10 equity shares

Interest expenses for the current year 6,00,000

Tax relating to interest expenses 30%

Question 10

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.

HOMEWORK SECTION

Question 11

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.

Question 12

In April, 2010, A Limited issued 18,00,000 Equity shares of ₹ 10 each, ₹ 5 per share was called up on that date which was paid by all the shareholders. The remaining ₹ 5 was called up on 1-9-2010. All the Shareholders (except one having 3,60,000 shares) paid the sum in September 2010. The net profit for the year ended 31-3-2011 is ₹ 33 lakhs after dividend on preference shares and dividend distribution tax of ₹ 6.60 lakhs.

Compute the basic EPS for the year ended 31st March, 2011 as per AS 20.

Question 13

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.

Question 14

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.

Question 15

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

PART A

	₹ 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

Question 16

XYZ Ltd. had issued 30,000, 15% convertible debentures of ₹ 100 each on 1st April, 2008. The debentures are due for redemption on 1st March, 2011. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal Value ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum.

Question 17

(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 case:

		No. of shares
1st April, 2010	Balance of equity shares	7,20,000
31st August, 2010	Equity shares issued for cash	2,40,000
1st February, 2011	Equity shares bought back	1,20,000
31st March, 2011	Balance of equity shares	8,40,000

(ii) Compute adjusted earnings per share and basic EPS based on the following information:

Net profit 2009-10	₹ 7,20,000
Net profit 2010-11	₹ 24,00,000
No. of equity shares outstanding until 31st December, 2010	8,00,000

Bonus issue on 1st January, 2011, 2 equity shares for each equity share outstanding at 31st December, 2010.

PAST PAPER SECTION

Question 18

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

Net Profit:	Year 2009 – 10	₹ 25,00,000
	Year 2010 – 11	₹ 49,00,000

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 of exercise rights 30-6-2010

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

(May'11)

Question 19

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 case:

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 (May'12)

Question 20

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 (May'12)

Question 21

M/s. A Ltd. had 8,00,000 Equity Shares outstanding on 1st April, 2013. The Company earned a profit of ₹ 20,00,000 during the year 2013-14. The average fair value per share during 2013-14 was ₹ 40. The Company has given Share Option to its employees of 1,00,000 Equity Shares at option price of ₹ 20. Calculate Basic EPS and Diluted EPS. (May'15)

Question 22

From the following information compute Basic and Diluted Earnings per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2017:

Net Profit for the year after tax: ₹ 75,00,000 Number of Equity Shares of ₹ 10 each outstanding: 10,00,000 Convertible Debentures Issued by the Company

Particulars	Nos.
8% Convertible Debentures of ₹ 100 each	1,00,000
Equity shares to be issued on conversion	1,10,000

Rate of Income Tax: 30% **(Nov'17)**

Question 23

As at 1st April, 2016 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 2016 the remaining ₹ 5 was called up and paid by all shareholders except one shareholder having 60,000 equity shares. The net profit for the year ended 31st March, 2017 was ₹ 21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹ 3,40,000.

Compute Basic EPS for the year ended 31st March, 2017 as per Accounting Standard 20 "Earnings per Share". **(May'18)**

Question 24

From the following information given by Sampark Ltd., Calculate Basis EPS and Diluted EPS as per AS 20:

	₹
Net Profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of ₹ 100 each	50,000
Each debenture is convertible into 8 Equity Shares	
Interest expense for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

(Nov'18)

Question 25

Net Profit for FY 2016-17	30,00,000
Net Profit for FY 2017-18	50,00,000
No. of shares outstanding prior to rights issue	20,00,000 shares
Rights Issue Price	₹ 20
Last day to exercise rights	1st June, 2017

Right issue is one new share for each five equity share outstanding (i.e. 4,00,000 new shares Fair value of one equity share immediately prior to exercise of rights on 1st June, 2017 was ₹ 26.00.

Compute Basic Earnings Per Share for FY 2016-17, FY 2017-18 and restated EPS for FY 2016-17. **(May' 19)**

Question 26

Following information is supplied by K Ltd.:

Number of shares outstanding prior to right issue - 2,50,000 shares.

Right issue - two new share for each 5 outstanding shares (i.e. 1,00,000 new shares)

Right issue price - ₹ 98

Last date of exercising rights - 30-06-2018.

Fair value of one equity share immediately prior to exercise of right on 30-06-2018 is ₹ 102.

Net Profit to equity shareholders:

2017-2018 - ₹ 50,00,000

2018-2019 -₹ 75,00,000

You are required to calculate the basic earnings per share as per AS-20 Earnings per Share. **(Nov' 19)**

Question 27

What do you mean by 'Weighted Average number of Equity Shares outstanding during the period' and why is it to be calculated ?

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 lieu of interest or principal on other financial instruments.

(iv) Equity shares issued in exchange for the settlement of a liability of the enterprise.

(v) Equity Shares issued as consideration for the acquisition of an assets other than cash.

(vi) Equity Shares issued for the rendering of services to the enterprise **(5 Marks) (Nov' 20)**

Question 28

At the time calculating diluted earnings per share, effect is given to all dilutive potential equity shares that are outstanding during the period". Comment and also calculate the basic and diluted earnings per share for the year 2020-21 from the following information:

(i)	Net profit after tax for the year	₹ 64,12,500
(ii)	No. of equity shares outstanding	15,00,000

(iii)	No. of 9% convertible debentures of ₹ 100 issued on 1st July,2020	75,000
(iv)	Each debenture is convertible into 8 Equity Shares	
(v)	Tax relating to interest expenses	35%

(Dec' 21)

Question 29

NAT, a listed entry, as on 1st April, 2021 had the following capital structure:

	₹
10,00,000 Equity Shares having face value of ₹ 1 each	10,00,000
10,00,000 8% Preference Shares having face value of ₹ 10 each	1,00,00,000

During the year 2021-2022, the company had profit after tax of ₹ 90,00,000

On 1st January, 2022, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 31" December, 2021.

On 1st January, 2022, NAT issued 2,00,000 equity shares of ₹ 1 each at their full market price of ₹ 7.60 per share.

NAT's shares were trading at ₹ 8.05 per share on 31st March, 2022.

Further it has been provided that the basic earnings per share for the year ended 31st March, 2021 was previously reported at ₹ 62.30.

You are required to :

(i) Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March, 2022 including the comparative figure, in accordance with AS-20 Earnings Per Share.

(ii) Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share? **(May' 22)**

Question 30

The following information is provided to you:

Net profit for the year 2022:	₹72,00,000
Weighted average number of equity shares outstanding during the year 2022:	30,00,000 shares
Average Fair value of one equity share during the year 2022:	₹25.00
Weighted average number of shares under option during the year 2022:	6,00,000 shares
Exercise price for shares under option during the year 2022:	₹20.00

You are required to compute Basic and Diluted Earnings Per Shares as per AS – 20.

(Nov'22 - 5 Marks)

AS 22 - ACCOUNTING FOR TAXES ON INCOME

1. SCOPE :

The Standard deals with the taxes on Income (Domestic taxes as well as Foreign taxes) Excluding Dividend Distribution Tax.

2. OBJECTIVES :

(1) To bring Matching between accounting income to be reported and tax expenses to be charged.

(2) Recognition of tax expense in P&L.

3. DIFFERNCE BETWEEN ACCOUNTING PROFIT AND TAX PROFIT:

There is a difference between accounting profit (i.e. Profit calculated on the basis of accounting policies) and taxable profit (i.e. profit calculated as per Income Tax laws). There are two main reasons for this difference.

1. **Timing difference:** These difference originate in one period and is capable of reversal in one or more subsequent periods. e.g.
   * Difference in rate of depreciation
   * Difference in method of depreciation
   * Section 43B items of the Income Tax Act (Outstanding Interest, Bonus, etc).
   * Provision for doubtful debts
   * Provision for warranties
   * Provision for decrease in value of assets
   * Provision for impairment of assets, etc.
2. **Permanent Difference:** These differences originate in one period and do not reverse subsequently e.g., expenses charged to profit & Loss but not allowed for tax purpose at all in any year or incomes credited to Profit & Loss but are exempt from tax.

4. TIMING DIFFERENCES:

Timing differences will lead to either Deferred Tax Asset or Deferred Tax Liability. When accounting profit is more than taxable profit, a deferred tax liability is created. However when accounting profit is less than taxable profit, a Deferred Tax Asset is created e.g.

- Accelerated depreciation allowed by Income Tax Act leads to creation of Deferred Tax Liability.
- Provision for doubtful debts will lead to creation of Deferred Tax Asset.

5. PERMANENT DIFFERENCES :

Permanent differences are differences that always remain and are of permanent nature.

- Permanent differences do not create Deferred Tax Asset / Deferred Tax Liability.
- These are excluded for determining of tax expense.

6. DIFREENCE BETWEEN TAX EXPENSES AND CURRENT TAX :

The difference between tax expenses and current tax (i.e. Tax payable as per Income Tax Laws) arises only on account of timing difference which creates Deferred Tax Asset or Deferred Tax Liabiliy

Tax expense = Current Tax + Deferred Tax

Current tax is calculated using tax rates and tax laws applicable for the relevant accounting year. Deferred Tax Assets or Deferred Tax Liabiliy is determined using tax rate and tax laws that have been enacted or substantially enacted at the Balance Sheet date. Further deferred tax is not discounted to its P.V.

7. RECOGNISION OF D.T.L AND D.T.A. :

Deferred Tax Liabiliy must be provided for, but prudence would require that Deferred Tax Assets should be recognised and carried forward only to the extent that there is resonable certainty that sufficient future taxable income will be available against which such Deferred Tax Asset can be realised. However in case of unabsorbed depreciation and carry forward losses under Income Tax laws, Deferred Tax Asset should be recognised only to the extent there is virtual certainty that sufficient future taxable income will be available against which such Deferred Tax Asset can be realised.

8. REVIEW OF DEFERRED TAX ASSET:

The carrying amount of deferred tax asset should be reviewed at each balance sheet date, if it is evident that any portion of the deferred tax asset is not recoverable because of uncertainty of future income, the deferred tax asset should be written down. Any such written down amount may be reversed in subsequent period to the extent that it becomes reasonably certain that sufficient future taxable income will be available.

9. **RE - ASSESSMENT OF UNRECOGNIZED DEFERRED TAX ASSET: Previously unrecognized** deferred tax asset is re-assessed at every balance sheet date. If it becomes reasonably certain that such unrecognized deferred tax asset will be realised, then unrecognized deferred tax asset is recognised now.

Any adjustment arising out of such review / reassessment is charged / credited to Profit & loss account of the year. (i.e. year of review / reassessment) It is not prior period item but a change in accounting estimate. However if the amount is material proper disclo- sure should be made because this item would be an item of exceptional nature.

10. **DISCLOSURE:**

- The break - up of deferred tax asset / liability should be disclosed.
- In case of deferred tax asset arising out of unabsorbed depreciation or loss, evidence-supporting recognition should be disclosed.
- Deferred tax asset / liability should be disclosed separately from current asset / liabilities. They should also be distinguished from advance tax / tax provision / tax refund due.
- Deferred tax asset and liability should be set off if permissible under the tax laws but to be shown separately if not permissible.

CLASSWORK QUESTIONS

Question 1

ABC Ltd. has provided depreciation as per accounting records ₹ 8,00,000 and as per tax records ₹ 14,00,000. Unamortised preliminary expenses, as per tax record is ₹ 10,000. There is adequate evidence of future profit sufficiency. How much deferred tax asset / liability should be recognized as transition adjustment. Tax rate is 30%.

Question 2

1. Cost of asset purchased in year 1 = 200 lakhs
2. Depreciation
   (a) Book at 20%
   (b) Income tax 100%
3. PBDT = 200 lakhs each for years 1 to 5
4. Rate of tax = 50%

Calculate deferred tax and show journal entries.

Question 3

A company ABC Ltd. prepares its accounts annually on 31st March. The company has incurred a loss of ₹ 1,00,000 in the year 2003 and made profits of ₹ 50,000 and 60,000 in year 2004 and year 2005 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 2003, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. It is also assumed that there is not difference between taxable income and accounting income except that set-off of loss is allowed in years 2004 and 2005 for tax purposes.

Question 4

Omega Limited is working on different projects those are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statement during 2006, 2007 and 2008 for₹11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income - tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 2006, 2007 and 2008 respectively. Income - tax rate is 35%. Compute the amount of deferred tax asset / liability for the years 2006, 2007 and 2008.

Question 5

Dilemma Ltd. has operating profit before taxes and depreciation of ₹ 500 Lacs in each of the 3 years. The company purchased a microcomputer for ₹ 240 Lacs in the beginning of Year 1. The expenditure was fully allowed as a deduction U/s 35 of the Income - tax Act. However the company has decided to amortise the expense over its useful life of 3 years in its books.

The tax rates in the 3 years are :

Year 1	40%
Year 2	38%
Year 3	35%

Calculate Deferred Taxes if it is assumed that future tax rates are known only one year ahead, pass journal entries for all the three years.

Question 6

Sheetal Ltd. has provided the following information for the year ended 31st March, 2019:

Particulars	Amount (₹)
Accounting profit	9,00,000
Book profit as per MAT	5,25,000
Profit as per Income Tax Act	95,000
Tax rate	30%
MAT rate	7.5%

You are required to calculate the deferred tax asset/liability as per AS-22 and amount of tax to be debited to the profit and loss account for the year. **(Nov'19)**

Question 7

Krishna Ltd. started business on 1st April 2005. The following details are available from the books of account and other records of Krishna Ltd.

Profit before depreciation and taxes

	₹
2005 - 2006	15,00,000
2006 - 2007	18,00,000
2007 - 2008	25,00,000
2008 - 2009	30,00,000

The company purchased the following machines:

Date of purchase	Amount (₹)
1. 4. 2005	4,00,000
1. 4. 2006	3,00,000
1. 4. 2007	4,00,000

The company charges depreciation on machines @ 15% p. a., whereas the rate of depreciation for tax purpose is 25% p. a. The company has no other fixed assets. Tax rates for the five relevant years were 50%, 45%, 40%, 35% and 35% respectively. You are required to Calculate the Deferred Taxes.

Question 8

The following details are available in the books of ABC Ltd.

Particulars	₹ in Lakhs
Provision for tax :	
For 2005 - 2006	200
For 2006 - 2007	300
For 2007 - 2008	250
Advance tax paid :	
For 2005 - 2006	175
For 2006 - 2007	350
For 2007 - 2008	270

ABC Ltd. estimates its Deferred Tax Liabilities to be ₹ 100 lakhs and its Deferred Tax Assets to be ₹ 20 lakhs. How will the above be disclosed?

PAST PAPER SECTION

Question 9

Rohit Ltd. has provided the following information:

	₹
Depreciation as per accounting records	2,50,000
Depreciation as per tax records	5,50,000
Unamortized preliminary expenses as per tax record	40,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognised as transition adjustment when the tax rate is 50%? **(May'18)**

Question 10

Write short note on Timing difference and Permanent Difference as per AS 22. **(May' 19)**

Question 11

From the following details of Aditya Limited for accounting year ended 31st March, 2020:

Particulars	₹
Accounting Profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

Calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the profit and loss account for the year. **(Nov' 20)**

Question 12

The following particulars are stated in the Balance Sheet of HS Ltd. as on 31-3-2019:

Particulars	(₹ in lakhs)
Deferred Tax Liability (Cr.)	60.00
Deferred Tax Assets (Dr.)	30.00
The following transactions were reported during the year 2019 -20 :	
Depreciation as per accounting records	160.00
Depreciation as per income tax records	140.00
Items disallowed for tax purposes in 2018-19 but allowed in 2019-20	20.00
Donation to Private Trust	20.00
Tax rate	30%

There were no additions to fixed assets during the year. You are required to show the impact of various items on Deferred Tax Assets and Deferred Tax Liability as on 31 -3-2020 as per AS-22. **(Jan' 21)**

Question 13

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

(i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs. There were no additions to Fixed Assets during the year.

(ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.

(iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).

(iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%.

You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. **(Jul' 21)**

Question 14

The following information is furnished in respect of Mohit Limited for the year ending 31st March, 2022.

(i) Depreciation as per accounting records ₹56,000
Depreciation for income tax records ₹38,000
The above depreciation does not include depreciation on new addition.

(ii) A new machinery purchased on 1st April, 2021 costing ₹24,000 on which 100% depreciation is allowed in the 1st Year for income tax purpose, whereas straight line method of depreciation is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of ₹1,28,000 before depreciation and taxes.

(iv) Donation to private trust during the year is ₹15,000 (not allowed under Income tax laws.)

(v) Corporate tax is 40%.

Prepare relevant extract of statement of Profit & Loss for the year ending 31st March, 2022. Also show the effect of the above items on Deferred Tax Liability / Assets as per AS – 22. **(Nov'22 - 5 Marks)**

AS 24 - DISCONTINUING OPERATIONS

1. OBJECTIVES :

(i) Reporting Information about discontinuing Operations:

(ii) This will enhance the ability of users of Financial Statement to make Projections of an enterprises.

- Cash Flows
- Earning generating capacity

  And
- Financial Position

By segregating Information about discontinuing Operations from Information about Continuing Operations.

2. REPORTING :

➢ **Separate Profit/Loss will be calculated for**

- Continuing Operations
- Discontinuing Operations

➢ **Separate Cash Flows will reported**

➢ **Separate Assets & Liabilities shall be reported**

3. MEANING OF DISCONTINUING OPERATION :

➢ **Discontinuing Operation should be single plan**

- To disposing off significant Assets and Labilities

  Either by selling in Single transactions

  Or by Demerger

  Or by Spin off of ownership
- To disposing off Assets and Labilities in piecemeal (Individually)
- To terminate through abandonment permanently without substantial Sale of Assets.

➢ **Discontinuing Operation should be component/segment as per AS – 17. (i.e. Separate major line of business or geographical area of operation)**

➢ **Discontinuing Operation should be Distinguishable Component Financially and Operationally.**

E.g. A company manufactures and sells 10 brands of consumer products that are grouped into five major product lines – beauty care, health care, food, pet care and baby care. Each brand comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each brand is a component of the entity. Each product line (i.e, a group of components) represents a major line of business that comprises a major part of the entity's operations and financial results. The company decides to exit the beauty care market and disposes of its related product line.

Ans. The disposal qualifies as a discontinued operation because the beauty care product line is a group of components of the entity that represents a major line of business that comprises a major part of an entity's operations and financial results (i.e., a strategic shift).

4. FOLLOWING MAY NOT BE CONSIDERED AS DISCOUNTING OPERATIONS:

A restructuring transactions or events that do not meet the definition of discontinuing operations as per AS – 24 should not be called as Discontinuing Operations.

- Gradual phasing out of a product line or class of service.
- Discontinuing, even if abruptly, Several Products within an ongoing line of business, doesn't necessary mean discontinuing Operations.
- Shifting of some marketing or production activities for a particular line of business from one location to another.
- Closing of a facility to achieve Productivity, Improvements or Cost Savings.
- Change in the Scope of Operations.
- Selling the subsidiary whose activities were similar to its holding Co.

5. INITIAL DISCLOSURE EVENT:

Information about planned discontinuance must be disclosed in the First Set of Financial Statement immediately after the 'Initial Disclosure event'.

Initial Disclosure event is the event out of these two and whichever occurs earlier:

- **Entering into an agreement to sell** substantially all the assets of the discontinuing Operation.

  Or

  Resolution of Discounting Operations is **approved** in Board meeting and **announce.**

CLASSWORK QUESTIONS

Question 1

Compel Ltd. is discontinuing a product segment which is not a reportable segment within the meaning of AS-17 and reported in segment information as an unallocated reconciling item. Management intends to sell-off the assets and settle the liabilities by piecemeal. Is it a discontinuing operation within the meaning of AS-24?.

Question 2

Qu Ltd. is in the business of manufacture of Passenger Cars and Commercial Vehicles. The Company is working on a strategic plan to shift from the Passenger Car segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the Division nor its Assets. As part of its plan, it will reduce the production of Passenger Cars by 20% annually. It also plans to commence another New Factory for the manufacture of Commercial Vehicles and transfer surplus employees in a phased manner:

1. You are required of comment if mere gradual phasing out in itself can be considered as a "Discontinuing Operation' within the meaning of AS-24.
2. If the Company passes a Resolution to sell some of the assets in the Passenger Car Division and also to transfer few other Assets of the Passenger Car Division to the factory, does this trigger the application of AS-24?
3. Would your answer to the above be different, if the Company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?

Question 3

Resource Enterprises produces a standard type of tools and equipments for industiral use. The company carry out its production into 3 processes. It has been found that over a period of a time cost of production of the first process is 15% higher than the market price of the intermediate product available freely in the market. The company has decided to close down the first process as a measure of cost saving. Should this event be treated as a discontinuing operations?

Question 4

A company has two divisions - cement and steel. It has started negotiating for disposal of the steel division informally since May 2008, discussion has been held with the possible buyers, the labour union has demonstrated against this secret deal, the company has given a statement that there is no move to sell the steel division. The significant reduction in the production has taken place because of decline in the market demand for the company's product not as planned strategy to close down operation. During November 2008 the Board of Directors has announced that they are considering disposal of the steel division because of continuing loss suffered by that division. But no formal resolution was passed. Necessary formalities for disposal of a division were fulfilled only during January 2009 and the steel division was disposed of in the last week of January 2009. The company follows calendar year as accounting year. Does this event require disclosure?

Question 5

A cosmetic producing Company provides the following information w.r.t. no of units produced :

Particulars	Cold Cream	Vanishing Cream
January 2013 - September 2013 p.m.	2,00,000	2,00,000
October 2013 - December 2013 p.m.	1,00,000	3,00,000
January 2014 - March 2014 p.m.	0	4,00,000

The Company has enforced a gradual change in product-line on the basis of an overall plan. The Board of Directors of the Company has passed a resolution in March 2013 to this effect. The Company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer.

CLASSWORK SOLUTIONS

Answer 1

Normally segments reportable under AS-17 are purely discontinuing operation for AS-24 also. But what about those segments which act as unallocated reconciling item? Reportable segment or part of reportable segment can also be discontinuing operation. Condition for discontinuing operation is that, the discontinuing operation should be major business line or area of operations.

In the present case C Ltd. is disposing one of the product segment through piecemeal distribution. Selling off the attributable assets and liabilities itself indicates that some of the assets and liabilities of the business are attributable to the segment. Hence it is a discontinuing operation.

Answer 2

1. Mere gradual phasing out in itself cannot be considered as a Discontinuing Operation (DO). Gradual or evolutionary phasing out of a product line or class of service is not DO para 9
2. Passing of Resolution to sell some of the assets in the Passenger Car Division and also to transfer few other Assets of the Passenger Car Division to the factory, does not trigger the application of AS-24. It is sale in its entirety remember and not some of the assets. Also starting the operations in the New Factory is altogether a new business and has nothing to do with old business.
3. Resolution to sell assets of the Passenger Car Division in a phased but time bound manner will lead to identification of a Discontinuing Operation as per AS-24. It means there is a single plan to discontinue the operation. The manner of discontinuance seems to be piecemeal distribution.

Answer 3

The company has made a good decision of outsourcing the service, in respect of a single process. This has been done by the company with a view to achieve cost reduction. The change is merely a cost -saving endeavor. Such a change does not meet definition criteria in para 3 (a) of AS-24. Hence, this change is not discontinuing operation.

Answer 4

As per AS 24, Information about planned discontinuance must be disclosed in the first set of financial statement immediately after the initial disclosure event, An initial disclosure event is the event out of these two whichever occurs earlier:-

- Entering into an agreement to sell substantially all the assets of the discontinuing operation
- Approving and announcing of the discontinuance plan

In the given case the company is planning to discontinue the steel division. The directors have announced the plan of discontinuance, during November 2008 but the board resolution is not yet passed. As per the standard the initial disclosure event will take place when the discontinuance plan is approved and announced, since board resolution is not passed it can be said that approval of the plan is not yet made, so the initial disclosure does not take place in the year 2008 and hence no disclosure with regards to discontinuance of the Steel division is required. In the year 2009 the steel division is disposed hence disclosures would be given in the financial statements of the year 2009.

Answer 5

By gradually reducing the size of operations in the product line of Cold Cream, the company has increased its scale of operation in Vanishing Cream. Such a change is a gradual or evolutionary phasing out of a product line or class of services and does not meet the definition criteria namely, disposing of substantially in its entirety, a component of the enterprise. Hence, this changeover is not a discontinuing operation.

HOMEWORK SECTION

Question 6

A healthcare goods producer has changed its geographic segment for one area, as follows:

Monthly Sales	Maharastra	Gujarat
January, 2008 - September, 2008	4,00,000	4,00,000
October, 2008 - December, 2008	2,00,000	6,00,000
January, 2009 - March, 2009	--	8,00,000

Earlier the company was marketing the production in two geographic segments. Because of stiff competition and falling margin in the Maharastra, it had gradually closed down its operation in Maharastra and shifted all activities to Gujarat. Should this event form part of discontinuing operations?

Question 7

A Company belonging to the process industry carries out three consecutive processes. The output of the first process is taken as input of the second process, and the output of the second process is taken as input of the third process. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period of time cost of production of the first process is 10% higher than the market price of the intermediate product available freely in the market. The company has decided to close down the first process as a measure of cost saving (vertical spin off) and outsource. Should this event be treated as discontinuing operations?

Question 8

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

(i) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.

(ii) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?

(iii) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

(Jul' 21)

AS 26 - INTANGIBLE ASSETS

1. OBJECTIVE :

AS 26 prescribes recognition criteria, measurement, amortization & disclosure of IAs

2. DEFINITION OF ASSET :

An asset is defined as a resource controlled by an enterprise as a result of past events & from which future economic benefits are expected to flow to the enterprise.

3. DEFINITION OF INTENGIBLE ASSETS :

An IA is an identifiable, non-monetary asset without physical substance held for use in the production or supplying of goods or services, or for rentals to others or for administrative purposes.

4. AS 26 IS APPLICABLE TO :

(a) Goodwill
(b) Advertising exps
(c) Preliminary exps
(d) R & D costs
(e) Patents, trademarks & copyrights
(f) Computer software etc

5. RECOGNITION CRITERIA :

An IA will be recognized i.e. recorded in the books provided both the following conditions are fulfilled :

(a) Probable future economic benefits will flow from the IA to the enterprise &
(b) The cost of the IAs can be reliably measured

6. COST OF INTENGIBLE ASSETS :

The cost of IA depends on the way it is acquired :

(a) Separate Acquisition
(b) Exchange for another asset
(c) Issue of shares or securities

(d) IAs arising from amalgamation (in the nature of purchase)

(e) Acquisition through government grants

(f) Self generated IAs

7. SUBSEQUENT EXPENDITURE ON IA :

Expenditure incurred on IAs after they have been recognized / recorded is called subsequent expenditure. It should be added to the cost of IA only if such subsequent expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance & the expenditure can be measured & attributed to the asset reliably.

8. CARRYING AMOUNT OF IA :

It is the amount at which assets are recognized in the Balance Sheet, net of accumulated amortization & impairment losses thereon

9. AMORTIZATION METHOD :

The depreciable amount of IAs is amortised over its useful life. Depreciable amount is cost less residual value. AS 26 provides that amortisation method should reflect the pattern in which the asset's economic benefits are consumed. If that is not determinable then SLM should be used. The residual value of IAs is assumed to be zero unless :

(a) There is commitment by a third party to purchase the asset at the end of its useful life or

(b) There is an active market for the asset that can be used to determine the residual value & that such a market would probably exist at the end of the asset's useful life. The residual value cannot be subsequently increase for changes in value (decrease is permitted).

The useful life of the IAs should be taken as 10 years unless there is clear evidence that the useful life is longer than 10 years. If economic benefits from IAs are achieved through legal right granted for finite period then the useful life cannot exceed the legal right period unless the legal right is renewable & the renewal is certain.

10. REVIEW OF AMORTISATION METHOD :

Amortisation method should be review annually. It should be changed if :

(a) The expected useful life has significantly changed or

(b) The pattern of future economic benefits has significantly changed.

Prospective / retrospective effect would depend upon whether it is a change in accounting estimate / policy.

11. DE-RECOGNISION OF INTENGIBLE ASSET :

An IA should be de-recognised / eliminated from Balance Sheet if :

(a) It is disposed or

(b) No future economic benefits are expected from its use.

Gain / loss on disposal should be recognized as income / expense in the P & L A/c.

12. INTERNALLY GENERATED GOODWILL :

Internally generated goodwill is not recognized in the financial statements because the cost cannot be reliably measured.

13. RESEARCH & DEVOLPMENT EXPENSE :

Research is original & planned investigation undertaken with the prospect of gaining new scientific or technical knowledge & understanding. Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, process systems or services prior to the commencement of commercial production or use. If an enterprise cannot distinguish the research phase from the development phase of a project to create an intangible asset, it should treat the expenditure on that project as if it were incurred in the research phase only. As per AS 26, research cost must be expensed when it is incurred i.e. research cost cannot be capitalized. Development costs are also to be expensed unless they meet the asset recognition criteria & the enterprise can demonstrate the following :

(a) Technical feasibility of completing the IA so that it will be available for use or sale.

(b) Its intention to complete the IA & its intention & ability to use or sell it etc..

➢ Cost of internally generated intangible would comprise of the costs which are incurred during the development phase of the IA & which are directly attributable to or reasonably allocable to the IA.

14. AS 26 IS NOT APPLICABLE TO :

(a) Ownership interest in other enterprise, investments

(b) Goodwill arising on amalgamation

(c) Goodwill arising on consolidation

(d) DTA

(e) Issue exps, discounts & premiums on borrowings & issue of shares etc.

15. DISCLOSURES :

The financial statements should disclose the following in respect of IA :

(a) Useful life or amortisation rate

(b) Amortisation method

(c) Gross carrying amount & accumulated amortisation at the beginning & end of the period

(d) Reconciliation of carrying amount at the beginning & end of the period

(e) If amortisation period is more than 10 years, the reason thereof

(f) R & D exps recognized as expenses during the period etc..

CLASSWORK QUESTIONS

Question 1

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?

Question 2

Hera Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹ 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in thousands)	Net operating cash flow (₹ in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method.

Question 3

NDA Corporation is engaged in research on new process design for its product.

It had incurred an expenditure of ₹ 530 Lakhs on research upto 31st March, 2010.

The Development of the process began on 1st April, 2010 and development phase expenditure was ₹ 360 lakhs upto 31st March 2011 which meets assets recognition criteria.

From 1st April 2011 the company will implement the new process design which will result in after tax saving of ₹ 80 Lakhs per annum for the next five years.

The cost of capital of company is 10%

Explain:

(i) Accounting treatment for research expenses.

(ii) The cost of internally generated intangible asset "as per AS 26".

(iii) The amount of amortization of assets.

(The present value of annuity factor of ₹ 1 for 5 Years @ 10% 3.7908)

Question 4

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.

Question 5

Base Limited is showing an intangible asset at ₹ 84 lakhs as on 1-4-2011. This asset was acquired for ₹ 112 lakhs on 1-4-2008 and the same was available for use from that date. The company has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

Question 6

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.

CLASSWORK SOLUTIONS

Answer 1

(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.

As per 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.

Answer 2

As per AS 26 "Intangibles Assets", the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliable, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. Initially net operating cash flow per thousand bottles is ₹3 lakhs for first two years and ₹ 4 lakhs from fourth year onwards, the pattern is established. Therefore Hera Ltd. should amortize the license fee of ₹200 lakhs as under.

Year	Net Operating Cash Inflow (NOCI)	Ratio	Amortize Amount (₹ in lakhs)
1	900	9	6.57
2	1,800	18	13.14
3	2,300	23	16.79
4	3,200	32	23.36
5	3,200	32	23.36
6	3,200	32	23.36
7	3,200	32	23.36
8	3,200	32	23.36
9	3,200	32	23.36
10	3,200	32	(bal.) 23.34
	27,400	274	200

Answer 3

(1) Research Expenditure – According to para 41 of AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred.

(2) Cost of internally generated intangible asset – The question states that the development phase expenditure amounting ₹360 lakhs incurred upto 31st March, 2011 meets asset recognition criteria. As per AS 26 for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years	80 lakhs p.a.
Company's cost of capital	10%
Annuity factor @10% for 5 years	3.7908
Present value of net cash flows (₹80 lakhs × 3.7908)	303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹360 lakhs or present value of future net cash flows ₹303.26 lakhs. Hence, cost of an internally generated intangible asset will be ₹ 303.26 lakhs. The difference of ₹56.74 lakhs (i.e. ₹ 360 lakhs - ₹ 303.26 lakhs) will be amortized by the enterprise for the financial year 2010.11

(3) Amortisation - The company can amortise ₹ 303.26 lakhs over a period of five years by charging ₹60.65 lakhs per annum from the financial year 2011-12 onwards.

Answer 4

As per 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 on 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 cannot 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.

Answer 5

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimates 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. Amortization should commence when the asset is available for use.

Base Limited has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified as per AS 26.

Accordingly, carrying amount of ₹ 84 lakhs would be amortized over remaining 7 years by ₹12 lakhs per year.

HOMEWORK SECTION

Question 7

AB Ltd. launched a project for producing product X in October, 2009. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2011. 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.

Question 8

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.

Question 9

A company acquired for its internal use a software 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

Question 10

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.

Question 11

M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on the process was ₹ 60 lacs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012.

Expenditure incurred till this date was ₹ 32 lacs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹ 90 lacs. As on 31-03-2014, the recoverable account of know-how embodied in the process is estimated to be ₹ 82 lacs. This includes estimates of future cash outflows and inflows:

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013 ?

(ii) What is the carrying amount of the intangible asset as on 31st March, 2013 ?

(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014?

(iv) What is the carrying amount of the intangible asset as on 31st March, 2014?

Question 12

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 each year. Determine the amortization under Accounting Standard 26.

(May'13)

Question 13

A company had deferred research and development cost of ₹ 450 Lakhs. Sales expected in the subsequent years are as under:

Year	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 3rt 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? **(May'12)**

Question 14

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. **(Nov'12)**

Question 15

M/s. Mahesh Ltd. is developing a new production process. During the Financial Year ended 31st March, 2013, the total expenditure incurred on the process was ₹ 60 lakhs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹ 32 lakhs.

Further expenditure incurred on the process for the Financial Year ending 31st March, 2014 was ₹ 90 lakhs. As on 31.03.2014, the recoverable amount of know-how embodied in the process is estimated to be ₹ 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out:

(i) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2013?

(ii) What is the carrying amount of the intangible asset as on 31st March, 2013?

(iii) What is the expenditure to be charged to Profit & Loss Account for the year ended 31st March, 2014?

(iv) What is the carrying amount of the intangible asset as on 31st March, 2014?

(May'15)

Question 16

A Company with a turnover of ₹ 375 crores and an annual advertising budget of ₹ 3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 37.5 crores from the new product. The Company had debited to its Profit and Loss account the total expenditure of ₹ 3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct? **(Nov'16)**

Question 17

Fast Ltd. acquired a patent at a cost of ₹ 40,00,000 for a period of five years and its product life-cycle is also five years. The company capitalized the cost and started amortizing the asset at ₹ 5,00,000 per annum. After two years, it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years are expected to be ₹ 18,00,000, ₹ 23,00,000, ₹ 22,00,000, ₹ 20,00,000 and ₹ 17,00,000. Find out the amortization cost of the patent for each of the years.

(May'17)

Question 18

A company acquired a patent at a cost of ₹ 160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹ 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹ 50 lakhs, ₹ 30 lakhs, ₹ 60 lakhs, ₹ 70 lakhs and ₹ 40 lakhs. Find out the amortization cost of the patent for each of the years. **(May'18)**

Question 19

A company acquired patent right for ₹ 1200 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	1	2	3	4	5
Estimated future cash flows (₹ in lakhs)	600	600	600	300	300

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 ₹ 150 lakhs. Determine the amortization under Accounting Standard 26.

(May'18)

Question 20

During 2016-17, an enterprise incurred costs to develop and produce a routine low risk computer software product, as follows:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Packing the products (1,500 units) (Phase 6)	16,500

After completion of phase 2, it was established that the product is technically feasible for the market.

You are required to state how the above referred cost to be recognized in the books of accounts. **(May' 19)**

Question 21

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product.

Question 22

Honey Ltd. is in the process of developing a new production method. During the financial year ended 31st March, 2018, total expenditure incurred on development of this production method was ₹ 98,00,000. On 1st Jan, 2018, the production method met the criteria as an intangible asset and expenditure incurred till this date was ₹ 68,00,000. Further expenditure incurred on the new method was ₹ 72,00,000 for the year ended 31st March, 2019 and recoverable amount of the know how embodied in the new method for this financial year is ₹ 52,00,000.

You are required to calculate:

(1) The carrying amount of the Intangible asset on 31st March, 2018.

(2) The expenditure to be shown in Statement of Profit and Loss Account for the year ended 31st March, 2019.

(3) The carrying amount of the Intangible asset on 31st March, 2019.

Question 23

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The Product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flow ₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per Accounting Standard 26.

Question 24

M/s. Pasa Ltd. is developing a new production process. During the financial year ended 31st March, 2019, the total expenditure incurred on the process was ₹ 80 lakhs. The production process met the criteria for recognition as an intangible asset on 1st November, 2018. Expenditure incurred till this date was ₹ 42 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2020 was ₹ 90 lakhs. As on 31.03.2020, the recoverable amount of know how embodied in the process is estimated to be ₹ 82 lakhs. This includes estimates of future cash outflows and inflows.

You are required to work out

(1) What is the expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2019 ?

(2) What is the carrying amount of the intangible asset as on 31st March, 2019 ?

(3) What is the expenditure to be charged to Profit and Loss Account for the year ended 31 St March, 2020 ?

What is the carrying amount of the intangible asset as on 31" March, 2020 ?

(Nov' 20)

Question 25

Surgical Ltd, is developing a new production process of surgical equipment. During the financial year ended 31st March 2020 the total expenditure incurred on the process was ₹ 67 lakhs. The production process met the criteria for recognition as an intangible asset on 1st January 2020. Expenditure incurred till this date was ₹ 35 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March 2021 ₹ 105 lakhs. As on 31st March 2021, the recoverable amount of technique embodied in the process is estimated to be ₹ 89 lakhs. This includes estimates of future cash outflows and inflows.

Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit and Loss Account for the year ended 31st March 2020;

(ii) Carrying amount of the intangible asset as on 31st March 2020;

(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31 st March 2021;

(iv) Carrying amount of the intangible asset as on 31st March 2021.

(Dec' 21)

Question 26

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%

(ii) Additional Import Duty 5%

(iii) Entry Tax 2% (Recoverable later from tax department).

(iv) Installation expenses ₹ 1,50,000.

(v) Professional fees for clearance from customs ₹ 50,000. Compute the cost of software to be Capitalized as per relevant AS.

(Jan' 21)

AS 29 - PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1. SCOPE:

THIS ACCOUNTING STANDARD COVERS THE FOLLOWING ARES :

- PROVISIONS
- CONTINGENT LIABILITIES
- CONTINGENT ASSETS

2. PROVISIONS :

(a) DEFINITION OF PROVISION :

A provision is a liability which can be measured only by using a substantial degree of estimation.

(b) RECOGNISION OF PROVISION :

- An enterprise has a present obligation as a result of a past event
- Its is probable that an outflow of resources embodying economic benefits will be required to settle the obligation &
- A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized. The amount of provision should be recognized before tax & is not discounted to its PV.

(c) NO PROVISION FOR FUTURE EXPENDITURE :

Financial statements deal with the financial position of an enterprise at the end of its reporting period & not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to operate in the future. The only liabilities recognized in an enterprise's B/S are those that exist at the B/S date. It is only those obligation arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognized as provisions.

(d) REVIEW OF PROVISION :

Provisions should be reviewed at each Balance Sheet date & adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

(e) **REIMBURSEMENT :**

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized, when & only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision. In the statement of the P & L, the expense relating to a provision may be presented net of the amount recognized for a reimbursement.

(f) **OBLIGATING EVENT :**

An obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation. Thus, a past event that leads to a present obligation is called an obligating event.

Where there are a number of similar obligations (e.g. : product warranties), the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

3. CONTINGENT LIABILITIES :

(a) **DEFINITION :**

- A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
- A CONTINGENT LIABILITY IS:
  - (i) A possible obligation that arises from past events & the existence of which be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise or
  - (ii) A present obligation that arises from past events but is not recognized because:
    - (1) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or
    - (2) a reliable estimate of the amount of obligation cannot be made

- An obligation is a present obligation if based on the evidence available, its existence at the balance sheet date is considered probable i.e. more likely than not
- An obligation is a possible obligation if based on the evidence available, its existence at the balance sheet date is considered not probable.

(b) TREATMENT OF CONTINGENT LIABILITY :

An enterprise should not recognize a contingent liability. A contingent liability is to be disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. When an enterprise is jointly & severally liable for an obligation, that part of the obligation which is expected to be met by other parties is treated as a contingent liability. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources economic benefits has become probable.

4. CONTINGENT ASSETS :

(a) DEFINITION :

A contingent asset is a possible asset that arises from past events, the existence of which will be confirmed only by the occurrence or non-occurrence of 1 or more uncertain future events not wholly within the control of the enterprise.

(b) TEREMENT OF CONTINGENT ASSETS :

An enterprise should not recognize a contingent asset. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise.

E.g.: a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. Where an inflow of economic benefits is probable, the contingent asset is usually disclosed in the Directors' Report & not in the financial statements. Contingent assets are assessed continually & if it has become virtually certain that an inflow of economic benefits will arise, the asset & the related income are recognized in the financial statements of the period in which the change occurs.

CLASSWORK QUESTIONS

Question 1

At the end of the financial year ending on 31st December, 2017, a company finds that there are twenty law suits outstanding which have not been settled till the date of, approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Probability Loss (₹)		
In respect of five cases (Win)	100%	
Next ten cases (Win)	60%	-
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken. as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

Question 2

After wedding in 2004 – 05, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31st March, 2005 the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31st March, 2006 its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable. How this should be dealt with in financial statement?

Question 3

CAPS has 50 students of C.A.P.C.C. with guarantee for returning ₹ 5,000 if student does not succeed. Our assessment puts 60% probability of success. Whether provision need or to be disclosed as contingent liability?

Question 4

Venu Ltd sold 1 Lakh Vacuum pumps during the Year with a warranty condition to make good by repair / replacement any manufacturing defects reported within six months from the date of sale. Past experience in this regard showed that there were no replacement carried out but minor / major repairs were necessitated to the extent of 10% / 5% respectively of the units sold. The cost of such minor/major repairs would amount to ₹ 1,000 / ₹ 6,000 respectively. While finalizing the accounts for the Year, the company does not reflect any provision in this regard. Comment

Question 5

An engineering goods Company provides after- sales warranty for 2 Years to its customers. Based on past experience, the Company has the 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 invoice as under-

Invoice Date	Amount (₹)
19.01.2011	40,000
29.01.2012	25,000
15.10.2012	90,000

Calculate the Provision to be made for warranty under AS- 29 as at 31.03.2012 and 31.03.2013. Also compute amount to be debited to profit and Loss Account for the Year ended 31.03.2013.

Question 6

Shyam Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2010-11, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2006 based on the recommendations of the commission. The company makes the provision of ₹ 680 lakhs for pay revision in the financial year 2010-11 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of ₹ 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made".

The accountant feels that the company should also book/recognise the income by ₹ 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant accounting standards.

Question 7

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties. Whether any provision is required?

CLASSWORK SOLUTION

Answer 1

According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

(i) There is a present obligation arising out of past events but not recognized as provision.

(ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

(iii) The possibility of an outflow of resources embodying economic benefits is also less likely to occur.

(iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise.

The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable.

As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made.

For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 30% of ₹ 1,20,000 + 10% of ₹ 2,00,000
= ₹ 36,000 + ₹ 20,000 = ₹ 56,000

Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
= ₹ 30,000 + ₹ 42,000 = ₹ 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 9,20,000 (₹ 56,000 x 10 + ₹ 72,000 x 5) as contingent liability.

Answer 2

(a) At 31st March, 2005.

On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Hence no provision is recognised. The matter is disclosed as a contingent liability unless the possibility of any outflow is regarded as remote.

(b) At 31st March, 2006

Present obligation as a result of a past obligating event – On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement is probable. A provision is recognised for the best estimate of the amount to settle the obligation.

Answer 3

Individually each students result is independent from each other but these are related and similar cases. If we see individually than only 40% chance of failure that means liability of ₹ 5,000 will arise is not probable. Hence, no provision needed. Only disclosure as contingent liability.

But above view is not appropriate. We should take whole group of 50 student together and we can say that likelihood of 40% failure will mean 20 students may fail requiring payment of ₹ 5,000 x 20 = ₹ 1,00,000 and hence ₹ 1,00,000 liability should be provided for.

Answer 4

- There is a present obligation because obligating event is the sales of the pumps with a warranty, which gives rise to an obligation.
- Outflow of resources is probable for the warranties as a whole.
- Best estimation can be made as under [6,000 x (5% of 1,00,000) + 1,000 x (10% Of 1,00,000)] = ₹ 400 Lakhs
- The Company should make a provision for warranty obligation on sale of Vacuum pumps to the extent of ₹ 400 Lakhs.

The Auditor should insist on such provision being created.

If provision is not made, he should qualify his Audit Report.

Answer 5

1. Computation of Provision at Year – end

Invoice Date	Last date of warranty	Provision as on 31.03.2012	Provision as on 31.03.2013
19.01.2011	19.01.2013	40,000 x 2% = 800	(warranty period has expired) Nil
29.01.2012	29.01.2014	25,000 x 3% =750	25,000 x 2% =500
15.10.2012	15.10.2014	Nil (invoice not Yet raised)	90,000 x 3% = 2,700
	Total	**1,550**	**3,200**

2. **Amount to be provision to profit & Loss A/c for the year ended 31.03.2013**

Balance of provision as on 31.03.2013	₹ 3,200
Less: Balance of provision as on 31.03.2012	₹ 1,550
	₹ 1,650

Answer 6

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

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of ₹ 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of ₹ 680 lakhs is not as per AS- 29 and also the concept of prudence will not be followed if ₹ 680 lakhs is simultaneously recognized as income. ₹ 680 lakhs is not the revenue at present but only reimbursement of claim for which an asset is created. However the accountant is correct to the extent as that non- recognition of ₹ 680 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Answer 7

The obligating event is the sale of the product with a warranty. An outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Therefore, provision for the best estimate of warranty costs should be made.

Question 8

X Ltd. has its financial year ended 31.3.2011, fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the probable outcomes as below:

Result	Probability	Amount of Loss ₹
For first ten cases:		
Win	0.6	---
Loss-low damages	0.3	90,000
Loss-high damages	0.1	2,00,000
For remaining five cases:		
Win	0.5	---
Loss-low damages	0.3	60,000
Loss-high damages	0.2	1,00,000

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

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

Question 9

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.

Question 10

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?

Question 11

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 annual accounts of the company? **(Nov'12)**

Question 12

M/s. Shishir Ltd., a public Sector Company, provides consultancy and engineering services to its clients. In the year 2014-15, the Government set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of ₹ 1250 lakhs for pay revision in the financial year 2014-15 on the estimated basis as the report of the commission is yet to come. As per the contracts with client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of ₹ 1250 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made."

The Accountant feels that the company should also book/recognize the income by ₹ 1250 lakhs in Profit & Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit.

Comment on the opinion of the Accountant with reference to relevant Accounting Standards. **(May'15)**

Question 13

M/s AB Ltd. is in the process of finalizing its account for the year ended 31st March, 2015. The company seeks your advice on the following:

(i) The company's sale tax assessment for assessment year 2012-13 has been completed on 14th February, 2015 with a demand of ₹ 5.40 crore. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of ₹ 3.70 crore.

(ii) The company has entered into a wage agreement in May 2015 whereby the labour union has accepted a revision in wage from June 2014. The agreement provides that the hike till May 2015 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 2015. **(May'16)**

Question 14

With reference to AS 29 "Provisions, Contingent Liabilities and Contingent Assets", define:

(i) A Provision

(ii) A Liability

(iii) A Contingent Asset

(iv) Present Obligation **(May'16)**

Question 15

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company. How would the matter be dealt in the annual accounts of the Company in the light of AS – 29? Explain in brief giving reasons tor you answer. **(Nov'16)**

Question 16

Legal Department of XYZ limited provides that as on 31st march 2017, there were 25 law suits pending which have not been settled till the approval by the Board of Directors. The possible outcomes of suits are follows:

Particulars	Probability	Loss (₹)
In respect of Seven cases (Win)	100%	
Next Twelve cases (Win)	60%	
Loss (Low damages)	30%	1,50,000
Loss (High damages)	10%	2,50,000
Remaining Six cases (Win)	50%	
Loss (Low damages)	35%	1,25,000
Loss (High damages)	15%	3,00,000

Outcome of each case is to be taken as a separate one. Ascertain the amount of contingent loss to be reported in the Financial Statement.

(Nov '17)

Question 17

A Ltd. manufactures engineering goods, provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following the 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, 2016	80,000
29th January, 2017	50,000
15th October, 2017	1,80,000

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2017 and 31st March, 2018. Also compute amount to be debited to profit and loss Account for the year ended 31st March. 2018.

(May'15)

Question 18

With reference to AS-29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:

(i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

(ii) During 2016-17 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2017-18, the financial condition of Brew Ltd. deteriorates and at 31st Dec. 2017 it goes into Liquidation. (Balance Sheet date 31-3-17). (Nov'18)

Question 19

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the 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 (₹)
11th Feb, 2017	60,000
25th Dec, 2017	40,000
04th Oct, 2018	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31st March, 2018 and 31st March, 2019. Also compute amount to be debited to P & L account for the year ended 31st March, 2019. **(Nov'19)**

Question 20

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

(i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.

(ii) The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place. **(Nov' 20)**

Question 21

A Limited sells goods with unlimited right of return from its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized for the year ended 31st March. **(Jul' 21)**

Question 22

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is ins the process of finalisation of the accounts for the year ended 31st March, 2022 and needs your advice on the following issues in line with the provisions of AS-29:

(i) On 1st April, 2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March, 2022, the company does not provide any provision tor replacement of lining of the furnace.

(ii) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalisation of the case. There are 70% chances that the penalty may not be levied.

(May' 22)

Question 23

At the end of the financial year ending on 31 March, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

Particulars	Probability	Loss (₹)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29

(Nov'22 - 5 Marks)