AS 1 – DISCLOSURE OF ACCOUNTING POLICIES			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Disclosure requirements:		
	• Changes in accounting policy	Q.1, Q.3 (ii)	Q.5
	• No changes in accounting policy	Q.3 (i)	Q.6, Q.8
2	Substance over from		Q.4, Q.7
3	Notes to Account	Q.2	
4	Different Accounting policies	Q.4	
5	Miscellaneous		Q.1, Q.2, Q.3

AS 1 – DISCLOSURE OF ACCOUNTING POLICIES

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	Q. P. NOV 20 (IPCC) Similar to ICAI – ILLU. 1						
2	ICAI – ILLU. 2						
3	QP DEC 21						
4	ICAI – P.Q.7						

1. QUESTION PAPER NOV 20 (IPCC) (Similar to ICAI - Illustration 1)

In the book 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. Realized 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.

SOLUTION

<u>REFERENCE:</u>

As per **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.**

<u>ANALYSIS / CONCLUSION:</u>

Rani 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 realizable value. Since net realizable 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. 2019-20, 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** (1,75,000 – 1,59,000)."

2. ILLUSTRATION 2 ICAI

Jagannath Ltd. had made a rights issue of shares in 20X2. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to end on 31st March, 20X2. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹ 10 crores. The board in consultation with the managing director, decided on the following:

i. *Value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores).*

ii. *Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.*

iii. *Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the provision being ₹ 10 crores.*

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2.

SOLUTION

REFERENCE:

As per **AS 1, 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.** In the case of a change in accounting policies which has a **material effect** in the current period, 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.**

ANALYSIS / CONCLUSION:

The notes on accounts of Jagannath Ltd. should properly disclose the change and its effect.

Notes on Accounts:

i. During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital-intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end **inventory** has been **valued at ₹ 50 crores** and the **profit** for the year is **increased by ₹ 20 crores.**

ii. The company has been providing 2% of sales for meeting "after sales expenses" during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the **profit** for the year is **increased by ₹ 12 crores** than would have been the case if the old policy were to continue.

iii. The company has decided to provide ₹ 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has **reduced the profit** disclosed in the **accounts by ₹ 10 crores.**

3. QP DEC 21

i. ABC Ltd. was previously making provisions for non-moving stocks based on not issued for the last 12 months up to 31.03,2020. Now, the company wants to make provision 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 M/s Kay Ltd, closing stock as on 31st March, 2021 amount 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 ₹ 1,54,0000.

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

SOLUTION

i) **REFERENCE:**

Accounting policies refer to the specific **accounting principles** and the **methods of applying** those principles adopted by the enterprise in the **preparation and presentation of financial** statements.

ANALYSIS:

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. *Accounting policy of a company may require that provision for non-moving inventories should be made.* ***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 inventory, the change in the amount of required provision of non-moving inventory from ₹ 5 lakhs to ₹ 4 lakhs is also not material.

CONCLUSION:

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 2020 -21:

"The company has provided for non-moving inventories 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 lower by ₹ 1 lakh."

ii) **REFERENCE:**

As per **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.**

ANALYSIS / CONCLUSION:

Company 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 realizable value. Since net realizable 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. 2020-21, 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 ₹ 9,000."**

4. ICAI – P.Q.7

Give examples of areas where accounting policies adopted could be differentfor different enterprises. Would there be any adverse impact due to the adoption of different policies, and if yes, how does Accounting Standard 1 seekto address such issue?

SOLUTION

*There are various areas where **different accounting policies** could be adopted by different entities within the same industry. An entity may choose to value its inventories using FIFO method, whereas another entity may choose to value the same using Weighted Average method.*
*While an entity is free to choose its accounting policy as long as in the financial statements reflect a **true and fair view of the state** of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended, the application of different accounting policies by different entities **affects the comparability** of the financial statements of such different entities by stakeholders, analysts, investors etc. **To mitigate the loss** of **comparability, Accounting Standard 1,** Disclosure of Accounting Policies requires disclosure of significant accounting policies as a part of the financial statements. This would **help users of the financial statements** to understand the policies followed by different entities, particularly if they belong to the same industry, and **make a correct analysis** of each entity resulting in more informed decision-making.*

AS 1 – DISCLOSURE OF ACCOUNTING POLICIES

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	Practical Q 1 / IPCC NOV 19 RTP / IPCC MAY 18 Exam/ MTP MARCH 2022/ QP May 2022						
2	INTER RTP NOV 2020 / RTP NOV 2020 (IPCC)						
3	ILLUSTRATION 3 (ICAI)/ RTP MAY 2016						
4	ILLUSTRATION 5, RTP NOV 2014, RTP NOV 2017						
5	ILLUSTRATION 7 (ICAI), MOCK TEST 2						
6	MAY 2017 / INTER MAY 20 RTP						
7	RTP NOV 16, RTP MAY 2019 IPCC						
8	NOV 2018 EXAM PAPER NEW, MTP APRIL 2022						

1. **Practical Q 1 / IPCC NOV 19 RTP / IPCC MAY 18 Exam/ MTP MARCH 2022/ QP May 2022**

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.

SOLUTION

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 in 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.

2. INTER RTP NOV 2020 / RTP NOV 2020 (IPCC)

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

SOLUTION

AS 1 recognizes three fundamental accounting assumptions. These are as follows:

i. **Going Concern:** The financial statements are normally prepared on the assumption that an **enterprise will continue its operations** in the **foreseeable future** and neither there is intention, nor there is need to materially curtail the scale of operations.

ii. **Consistency:** The principle of consistency refers to the practice of using same **accounting policies** for similar transactions in **all accounting periods** unless the change is required (i) by a **statute, (ii)** by an **accounting standard or (iii)** for **more appropriate presentation** of financial statements.

iii. **Accrual basis of accounting:** Under this basis of accounting, **transactions** are **recognised** as **soon as they occur, whether or not cash** or cash equivalent **is actually received** or paid and recorded in the financial statements of the periods to which they relate.

3. ILLUSTRATION 3 (ICAI)/ RTP MAY 2016

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and, it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the profit and loss accounts. State whether the treatment done by the Company is correct or not.

SOLUTION

REFERENCE:

As per **AS 1 'Disclosure of Accounting Policies'**, prudence is one of the major considerations governing the selection and application of accounting policies. Further as per AS 1, Accrual is one of the fundamental accounting assumptions.

Prudence: In view of the **uncertainty** attached to **future events**, **profits are not anticipated** but recognised only when realised though not necessarily in cash. **Provision is made** for all known **liabilities** and losses even though the amount cannot be determined with certainty and represents only a **best estimate** in the light of available information.

Accrual basis of accounting: Under this basis of accounting, **transactions are recognised as soon as they occur, whether or not** cash or cash equivalent is **actually received** or paid and recorded in the financial statements of the periods to which they relate.

ANALYSIS:

Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. **Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting.**

CONCLUSION:

The treatment done by the company, of not providing the interest amount from due date to the date of repayment is not correct.

4. ILLUSTRATION 5, RTP NOV 2014, RTP NOV 2017

A limited has sold its building for ₹ 50lakhs and the purchaser has paid the full price. The Company has given possession to the purchaser. The book value of the building is ₹ 35lakhs. As at 31st March 2013, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this treatment? What accounting treatment should the buyer give in its financial statements?

SOLUTION

REFERENCE:

AS-1 "Disclosures of Accounting Policies", states that the accounting treatment and presentation in Financial Statements of **transactions** should be governed by their **substance and not merely by the legal form.**

ANALYSIS:

Although legal title has not been transferred, the economic reality and substance is that the **rights and beneficial interest** in the immovable property have been **transferred.** Therefore, recording of acquisition/disposal (by the transferee and transferor respectively) would, **in substance,** represent the purchase/sale.

CONCLUSION:

In view of this A Ltd., should record the sales and recognize the profit of ₹15 lakhs in its profit and loss account. It should eliminate building from its balance sheet. In notes to accounts, it should disclose that building has been sold, full consideration has been received, possession has been handed over to the buyer and documentation and legal formalities are pending.

The buyer should **recognize the building as an asset** in his balance sheet and charge depreciation on it. The buyer should disclose in his notes to account that possession has been received however documentation and **legal formalities are pending.**

5. ILLUSTRATION 7 (ICAI), MOCK TEST 2

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 AS-1.

SOLUTION

REFERENCE:

As per **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**.

ANALYSIS / CONCLUSION:

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.**

6. MAY 2017 / INTER MAY 20 RTP

ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 based on technical evaluation:

Total value of inventory	₹ 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?

SOLUTION

REFERENCE:

Accounting policies refer to the specific **accounting principles** and the **methods of applying** those principles adopted by the enterprise in the **preparation and presentation of financial** statements.

ANALYSIS:

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made. **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 inventory, the change in the amount of required provision of non-moving inventory from ₹ 3.5 lakhs to ₹ 2.5 lakhs is also not material.

CONCLUSION:

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 2019-20:

"The company has provided for non-moving inventories 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 lower by` I lakh."**

7. RTP NOV 16, RTP MAY 2019 IPCC

Om Ltd. purchases goods on behalf of its customers for execution of work under a works contract against which it receives full payment and necessary declaration form under Central Sales Tax Act to be passed on to the supplier. The company follows the practice of treating the same as its purchases and accordingly debits to its Profit and Loss Account. Give your views on the above.

SOLUTION

REFERENCE:

AS-1 "Disclosures of Accounting Policies", states that the accounting treatment and presentation in Financial Statements of **transactions** should be governed by their **substance and not merely by the legal form.**

ANALYSIS:

The treatment in the given case would depend on the terms of the Works Contract and also the substance of the agreement. Accordingly, there can be two possibilities in the instant case, viz.

SITUATION 1

The **Company acts as the agent** of the customer.

Disclosure should be made to this effect that the material purchased belongs to the customer.

Where ownership of goods vests with the customers and the company merely purchases goods on behalf of its customers, it acts in the capacity of an agent for execution of works under a works contract for which it receives full payment.

Hence, these **purchases cannot be treated as the purchases of the Company** and so, the debit to its P&L A/c is **not correct**

SITUATION 2

The **Company is the owner of the materials purchased in substance** and has the right, (though a restricted one) to use the materials, for all practical purposes.

If the terms of Works Contract provide for factor linked payment by customer and in substance the materials acquired by the Company belongs to the company only, irrespective of the legal form of ownership, the Company is **justified in debiting its P&L A/c.**

8. NOV 2018 EXAM PAPER NEW, MTP APRIL 2022

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?

SOLUTION

REFERENCE:

Accounting policies refer to the specific **accounting principles** and the **methods of applying** those principles adopted by the enterprise in the **preparation and presentation of financial** statements.

ANALYSIS:

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. **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 inventory, the change in the amount of required provision of non-moving inventory from ₹ 4 lakhs to ₹ 3 lakhs is also not material.

CONCLUSION:

The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2017 -18 in the following manner:

"The company has provided for non-moving inventories 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 **value of net assets at the end of the year would have been lower by ` 1 lakh.**"

MCQs

1. Which of the following is NOT a major consideration in selection and application of accounting policies?
   a) Prudence
   b) Comparability
   c) Materiality
   d) Substance over form

2. Adoption of different accounting policies by different companies operating in the same industry affects which of the qualitative characteristics the most?
   a) Comparability
   b) Relevance
   c) Faithful representation
   d) Reliability

3. Which of the following statement would not be correct in relation to disclosures to be made in the financial statements after making any change in an accounting policy?
   a) Any change in an accounting policy which has a material effect should be disclosed.
   b) The amount by which any item in the financial statements is affected by such change should be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
   c) If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.
   d) If a change is made in an accounting policy which has material effect on the financial statements for the current period and is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed only in the later periods i.e. year(s) next to the year in which the change is adopted

Answers					
1	(b)	2	(a)	3	(d)

AS 2 – VALUATION OF INVENTORIES			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	NRV Computation	Q.1, Q.3, Q.11	Q.17, Q.18
2	Valuation Basic		Q.2, Q.6
3	Computation of Cost	Q.8, Q.4, Q.7, Q.9, Q.10	Q.7, Q.21, Q.5, Q.12
	• Gross Margin		Q.1, Q.15
	• Profit Calculation	Q.6	
4	By Product Valuation		Q.8
5	Normal & Abnormal Loss		Q.11, Q.16
6	Miscellaneous	Q.2	Q.13, Q.19, Q.20, Q.3, Q.10, Q.14
7	Special Case	Q.5	Q.4, Q.9

AS 2 - VALUATION OF INVENTORIES

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	EXAMPLE 1						
2	EXAMPLE 2						
3	QP JAN 2021 (Similar to ICAI P.Q.7)						
4	IPCC QP JAN 21						
5	QUESTION						
6	QP May 22						
7	INTER RTP NOV 2020 (IPCC RTP NOV 2020) / INTER RTP NOV 2018						
8	QP JULY 21						
9	ICAI - ILLU. 8						
10	INTER QP NOV 2019						
11	ICAI - ILLUSTRATION 2						

1. EXAMPLE 1

Cost of a partly finished unit at the end of 20X1-X2 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. Assume that the partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further. Calculate the value of Inventory as per AS 2.

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS:

The value of inventory is determined below:

Particulars	₹
Net selling price	250
Less: Estimated cost of completion	(100)
	150
Less: Brokerage (4% of 250)	(10)
Net Realisable Value	140
Cost of inventory	150
Value of inventory (Lower of cost and net realisable value)	**140**

2. EXAMPLE 2

ABC Ltd. has a plant with the capacity to produce 1 lac unit of a product per annum and the expected fixed overhead is ₹ 18 lacs. Fixed overhead on the basis of normal capacity is ₹ 18 (18 lacs/1 lac).

Case 1: Actual production is 1 lac units. Fixed overhead on the basis of normal capacity and actual **overhead** will lead to **same figure of ₹ 18 lacs.** Therefore, it is advisable to include this on **normal capacity.**

Case 2: Actual production is 90,000 units. **Fixed overhead is not going to change with the change in output** and will remain constant at ₹ 18 lacs, therefore, overheads on actual basis is ₹ 20 per unit (18 lacs/ 90 thousands). Hence by **valuing inventory at ₹ 20 each** for fixed overhead purpose, it will be **overvalued** and the **losses of ₹ 1.8 lacs** will also be included in closing inventory leading to a higher gross profit then actually earned. Therefore, it is **advisable to include fixed overhead** per unit on **normal capacity to actual production (90,000 x 18) ₹ 16.2 lacs** and rest **₹ 1.8 lacs should be transferred to Profit & Loss Account.**

Case 3: Actual production is 1.2 lacs units. Fixed overhead is not going to change with the change in output and will remain **constant at ₹ 18 lacs,** therefore, **overheads on actual basis is ₹ 15 (18 lacs/ 1.2 lacs).** Hence by valuing inventory at ₹ 18 each for fixed overhead purpose, we will be **adding** the element of **cost to inventory** which actually has not been incurred. At ₹ 18 per unit, total fixed overhead comes to ₹ 21.6 lacs whereas, **actual fixed overhead expense is only ₹ 18 lacs. Therefore, it is advisable to include fixed overhead on actual basis** (1.2 lacs x 15) ₹ 18 lacs.

3. INTER QP JAN 2021 (Similar to ICAI P.Q.7)

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 (purchased @ ₹100 per unit). Replacement cost of Raw Material X as on 31.03.2019 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 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.

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS:

As per the above reference, the valuation will be done as under:

Particulars	Partly Finished Goods	Finished Product
Quantity	400 Units	900 Units
Expected selling price	280	280
Less: Additional cost to complete the product	(50)	
Less: Brokerage 5% of ₹ 280	(14)	(14)
Net Realisable value	216	266
Total Cost Incurred	295 (245 + 50)	295 (Given)
Closing Inventory valuation as per AS 2	**216**	**266**

When there has been a decline in the price of materials and it is estimated that the **cost of the finished products will exceed net realizable value,** the materials are written down to net realizable value. In such circumstances, the **replacement cost** of the materials may be the **best available measure** of their net realizable value.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e., ₹ 80 per unit

CONCLUSION:

Valuation of Total Inventory as on 31.03.2019:

Particulars	Units	Valuation per unit	Amount
Raw material X	900	80	72,000
Partly finished goods	400	216	86,400
Finished goods P	800	266	2,12,800
Value of Inventory			**3,71,200**

4. IPCC QP JAN 21

A company purchased 20,000 Kg of certain material at ₹ 140 per Kg. Purchase price includes the GST of ₹ 1,00,000, in respect of which full input tax credit is admissible. The company availed full GST input tax credit. Freight inward incurred ₹ 1,20,000. Unloading charges ₹ 32,000. Normal Loss during transit is 8% The enterprise actually received 18,200 Kg and consumed 16,500 Kg. compute cast of inventory as per AS 2 and also allocate material cost

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**
b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.
c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Computation of cost of Inventory and allocation of material cost as per AS 2 is as follows:

Particulars	Amount
Purchase Price (20,000 X ₹ 140)	28,00,000
Less: Input Tax Credit	(1,00,000)
	27,00,000
Add: Freight and Unloading charges	1,52,000
(A) Total Material Cost	28,52,000
(B) Number of units normally received 92% of 20,000 kgs	18,400 Kg
Normal Cost per Kg (A) / (B)	₹ 155

Conclusion: Allocation of Material Cost:

Particulars	Kg	₹ / Kg	₹
Material Consumed	16,500	155	25,57,500
Cost of Inventory	1,700	155	2,63,500
Abnormal Loss	200	155	31,000
Total Material Cost	**18,400**		**28,52,000**

5. QUESTION

Vidya Ltd.'s normal production volume is 50,000 units and the Fixed Overheads are estimated at Rs.5,00,000. Give the treatment of Fixed Production OH under AS-2, if actual production during a period was – (a) 42,000 units, (b) 50,000 units and (c) 60,000 units.

SOLUTION

<u>REFERENCE:</u>

As per AS 2, Fixed production overheads are those indirect costs of production that **remain relatively constant** regardless of the volume of production.

- The allocation of **fixed production overheads** for the purpose of their inclusion in the costs of **conversion** is **based on the normal capacity** of the production facilities.
- The amount of fixed production overheads allocated to each unit of production is **not increased as a consequence of low production or idle plant.** Unallocated overheads are recognised as an expense in the period in which they are incurred.
- In periods of **abnormally** high production, the amount of fixed production overheads allocated to each unit of production **is decreased** so that inventories are **not measured above cost**

<u>ANALYSIS:</u>

Fixed Production OH Recovery Rate (based on Normal Capacity) = Rs.5,00,000 ÷ 50,000 = Rs.10 per unit.

The treatment of Fixed OH in different cases is as under:

	Particulars	Situation (a)	Situation (b)	Situation (c)
1.	Normal Production	50,000 units	50,000 units	50,000 units
2.	Actual Production	42,000 units	50,000 units	60,000 units
3.	Difference in Production (1 – 2)	8,000 units (Short) Actual < Normal	Nil Actual = Normal	10,000 units (Excess) Actual > Normal
4.	Recovery Rate to be used as per AS – 2	Normal Rate = Rs.10 per unit	Normal Rate = Rs.10 per unit	Revised Rate = Rs.5,00,000 ÷ 60,000 = Rs.8.33 per unit

5.	Inventoriable Costs, i.e. Recovered Costs	42,000 units x Rs.10 = Rs.4,20,000	50,000 units x Rs.10 = Rs.5,00,000	60,000 units x Rs.8.33=Rs.5,00,000
6.	Balance treated as Period Costs	Rs.80,000	Nil	Nil

6. QP May 22

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 Liters @ ₹ 95 per litre.

v) Closing inventory 13,000 litres.

You are required to computer 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 months of June, 2021.

SOLUTION

Cost of closing inventory for 13,000 litres as on 30th June 2021	
10,000 litres @ ₹ 95	9,50,000
3,000 litres @ ₹ 90	2,70,000
Value of inventory (determined at cost in absence of NRV)	12,20,000

Calculation of cost of goods sold	
Opening inventories (10,000 litres @ ₹ 92)	9,20,000
Purchases June – 1 (20,000 litres @ ₹ 90)	18,00,000
June – 30 (10,000 litres @ ₹ 95)	9,50,000

	36,70,000
Less: Closing inventories	(12,20,000)
Cost of Goods Sold	24,50,000

Calculation of Profit	
Sales (Given) (A)	30,40,000
Cost of Goods Sold	24,50,000
Add: General Overheads	4,00,000
Total Cost (B)	28,50,000
Profit (A-B)	1,90,000

7. INTER RTP NOV 2020 (IPCC RTP NOV 2020) / INTER RTP NOV 2018

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, 2020

Particulars	**₹ Per unit**
Raw Material X	
Cost price	400
Freight Inward	40
Replacement cost	320
Chemical Y	
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 25,000 units.

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

You are required to calculate the total value of closing stock of Raw Material X and Chemical Y according to AS 2, when Net realizable value of Chemical Y is ₹ 600 per unit.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Statement showing cost calculation of Raw material X and Chemical Y

Raw Material X	₹
Cost Price	400
Add: Freight Inward	40
Cost of Raw Material	440
Chemical Y	₹
Materials consumed	440
Direct Labour	120
Variable overheads	80
Fixed overheads (₹4,00,000/25,000 units)	16
Cost	**656**

Net Realizable Value of the Chemical Y (Finished Goods) is ₹ 600 per unit which is less than its cost ₹ 656 per unit. Hence, **Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV** since NRV is less than the cost.

Conclusion: Value of Closing Stock:

Particulars	Qty.	Rate (₹)	Amount (₹)
Raw Material X	1,000	320	3,20,000
Finished Goods Y	2,400	600	14,40,000
Total Value of Closing Stock			**17,60,000**

8. QP JULY 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.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**
b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.
c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

Calculation of raw material consumed during the year

Particulars	Unit (Kg)
Opening Inventory	2,200
Purchases	20,000
Less: Closing Inventory	(1,800)
Raw Material Consumed	**20,400**

Statement Showing the Computation of Value of Closing Inventory

Value of Closing Finished Goods

Particulars	Amount (₹)
Cost of Raw Material consumed (20,400 units X ₹ 20 per kg)	4,08,000
Direct Labour	3,06,000
Fixed Overheads (3,00,000/30,000 x 20,400)	2,04,000
Cost of Production	9,18,000
Cost of Closing Inventory of Finished Goods per unit(₹9,18,000/20,400)	45
Net Realizable Value (NRV) per unit	40

*Since **net realizable value is less than cost,** closing inventory of Finished Goods will be valued at ₹ 40 per unit*

Value of Closing Raw Materials

*As **NRV of finished goods is less than its cost,** the relevant raw material will be valued at **its replacement cost,** which is the best available measure of its NRV i.e. @ ₹ 19 per kg.*

CONCLUSION:

Value of closing inventory would be as under:

Particulars	Rs
Finished Goods 2,400 units @ ₹ 40/- per unit	₹ 96,000
Raw Materials 1,800 kg @ ₹ 19/- per kg	₹ 34,200
	₹ 1,30,200

9. ILLUSTRATION 8

Cap Products Ltd. has an annual capacity of 40,000 units. The production overheads for the year are estimated at Rs.3,20,000 whereas the total variable cost incurred is Rs.6,90,000. The administrative costs and selling costs were Rs.2,00,000 and Rs.1,80,000 respectively. At the end of year, there were 6,000 units in stock. Find out the value of inventory given that the factory remained closed for one month for non-receipt of orders which is a normal practice. Would your answer be different if the factory remained closed for any abnormal reason?

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. Administration and selling cost should **not be included** in inventory valuation.

d. The allocation of overhead is **not to be effected by abnormal reasons**

ANALYSIS:

Valuation of Inventory

Particulars	**Rs.**
Variable cost	6,90,000
Production overhead	3,20,000
Total cost	10,10,000
No. of units produced	40,000
Cost per unit	25.25
No. of units in closing stock	6,000
Value of closing inventory	**1,51,500**

10. INTER QP NOV 2019

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.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**
b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.
c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

As per the above reference, the valuation will be done as under:

Particulars	Partly Finished Goods	Finished Product
Quantity	650 Units	1800 Units
Expected selling price	350	350
Less: Additional cost to complete the product	50	0
Net Realisable value	300	350
Total Cost Incurred	360(310 + 50)	360 (Given)
Closing Inventory valuation as per AS 2	**300**	**350**

CONCLUSION:

Valuation of Total Inventory as on 31.03.2019:

Particulars	Units	Valuation per unit	Amount
Raw material	800	140	1,12,000
Partly finished goods	650	300	1,95,000
Finished goods	1800	350	6,30,000
Value of Inventory			**9,37,000**

11. ICAI – ILLUSTRATION 2

X Co. Limited purchased goods at the cost of ₹ 40 lakhs in October, 20X1. Till March, 20X2, 75% of the stocks were sold. The company wants to disclose closing stock at 10 lakhs. The expected sale value is ₹ 11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.20X2.

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS & CONCLUSION:

Particulars	₹
Expected selling price	11,00,000
Less: Commission (10% of 11,00,000)	1,10,000
Net Realisable Value	9,90,000
Cost of inventory	10,00,000
Value of inventory (Lower of cost and net realisable value)	9,90,000

AS 2 - VALUATION OF INVENTORIES

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	EXAMPLE 3						
2	EXAMPLE 4						
3	INTER QP MAY 2019						
4	IPCC QP MAY 2019						
5	ICAI ILLUSTRATION 4						
6	ICAI – ILLU. 1						
7	INTER RTP MAY 2020 (IPCC RTP MAY 2020)						
8	RTP NOV 15 , QP NOV 12						
9	RTP MAY 2013						
10	RTP MAY 2018						
11	MOCK TEST 2						
12	RTP MAY 2015						
13	RTP Nov 2015						
14	RTP May 16., RTP May 22						
15	RTP MAY 2017						
16	ICAI - ILLU. 3, MTP APR 22						
17	INTER RTP MAY 2019, ICAI - ILLU. 5						
18	INTER RTP NOV 2019 , IPCC RTP NOV 2019, INTER RTP NOV 2016, INTER RTP NOV 2017						
19	RTP MAY 22						
20	RTP MAY 22						
21	Mock test oct 21 series 1						

1. EXAMPLE 3

A trader purchased certain articles for ₹ 85,000. He sold some of articles for ₹ 1,05,000. The average percentage of gross margin is 25% on cost. Opening stock of inventory at cost was ₹ 15,000. Calculate the cost of closing inventory.

SOLUTION

Calculation of Cost of closing inventory:

Particulars	₹
Sale value of opening stock and purchase (₹ 85,000 + ₹ 15,000) x 1.25	1,25,000
Sales	(1,05,000)
Sale value of unsold stock	20,000
Less: Gross Margin (₹ 20,000 / 1.25) x 0.25	(4,000)
Cost of inventory	**16,000**

2. EXAMPLE 4

Calculate the value of Inventory as per the cost and net realisable value of two items that a company has in its inventory are given below:

	Cost	**Net Realisable Value**
Item 1	50,000	45,000
Item 2	20,000	24,000
Total	70,000	69,000

AS 2

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories**, Inventories should be valued at the **lower of cost** and **net realisable value.**

	Cost	Net Realisable Value	Inventory Value
Item 1	50,000	45,000	45,000
Item 2	20,000	24,000	20,000
Total	**70,000**	**69,000**	**65,000**

3. INTER QP MAY 2019

State whether the following statements are 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-2, inventories should be valued at the lower of cost and selling price.

SOLUTION

False.

As per **AS 2 – Valuation of Inventory,** Inventories should be valued at the **lower of cost and net realisable value.**

4. IPCC QP MAY 2019

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?

SOLUTION:

REFERENCE:

As per **AS 2 – Valuation of Inventory,** Inventories should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business less the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS:

Valuation of closing stock

Particulars	₹
Closing stock at cost	4,50,000
Less: Adjustment for 100 coats (Working Note 1)	(20,000)
Value of inventory	4,30,000

Working Notes:

1. **Adjustment for Coats**

	₹
Cost included in Closing Stock	2,20,000
NRV of Coats	2,00,000
Adjustment to be made as NRV is less than Cost	**20,000**

2. No adjustment required for skirts and shirts as their NRV is more than their cost which was included in value of inventory.

5. ICAI ILLUSTRATION 4

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

Particulars	₹ per kg.
Material cost	200
Direct labour	40
Direct variable overhead	20

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

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. The cost of conversion include **a systematic allocation** of fixed and variable overheads that are incurred in converting materials into finished goods. The **allocation of fixed overheads** for the purpose of their inclusion in the cost of **conversion** is **based on normal capacity** of the production facilities.

ANALYSIS:

Cost per kg. of finished goods:

Particulars		₹
Material Cost		200
Direct Labour	40	
Direct Variable Production Overhead	20	
Fixed Production Overhead (20,00,000/2,00,000)	10	70
		270

Hence the value of 4,000 kgs. of finished goods = 4,000 kgs x ₹ 270 = ₹ 10,80,000

6. ILLUSTRATION 1

Vidya Ltd deals in 3 products A, B and C, which are neither similar nor interchangeable. At the end of a financial year, the Historical Cost and NRV of items of Closing Stock are given below. Determine the value of Closing Stock.

Items	Historical Cost (in Rs. Lakhs)	Net Realisable Value (in Rs. Lakhs)
A	40	28
B	32	32
C	16	24

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories**, Inventories should be valued at the **lower of cost** and **net realisable value.**

ANALYSIS:

The Value of Closing Stocks is determined as under :

Stock Item	Historical Cost	NRV	Valuation = Least of Cost or NRV
A	Rs.40 lakhs	Rs.28 lakhs	Rs.28 lakhs
B	Rs.32 lakhs	Rs.32 lakhs	Rs.32 lakhs
C	Rs.16 lakhs	Rs.24 lakhs	Rs.16 lakhs
Total			Rs.76 lakhs

7. INTER RTP MAY 2020 (IPCC RTP MAY 2020)

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**
b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.
c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Raw material consumed	**Rs / Kg**	**Kg**
Opening value of Raw Material (11,000 / 1,100)	10	1,100
Add: Purchase value of Raw Material (1,00,000 / 10,000)	10	10,000
Less: Closing value of Raw Material (given)		900
Raw Material Consumed		**10,200**

Calculation of cost for closing inventory

Particulars	**₹**
Cost of Raw Material (10,200kg x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead (75,000 X 10,200 / 15,000)	51,000
Cost of Production	**2,29,500**
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit (Given)	₹ 20.00

As per the above analysis and reference, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e., ₹ 9.50.

CONCLUSION:

Particulars	Rs.
Finished Goods (1,200kg X 20)	24,000
Raw Material (900kg X 9.50)	8,550
Value of Closing Inventory	**32,550**

8. RTP NOV 2015 , SUGGESTED NOV 2012

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

Item	Unit	Amount (Rs)	Output (Unit)	Closing stock as on 31.03.2012
Raw Material	15000	1,60,000	MP1 – 6250	800
Wages	-	82,000	MP2 – 5000	200
Fixed Overhead	-	58,000	BP – 1600	-
Variable Overhead	-	40,000	-	-

Average market price of MP1 and MP2 is Rs.80 per unit and Rs.50 per unit respectively, by product is sold @ 25 per unit. There is a profit of Rs.5,000 on sale of by-product after incurring separate processing charges of Rs.4,000 and packing charges of Rs6,000. Rs.6,000 was realized from sale of scrap. Calculate the value of Closing Stock of MP1 and MP2 as on 31.03.2012.

SOLUTION

REFERENCE:

As per **AS 2**, When the costs of **conversion** of each product are **not separately identifiable** (joint or by products), they are **allocated** between the products **on a rational and consistent basis.**

ANALYSIS:

Joint Cost = Rs.1,60,000 + Rs.82,000 + Rs.58,000 + Rs.40,000 = Rs.3,40,000

NRV of By-product = Sale Price Rs.40,000 (1,600 x 25) – Further Cost 10,000 = Rs.30,000

NRV of By-product and Scrap = Rs.30,000 + Rs.6,000 = Rs.36,000

Net Joint Cost = Rs.3,40,000 – Rs.36,000 = Rs.3,04,000.

Particulars	MP 1	MP 2	Total
Production Quantity	6,250	5,000	11,250
Apportionment Joint Cost based on sale value (80 x 6,250) : (50 x 5,000) or 2:1	2,02,667	1,01,333	3,04,000
Average Joint Cost	32.43	20.27	-
Closing Stock Units	800	200	-
Value	**25,944**	**4,054**	**29,998**

Note: it is assumed that Net Realisable Value is more than Cost. The Profit on by-product is irrelevant, since only Net Realisable Value has to be considered.

9. RTP MAY 2013

The closing inventory at cost of a Company amounted to Rs.9,56,700. The following items were included at cost in the total:

(i) 350 Shirts, which had cost Rs.380 each and normally sold for Rs.750 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(ii) 700 Trousers, which had cost Rs.520 each. These too were found to be defective. Selling expenses for the batch totalled Rs.3,800. They were sold for Rs.950 each. What should be the closing inventory value (to the nearest rupee), after considering the above items?

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventory**, Inventories should be valued at the **lower of cost and net realisable value**. Net realisable value is the **estimated selling price** in the ordinary course of business less the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS:

Valuation of closing stock

Particulars	₹
Value of closing inventory (given)	9,56,700

Less: Adjustment to bring the stock of shirts at net realizable value (W.N.1)	(8,313)
Revised value of closing inventory as per AS 2	9,48,387

Working Note:

1. Valuation of Shirts as per AS 2

Particulars	**Shirt**	**Trouser**
Cost price per unit	380	520
Selling Price	375 (750 X 50%)	950
Less : Selling expense	18.75 5% of Rs.375	5.43 (3800/700 units)
Net Realisable Value	356.25	944.57
Lower of NRV and cost	356.25	520
Excess of cost over NRV	**23.75**	-

Therefore, **value of inventory of shirts is to be reduced by Rs.8,313** (Rs.23.75 x 350 shirts)

Since, inventory of trousers is already carried at cost, no further adjustment is required in the total value of closing inventories.

10. RTP MAY 2018

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

You are required to advise the company on the valuation of the inventories in line with the provisions of AS 2.

SOLUTION

FACTS:

Contract for sale of fancy terry towels have been received but the ownership is yet to be transferred to foreign buyers.

REFERENCE:

As per **AS 2 - Valuation of Inventories,** inventories should be **valued at lower of historical cost and net realizable value.** It also states that at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be **substantially complete** prior to the execution of the transaction generating revenue.

ANALYSIS:

As per the above reference, the closing inventory of fancy terry towel should be valued at **'lower of cost and net realizable value'**. Further, **export incentives are recorded only in the year the export sale takes place.**

CONCLUSION:

The policy adopted by the company for valuing its closing inventory of inventories of finished goods is **not correct.**

11. MOCK TEST 2

Omega Ltd., has a normal wastage of 4% in the production process. During the year 2016 -17, the Company used 12,000 MT of raw material costing Rs. 150 per MT. At the end of the year 630 MT of wastage was ascertained in stock. The accountant wants to know how this wastage is to be treated in the books.

You are required to compute the amount of normal and abnormal loss and treatment thereof in line with AS 2 "Valuation of inventories".

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, **abnormal** amounts of **wasted** materials, labour and other production costs are **excluded from cost** of inventories and such costs are **recognized as expenses** in the period in which they are incurred. The **normal** loss will be **included in determining the cost** of inventories (finished goods) at the year end.

ANALYSIS: Calculation of Normal Loss and Abnormal Loss:

Particulars	Quantity	Rs.
Material used @ Rs. 150	12,000 MT	18,00,000
Normal Loss (4% X 12,000 MT)	480 MT	
Value of Material per unit	11,520 MT	156.25 (18,00,000 / 11,520)
Abnormal Loss in Quantity (630 MT – 480 MT)	150 MT	
Value of Abnormal Loss (150 MT X 156.25)		**23,437.50**

Conclusion: Amount of Rs. 23,437.50 will be charged to the Profit and Loss statement as Abnormal Loss.

12. (RTP MAY 2015)

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 Net Realizable Value of the Finished Goods Y is ₹ 400.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

Raw Material X	₹
Cost Price	200
Less: Cenvat Credit	(10)
	190
Add: Freight Inward	20
Unloading charges	10
Cost of Raw Material	**220**

Finished goods Y	₹
Materials consumed	220
Direct Labour	60
Direct overhead	40
Fixed overheads (₹ 2,00,000/20,000 units)	10
Cost	**330**
Net Realisable Value	**400**

As NRV is greater than the cost of Finished Goods Y i.e. ₹ 330, Raw Material and Finished Goods are to be valued at cost

Conclusion: Value of Closing Stock:

Particulars	Qty	Rate	Amount (₹)
Raw Material X	500	220	1,10,000
Finished Goods Y	1,200	330	3,96,000
Total Cost of Closing Stock			5,06,000

13. (RTP Nov 2015)

CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses". State your comments on this treatment.

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, cost of inventories **comprises** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition. It further states that **Interest** and other **borrowing costs** are usually **not included** in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition.

ANALYSIS:

As per the reference above, the **proposal** of CC Ltd. to include interest on bank overdraft as an element of cost is **not acceptable** because it does not form part of cost of production.

CONCLUSION:

The treatment by CC Ltd for Interest is **incorrect.**

14. (RTP May 2016., RTP May 2022)

On the basis of information given below, find the value of inventory (by periodic inventory method) as per AS 2, to be considered while preparing the Balance Sheet as on 31st March, 2015 on weighted Average Basis.

Details of Purchases:

Date of purchase	Unit (Nos.)	Purchase cost per unit (₹)
01-03-2015	20	108
08-03-2015.	15	107
17-03-2015	30	109
25-03-2015	15	107
Details of issue of Inventory:		
Date of Issue	**Unit (Nos.)**	
03-03-2015	10	
12-03-2015	20	
18-03-2015	10	
24-03-2015	20	

Net realizable value of inventory as on 31st March, 2015 is ₹ 107.75 per unit. What will be the value of Inventory as per AS 2?

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventory**, Inventories should be valued at the **lower of cost and net realisable value.**

ANALYSIS:

Net Realisable Value of Inventory as on 31st March, 2015 (₹ 107.75 x 20 units)	₹ 2,155
Value of inventory as per Weighted Average basis	
Total units purchased and total cost:	
01.03.2015 (₹ 108 x 20 units)	₹ 2160
08.3.2015 (₹ 107 x 15 units)	₹ 1605
17.03.2015 (₹ 109 x 30 units)	₹ 3270
25.03.2015 (₹ 107 x 15 units)	₹ 1605
Total 80 units	₹ 8640
Weighted Average Cost = ₹ 8640/80 units	₹ 108
Total Value (₹ 108 x 20 units)	₹ 2,160

Value of inventory to be considered while preparing Balance Sheet as on 31st March, 2015 is, Cost or Net Realisable value whichever is lower i.e. ₹ 2,155.

15. RTP MAY 2017

Suraj Stores is a departmental store, which sell goods on retail basis. It makes a gross profit of 20% on net sales. The following figures for the year-end are available:

Opening Inventory ₹ 50,000; Purchases ₹ 3,60,000; Purchase Returns ₹ 10,000; Freight Inwards ₹ 10,000; Gross Sales ₹ 4,50,000; Sales Returns ₹ 11,250; Carriage Outwards ₹ 5,000.

Compute the estimated cost of the inventory on the closing date.

SOLUTION

ANALYSIS:

Calculation of cost of closing inventory

Particulars	₹
Opening Inventory	50,000
Purchases less returns (₹3,60,000 –₹ 10,000)	3,50,000
Freight Inwards	10,000
	4,10,000
Less: Net Sales (₹ 4,50,000 –₹ 11,250)	(4,38,750)
	(28,750)
Add: Gross Profits (₹ 4,38,750 x 20%)	87,750
Closing Inventory	**59,000**

16. ICAI ILLUSTRATION 3, MTP APRIL 2022

In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. State with reference to Accounting Standard, how will you value the inventories in this case?

SOLUTION

REFERENCE:

As per **AS 2 'Valuation of Inventories'**, **abnormal** amounts of **wasted** materials, labour and other production costs are **excluded from cost** of inventories and such costs are **recognized as expenses** in the period in which they are incurred. The **normal** loss will be **included in determining the cost** of inventories (finished goods) at the year end.

ANALYSIS:

Particulars	Quantity	Rs.
Input Value of Material @ Rs. 1000	5,000 MT	50,00,000
Normal Loss (5% X 5,000 MT)	250 MT	
Value of Material per unit	4,750 MT	1052.6315 (50,00,000 / 4,750)
Abnormal Loss in Quantity (300 MT – 250 MT)	50 MT	
Value of Abnormal Loss (50 MT X 1052.6315)		52,632
Value of Inventory	**4750**	49,47,368 **(50,00,000 – 52,632)**

The **cost of abnormal waste ₹ 52,632** will be charged to the profit and loss statement.

AS 2

17. INTER RTP MAY 2019, ICAI ILLUSTRATION 5

On 31st March 2017, a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2017-18 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price. The firm seeks your advice regarding the amount at which the unfinished unit should be valued as at 31st March, 2017 for preparation of final accounts. Assume that the partly finished unit cannot be sold in semi finished form and its NRV is zero without processing it further.

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value.** Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

Valuation of unfinished unit

Particulars	₹
Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (4% of 750)	(30)
Net Realisable Value	410
Cost of inventory	530
Value of inventory (Lower of cost and net realisable value)	**410**

18. INTER RTP NOV 2019 , IPCC RTP NOV 2019, INTER RTP NOV 2016, INTER RTP NOV 2017

Hello Ltd. purchased goods at the cost of ₹ 20 lakhs in October. Till the end of the financial year, 75% of the stocks were sold. The Company wants to disclose closing stock at ₹ 5 lakhs. The expected sale value is ₹ 5.5 lakhs and a commission at 10% on sale is payable to the agent. You are required to ascertain the value of closing stock?

SOLUTION

REFERENCE:

As per **AS 2, Inventories** should be valued at the **lower of cost and net realisable value**. Net realisable value is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the estimated costs necessary to make the sale.

ANALYSIS & CONCLUSION:

Particulars	₹
Expected selling price	5,50,000
Less: Commission (10% of 5,50,000)	(55,000)
Net Realisable Value	4,95,000
Cost of inventory [20,00,000 - (75% X 20,00,000)]	5,00,000
Value of inventory (Lower of cost and net realisable value)	4,95,000

19. RTP MAY 22

"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 examples of such costs as per AS 2 'Valuation of Inventories'.

SOLUTION

As per **AS 2 "Valuation of Inventories"**, certain costs are excluded from the cost of the inventories and are **recognised as expenses** in the period in which incurred.

Examples of such costs are:

(a) **abnormal** amount of wasted materials, labour, or other production costs;

(b) **storage costs,** unless those costs are necessary in the production process prior to a further production stage;
(c) **administrative overheads** that **do not contribute** to bringing the inventories to their present location and condition; and
(d) **selling and distribution costs.**

20.RTP MAY 22

Rohan Pvt. Ltd., a wholesaler in agriculture products, has valued the inventory on Net Realizable Value on the ground that AS 2 does not apply to inventory of agriculture products.

SOLUTION

REFERENCE:

AS 2 does not apply to producers of agricultural products but **applies to traders in agricultural products.**

ANALYSIS:

AS 2 will **apply to Rohan Pvt. Ltd.** and it will have to value inventory at lower of cost or market value.

CONCLUSION:

Contention of Rohan Pvt. Ltd. to value the inventory on Net Realizable Value is **incorrect.**

21. Mock test oct 21 series I

From the following information provided by XYZ Limited you are required to compute the closing inventory:

Raw Material P	
Closing balance	600 units
	₹ per unit
Cost price including GST	250
Input tax credit available	20
Freight inward	30
Handling charges	15

Replacement cost	180
Finished goods Q	
Closing balance	1500 units
	₹ per unit
Material consumed	250
Direct labour	70
Direct overhead	30

Total fixed overhead for the year was ₹ 3,00,000 on a normal capacity of 30,000 units while actual production has been of 25,000 units. Calculate the value of closing stock, when

(i) Net realizable value of the finished good Q is ₹ 450 per unit.

(ii) Net Realizable value of the Finished Good Q is ₹ 340 per unit.

SOLUTION

REFERENCE:

As per **AS 2 – Valuation of Inventories,**

a. Inventories should be valued at the **lower of cost and net realisable value.**

b. The **cost** of inventories should **comprise** all costs of **purchase,** costs of **conversion** and other costs incurred in bringing the inventories to their **present location** and condition.

c. When there has been a **decline** in the price of materials and it is estimated that the **cost** of the finished products will **exceed net realizable value,** the materials are written down to net realisable value. In such circumstances, the **replacement cost** of the materials may be the best available measure of their net realisable value.

ANALYSIS:

(i) When Net Realizable Value of the Finished Good Q is ₹ 450 per unit Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw Material P	Cost	600	275	1,65,000
Finished Good Q	Cost	1,500	360	5,40,000
Total value of closing stock				7,05,000

(ii) When Net Realizable Value of the Finished Good Q is ₹ 340 per unit

Since NRV of finished goods Q is less than its cost i.e. ₹ 360 (Refer W.N.), raw material P is to be valued at replacement cost and finished goods is to be valued at NRV.

Value of Closing Stock:

	Valuation Base	Qty.	Rate (₹)	Amount (₹)
Raw material P	Replacement cost	600	180	1,08,000
Finished good Q	Net Realisable Value	1,500	340	5,10,000
Total value of closing stock				6,18,000

Working Note:

Statement showing calculation of cost of raw material P and finished good Q

Raw Material P	₹
Cost Price (250-20)	230
Add: Freight Inward	30
Handling charges	15
Cost	275
Finished Goods Q	₹
Materials consumed	250
Direct Labour	70
Variable overheads	30
Fixed overheads (₹ 3,00,000 / 30,000 units)	10
	360

MCQs

1. Which item of inventory is under the scope of AS 2 (Revised)?
   a) WIP arising under construction contracts
   b) Raw materials
   c) Shares
   d) Debentures held as stock in trade.

2. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be
   a) sold at or above cost.
   b) sold above cost.
   c) sold less than cost.
   d) sold at market value(where market value is more than cost).

3. All of the following costs are excluded while computing value of inventories except?
   a) Selling and Distribution costs
   b) Allocated fixed production overheads based on normal capacity.
   c) Abnormal wastage
   d) Storage costs (which is necessary part of the production process)

4. Identify the statement(s) which is/are incorrect.
   a) Storage costs which is a necessary part of the production process is included in inventory valuation.
   b) Administration overheads are never included in inventory valuation.
   c) Full amount of variable production overheads incurred are included in inventory valuation.
   d) Administration overheads are always included in inventory valuation.

Answers							
1.	(b)	2.	(a)	3.	(b)	4.	(b)

AS 10 - PROPERTY PLANT & EQUIPMENT			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Measurement at initial recognition	Q.18, Q.8, Q.9, Q.14, Q.10	Q.5, Q.26, Q.6, Q.4, Q.7, Q.14, Q.19
2	Nature of expenses & applicability	Q.1, Q.3	Q.13, Q.1, Q.25, Q.18
3	Exchange of Assets		Q.16, Q.15
4	Revaluation		
	• Cost Model	Q.4	Q.10
	• WDV Model	Q.11	Q.12
5	Depreciation	Q.12, Q.6	
6	Change in Accounting Estimate		Q.23, Q.17
7	Miscellaneous	Q.2, Q.15, Q.7, Q.13, Q.5,	Q.8, Q.20, Q.21, Q.22, Q.2, Q.3, Q.11, Q.9
8	Special Case	Q.16, Q.17	Q.24

AS 10 - PROPERTY, PLANT AND EQUIPMENT

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 6						
2	ICAI - ILLUSTRATION 7						
3	INTER QP - NOV 2018						
4	QUESTION						
5	ICAI - ILLUSTRATION 13						
6	ICAI - ILLUSTRATION 14						
7	ICAI - ILLUSTRATION 10						
8	QUESTION						
9	QUESTION						
10	QUESTION						
11	QUESTION (Similar to ICAI P.Q. 15)						
12	INTER QP NOV 2020						
13	ILLUSTRATION						
14	INTER RTP MAY 2019 / IPCC RTP MAY 2019) (Similar to ICAI P.Q. 13)						
15	ICAI – P.Q. 12						
16	ICAI – P.Q. 16						
17	ICAI – P.Q. 17						
18	ICAI – P.Q. 18						

1. QUESTION (ILLUSTRATION 6 – ICAI)

Entity A, which operates a major chain of Supermarkets, has acquired a new store location. The new location requires significant Renovation Expenditure. Management expects that the renovations will last for 3 Months during which the Supermarket will be closed.

Management has prepared the budget for this period including expenditure related to Construction and Re-Modelling Costs, salaries of staff who will be preparing the Store before its opening and related Utilities Costs. What will be the treatment of such expenditures?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The costs of construction and re-modelling the supermarket are **necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. However, if the cost of salaries, utilities and storage of goods are in the **nature of operating expenditure** that would be incurred if the supermarket was open, then these costs are **not necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and **should be expensed.**

CONCLUSION:

Construction and re-modelling cost **should be capitalized by Entity A.**

2. QUESTION (ILLUSTRATION 7 - ICAI)

An amusement park has a 'soft opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later.

Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

SOLUTION

FACTS:

Amusement Park management wants to capitalise the net operating costs incurred during soft opening as it is a trial run.

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the **cost** of an item of property, plant and equipment **comprises** any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management.

AS 10 specifically mentions inauguration costs are not part of PROPERTY, PLANT & EQUIPMENT.

ANALYSIS:

As per the reference above, inauguration costs cannot be capitalised. Also, even though park is running at less than full operating capacity (80% of operating capacity), there is **sufficient evidence** that park is **capable of operating** in the manner intended by management.

CONCLUSION:

Contention of management to capitalise the cost is **incorrect.** Net operating cost should not be capitalised, but **should be recognised as expense** in the statement of profit and loss.

3. QUESTION (INTER QP - NOV 2018)

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".

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT**, the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management.

The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

Management of Neon enterprise should capitalise the cost of construction and remodeling because they are **necessary to bring the restaurant to the condition necessary for it to be capable of operating in the manner intended by management.**

However, the cost of salaries of staff engaged in the preparation of restaurant ₹7,50,000 before its opening are of **operating nature** as they would be incurred even when the restaurant would be open.

CONCLUSION:

Construction and re-modelling cost of restaurant - **₹ 30,00,000 should be considered as a part of asset.**

Cost of Salary - **₹ 7,50,000 should be charged to Profit and Loss Account** as expense.

4. QUESTION

An Entity decides to revalue its Building on 1st April. On the date of revaluation, the Building stand at a cost of ₹ 100 Lakhs and Accumulated Depreciation is ₹ 40 Lakhs. The Building are now revalued at ₹ 150 Lakhs. How should the Entity account for the Revalued Building in its books of account?

SOLUTION

REFERENCE:

When an item of **AS 10 PROPERTY, PLANT & EQUIPMENT** is revalued, the **carrying amount of that asset is adjusted to the revalued amount.** At the date of revaluation, gross carrying amount and accumulated depreciation amount changes.

Gross carrying amount is adjusted in a manner that is **consistent with the revaluation** of the carrying amount of the asset.

Gross Carrying Amount —>

- May be restated by reference to observable market data. Or
- May be restated proportionately to the change in the carrying amount.

Accumulated Depreciation at the date of revaluation

- adjusted to equal the difference between the gross carrying amount of the asset after taking into account accumulated impairment losses.

ANALYSIS / CONCLUSION:

Building is revalued to ₹150 lakhs i.e., 150% increase from original cost of ₹100 Lakhs.

So, applying that ratio of 150%, the gross carrying amount will be ₹100 + ₹150 = ₹250 lakhs and,

Accumulated depreciation will be ₹40 Lakhs + 150% = **₹60 Lakhs.**

As given above, if item of **PROPERTY, PLANT & EQUIPMENT** is revalued, the **carrying amount** of such item is adjusted to the **revaluation account.**

5. QUESTION (ILLUSTRATION 13 – ICAI)

Entity B constructs a machine for its own use. Construction is completed on 1st November 20X1 but the company does not begin using the machine until 1st March 20X2. Comment.

SOLUTION

FACTS:

Machine constructed for its own use was completed on 1stNovember 2021 but was not used until 1stMarch 2022.

REFERENCE:

As per **AS 10, "Property, plant and equipment,"**

Depreciation of an asset begins when it is **available for use,** i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

ANALYSIS:

Depreciation should commence as soon as the asset is acquired and is available for use. The fact that the machine was not used for a period after it was ready to be used is not relevant in considering when to begin charging depreciation.

CONCLUSION:

The entity **should begin charging depreciation from the date the machine is ready for use, i.e., 1st November 2021.**

6. QUESTION (ILLUSTRATION 14 – ICAI)

A property costing 10,00,000 was bought in 20X1. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years. The estimated residual value in 20 years' time, based on 20X1 prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000.

Calculate the amount of depreciation.

SOLUTION

In case (a)

REFERENCE:

As per **AS 10, "Property, plant and equipment,"**

The residual value of an asset **may increase** to an amount equal to or **greater than its carrying amount.** If it does, the **depreciation charge** of the asset is **zero** unless and until its residual value **subsequently decreases** to an amount **below** its **carrying amount.**

ANALYSIS:

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

CONCLUSION:

Therefore, there will be **no depreciation amount.**

In case (b)

REFERENCE:

As per AS 10, "Property, plant and equipment,"

The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, the depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

ANALYSIS:

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹ 9,00,000 **i.e., less than carrying amount.**

CONCLUSION:

The depreciable amount is, therefore, **1,00,000.**

Annual depreciation (on a straight-line basis) will be **5,000** [{10,00,000 –9,00,000} ÷ 20].

7. QUESTION (ILLUSTRATION 10 – ICAI)

Entity A is a large manufacturing group. It owns a number of industrial buildings, such as factories and warehouses and office buildings in several capital cities. The industrial buildings are located in industrial zones, whereas the office buildings are in central business districts of the cities. Entity A's management wants to apply the revaluation model as per AS 10 (Revised) to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. State whether this is acceptable under AS 10 (Revised) or not with reasons?

SOLUTION

FACTS:

Entity A's management wants to apply the revaluation model as per AS 10 to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings.

REFERENCE :

As per **AS 10, "Property, plant and equipment,"**

1. An enterprise should choose
   - Either **Cost Model** or
   - **Revaluation Model**

as its accounting policy and **should apply that policy to an entire class of PPE.**

2. A **class of PPE** is a grouping of assets of a **similar nature** and use in operations of an enterprise. If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

ANALYSIS:

The **office buildings can be clearly distinguished from the industrial buildings** in terms of their function, their nature and their general location. The **different characteristics of the buildings enable them to be classified as different PPE classes.** The different measurement models can, therefore, be applied to these classes for subsequent measurement.

CONCLUSION:

All properties within the **class of office buildings must be carried at revalued amount.**

8. QUESTION

On 1st April, an Enterprise acquired a machine under the following terms:

Particulars	Rs.
List Price of Machine	80,00,000
Import Duty	5,00,000
Delivery Fees	1,00,000
Electrical Installation Costs	10,00,000
Pre-Production Testing	4,00,000
Purchase of a 5-year Maintenance Contract with the Vendor	7,00,000

The Enterprise was granted a Trade Discount of 10% on the initial List Price of the Asset and a settlement discount of 5%, if payment for the Machine was received within 1 month of purchase. The Enterprise paid for the Plant on 20th April. At what Cost the Asset will be recognised?

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Rs.
List Price 80,00,000 Less : Trade Discount [10%]	72,00,000
Import Duty [non-refundable]	5,00,000
Delivery Fees	1,00,000
Electrical Installation Costs	10,00,000
Pre-Production Testing	4,00,000
Total Capitalized Cost of Asset	92,00,000

Notes:

1) Maintenance Contract is a **separate contract** to get service, so, the Maintenance Contract Cost of Rs.7,00,000 should be taken as a **Prepaid Expenses** and charged to the Profit or Loss over a period of 5 years.
2) Settlement Discount Received of [Rs. 72,00,000 x 5%] = Rs.3,60,000 is to be shown as **Other Income** in the Profit or Loss Statement Account.

9. QUESTION

Deenabandu 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 Rs.47,290. These activities were supervised by a Technician during the entire period, who is employed for this purpose of Rs. 15,000 per month. The Technician's Services were given to Department A by Department B, which billed the services at Rs. 16,500 per month after adding 10% profit margin.

The Machine was purchased at Rs. 52,78,000 including GST. Rs. 18,590 Transportation Charges were incurred to bring the Machine to the Factory. An Architect was engaged at a fee of Rs. 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 the 2nd month. The Company operates on Bank Overdraft @ 11%.

Ascertain the amount at which the Asset should be recognized as PPE under AS 10.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Cost of PPE [i.e., Machine] is calculated as under: -

Particulars		**Rs.**
Purchase Price	Given	52,78,000
Less: GST	Not adjusted since Rate & input Tax Credit availability not given.	Nil
Add: Site Preparation Cost	Given	47,290
Add: Technician's Salary	Specific/Attributable Cost for 2 months, w/o Profits [Note 2]	30,000
Add: Initial Delivery Cost	Transportation	18,590
Add: Professional Fees for installation	Architect's Fees	10,000
Total Cost of Asset		**53,83,880**

Notes:

1) If GST Rate is given and Input Tax Credit is available, it should not be included in Cost of PPE.
2) Internally Booked Profits should be eliminated in arriving at the Cost of PPE.
3) Interest on Bank Overdraft for earlier payment of Invoice is not relevant under AS-10 or AS-16.

10. QUESTION

Jivan Ltd. purchased a Machinery from Kripa Ltd. on 31.08.2017. Quoted Price was Rs.275 Lakhs. The Vendor offers 2% Trade Discount. GST on Quoted Price is 6%. Jivan Ltd. spent Rs. 60,000 for transportation and Rs. 45,000 for Architect's Fees. They also spent Rs. 15,000 for Material, Rs. 10,000 for Labour and Rs. 4,000 as overheads during the trial run of the Machine. The Machine was ready for use on 15.01.2018 but it was put to use on 15.03.2018. Find out the original cost of the machine.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Rs. Lacs
Quoted Price of Machinery	275.00
Less: Trade Discount	5.50
Net Price	269.50
Transportation Cost [Cost of bringing the asset to present location]	0.60
Architect Fees [directly attributable Cost]	0.45
Pre-Operative Cost [assuming directly relatable to the Machinery] [0.15 + 0.10 + 0.04]	0.29
Net Cost	**270.84**

11. QUESTION (Similar to ICAI P.Q. 15)

Digambar Ltd acquired a Machinery for ₹ 25,00,000 five years ago. Depreciation was charged at 10% on SLM basis, for a useful life of ten years. Two years after acquisition, the Company revalued the Machinery to 30,00,000 and created a Revaluation Reserve to that extent. Depreciation was provided on the revalued amount over the balance useful life of eight years. The Machinery was sold in the current year for ₹ 11,25,000. Give the accounting treatment for the above in the Company's accounts. What will be the treatment, if the Machinery fetched only 4,25,000 now?

SOLUTION

Particular	₹
Original cost of the Asset	25,00,000
Less: Depreciation for year 1 and year 2 (₹25,00,000 x 10%X 2 years)	5,00,000
Book value in year 3	20,00,000
Add: Revaluation Surplus, to adjust / increase book value to ₹ 30,00,000	10,00,000
Revalued Amount of Asset	30,00,000
Less: Depreciations in years 3 - 5 = 30,00,000 / 8 years X 3 years	11,25,000
Book value of machinery at the end of year 5 (years of disposal)	18,75,000

The treatment of gain / Loss on disposal / Revaluations is as under -

Particular	Disposal proceeds = ₹ 11,25,000	Disposal proceeds = ₹ 4,25,000
(A) BOOK VALUE less disposal proceeds = Loss recognized in profit or Loss	₹ 18,75,000 - ₹ 11,25,000 = ₹ 7,50,000 (Loss)	₹ 18,75,000 - ₹ 4,25,000 = ₹ 14,50,000 (Loss)
(B) Revaluation Surplus directly transferred to Retained Earning	₹ 10,00,000	₹ 10,00,000

12. QUESTION (INTER QP NOV 2020)

A Ltd following assets. Calculate depreciation for the year ending 31st March,2020 for each assets 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 decides to use these assets for further 2 years only.

SOLUTION (i)

REFERENCE:

As per **AS 10, "Property, plant and equipment,"**

The residual value of an asset **may increase** to an amount equal to or **greater than its carrying amount.** If it does, the **depreciation charge** of the asset is **zero** unless and until its residual value **subsequently decreases** to an amount **below** its **carrying amount.**

ANALYSIS:

The company considers that the residual value, based on prices prevailing at the balance sheet date, **will equal to the cost.**

CONCLUSION:

Therefore, no depreciation amount and **depreciation are correctly zero.**

SOLUTION (ii)

Land has an **unlimited useful life and therefore is not depreciated**

SOLUTION (iii)

REFERENCE:

As per AS 10, "Property, plant and equipment,"

Depreciation of an asset **begins when it is available for use,** i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

ANALYSIS & CONCLUSION:

The entity should begin charging depreciation from the date the machine is ready for use. The fact that the machine was **not used for a period after it was ready to be used is not relevant** in considering when to begin charging depreciation.

SOLUTION (iv)

REFERENCE:

As per AS 10, "Property, plant and equipment,"

Depreciation is recognised even if the fair value of the asset exceeds its carrying amount.

ANALYSIS & CONCLUSION:

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (50,000/5 years). On 1st April,2019, the asset's net book value is [50000 – (10,000 x 2)] ₹ 30,000. The remaining useful life is 2 years.

The company should amend the annual provision for depreciation to charge the unamortised cost over the revised remaining life of 2 years. Consequently, it should charge depreciation for the next 2 years at ₹ 15,000 per annum i.e. (30,000 / 2 years)

13. ILLUSTRATION

Entity A carried plant and machinery in its books at 2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost 20,00,000. The machines were acquired by the insurance company and the company did not receive 20,00,000 as cash compensation. State, how Entity A should account for the same?

SOLUTION

FACTS:

Entity A carried plant and machinery in its book at Rs. 2,00,000 which were destroyed by fire but the assets were insured 'new for old.' The machines were acquired by the insurance company and the company did not receive 20,00,000 as cash compensation.

REFERENCE:

As per **AS 10 Property, Plant & Equipment,** Impairments or losses of items of property, plant and equipment, related claims for or payments of **compensation** from third parties and any **subsequent purchase** or construction of replacement assets are **separate economic events** and are accounted for as below:

The cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with AS 10

ANALYSIS / CONCLUSION:

Entity A should also separately recognise a receivable and a gain in the income statement resulting from the insurance proceeds under AS 29 once receipt is virtually certain. The **receivable should be measured at the fair value of assets** that will be provided by the insurer.

Entity A should account for a **loss in the Statement of Profit and Loss** on **derecognition** of the **carrying value** of plant and machinery in accordance with AS 10.

14. QUESTION (INTER RTP MAY 2019 / IPCC RTP MAY 2019) (Similar to ICAI P.Q. 13)

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

1.	Cost of the plant (cost per supplier's invoice plus taxes)	5000000
2.	Initial delivery and handling costs	4,00,000
3.	Cost of site preparation	12,00,000
4.	Consultants used for advice on the acquisition of the plant	14,00,000
5.	Interest charges paid to supplier of plant for deferred credit	4,00,000
6.	Estimated dismantling costs to be incurred after 7 years	6,00,000
7.	Operating losses before commercial production	8,00,000

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

SOLUTION

FACTS:

Preet Ltd. is installing a new plant at its production facility. It has incurred various costs.

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

1. Cost of the plant	50,00,000
2. Initial delivery and handling costs	4,00,000
3. Cost of site preparation	12,00,000
4. Consultant fees	14,00,000
5. Estimated dismantling costs to be incurred after 7 years	6,00,000
Total Cost	86,00,000

CONCLUSION:

Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 4,00,000 and operating losses before commercial production amounting to ₹ 8,00,000 are **not regarded as directly attributable** costs and thus cannot be capitalized. They should be **written off to the Statement of Profit and Loss** in the period they are incurred.

Plant should be recognized at 86 Lakhs.

15. ICAI – P.Q. 12

1. With reference to AS-10 Revised, classify the items under the following heads:

HEADS

(i) Purchase Price of Property, plant and Equipment (PPE)

(ii) Directly attributable cost of PPE or

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

ITEMS

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

(2) Initial delivery and handling costs.

(3) Initial operating losses, such as those incurred while demand forthe output of an item builds up.

(4) 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.

(5) Trade discounts and rebates.

(6) Costs of relocating or reorganizing part or all of the operations ofan enterprise.

(7) Installation and assembly costs.

(8) Administration and other general overhead costs.

SOLUTION

Heads

(i) Purchase price of PPE

(ii) Directly attributable cost of PPE

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

Items		Classified under Head
1	Import duties and non-refundable purchase taxes	(i)
2	Initial delivery and handling costs	(ii)
3	Initial operating losses, such as those incurred while demand for the output of an item builds up	(iii)
4	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)
5	Trade discounts and rebates (deducted for computing purchase price)	(i)
6	Costs of relocating or reorganizing part or all of the operations of an enterprise.	(iii)
7	Installation and assembly costs	(ii)
8	Administration and other general overhead costs	(iii)

16. ICAI – P.Q. 16

Akshar Ltd. installed a new Plant (not a qualifying asset), at its production facility, and incurred the following costs:

- Cost of the Plant (as per supplier's invoice): ₹ 30,00,000
- Initial delivery and handling costs: ₹ 1,00,000
- Cost of site preparation: ₹ 2,00,000
- Consultant fee for advice on acquisition of Plant: ₹ 50,000
- Interest charges paid to supplier against deferred credit: ₹ 1,00,000
- Estimate of Dismantling and Site Restoration costs: ₹ 50,000 after 10 years (Present Value is ₹ 30,000)
- Operating losses before commercial production: ₹ 40,000

The company identified motors installed in the Plant as a separate component and a cost of ₹ 5,00,000 (Purchase Price) and other costs were allocated to them proportionately. The company estimates the useful life of the Plant and those of the Motors as 10 years and 6 years respectively and SLM method of Depreciation is used.

At the end of Year 4, the company replaces the Motors installed in the Plant at a cost of ₹ 6,00,000 and estimated the useful life of new motors to be 5 years. Also, the company revalued its entire class of Fixed Assets at the end of Year 4. The revalued amount of Plant as a whole is ₹ 25,00,000. At the end of Year 8, the company decides to retire the Plant from active use and also disposed the Plant as a whole for ₹ 6,00,000.

There is no change in the Dismantling and Site Restoration liability during the period of use. You are required to explain how the above transaction would be accounted in accordance with AS 10.

SOLUTION

1. ***Cost at Initial Recognition:***

Particulars	₹
Cost of the Plant (as per Invoice)	30,00,000
Initial Delivery and Handling Costs	1,00,000
Cost of Site Preparation	2,00,000
Consultants' Fees	50,000
Estimated Dismantling and Site Restoration Costs	30,000
Total Cost of Plant including Motors	33,80,000
Less: Cost of Motors identified as a separate component(1/6)*	5,63,333
Cost of the Plant (excluding Motors – balance 5/6)	**28,16,667**

* Purchase price of Motors = ₹ 5,00,000 out of ₹ 30,00,000 i.e., 1/6 of valueof Plant

Note: Since the asset is not a qualifying asset, payment of interest to the supplier is not capitalized. Further, operating losses of ₹ 40,000 incurred before commercial production is not a directly attributable cost, and hence excluded from cost of asset. These costs are expensed to the P/L as and when they are incurred.

1. ***Recognition of Motors Replacement***

Particulars	₹
Cost of Motors determined above	5,63,333
Less: Depreciation for 4 years (as per SLM)	3,75,555
5,63,333 ÷ 6 years x 4 years	
Carrying Amount of Motors at the end of Year 4	**1,87,778**

Accounting: The company should derecognize the existing Carrying Amount of Motors replaced of ₹ 1,87,778. Further, the acquisition cost ofnew motors of ₹ 6,00,000 would be capitalized as a separate component. This amount will be depreciated over the next 5 years at ₹ 6,00,000 ÷ 5 years = ₹ 1,20,000 p.a.

2. Revaluation

Particulars	₹
Cost of the Plant at initial recognition [from (1) above]	28,16,667
Less: SLM Depreciation for 4 years: ₹ 28,16,667 ÷ 10 years x4 years	11,26,667
Carrying Amount of Plant at the end of Year 4	16,90,000
Revalued Amount of Plant (Excluding Motors, since thesame is treated as a separate component: ₹ 25,00,000 – ₹ 6,00,000)	19,00,000
Therefore, Gain on Revaluation credited to Revaluation Reserve	**2,10,000**
Revised Depreciation Charge p.a.: 19,00,000 ÷ 6 years	**3,16,667**

3. Derecognition

Particulars	Motors	Plant (excluding Motors)
Cost / Revalued Amount at end of Year 4	6,00,000	19,00,000
Less: Depreciation for Years 5-8	1,20,000 x 4 = 4,80,000	3,16,667 x 4 =12,66,668
Carrying Amount before Disposal / De-recognition	1,20,000	6,33,332
Less: Disposal Proceeds ₹ 6,00,000 allocated in ratio of carrying amount	95,575	5,04,425
Loss to be written off to P/L	**24,425**	**1,28,907**

Notes:

(a) The Revaluation Surplus of ₹ 2,10,000 would be transferred directly to Retained Earnings.

(b) The allocation of disposal proceeds of ₹ 6,00,000 for the plant as whole is apportioned based on carrying amount of motors and plant (excluding motors)

Alternatively, it may be apportioned as 1/6 towards motors and 5/6 plant (excluding motors) based on the reasoning that the initially, motors amounted to 1/6 of the entire plant. This approach may not be preferable because there has been a revaluation of the plant (excluding motors) and a disposal and subsequent acquisition of the Motor, which is not in the initial proportion of 5/6 and 1/6 respectively.

17. ICAI – P.Q. 17

Bharat Infrastructure Ltd. acquired a heavy machinery at a cost of ₹ 1,000 lakhs, the breakdown of its components is not provided. The estimated useful life of the machinery is 10 years. At the end of Year 6, the turbine, which is a major component of the machinery, needed replacement, as further usage and maintenance was uneconomical. The remainder of the machine is in good condition and is expected to last for the remaining 4 years. The cost of the new turbine is ₹ 450 lakhs. Give the accounting treatment for the new turbine, assuming SLM Depreciation and a discount rate of 8%.

SOLUTION

As per **AS 10, Property, Plant and Equipment**, the **derecognition** of the **carrying amount** of components of an item of Property, Plant and Equipment occurs **regardless** of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is **not practicable** for an enterprise to determine the carrying amount of the replaced part/ inspection, it **may use the cost of the replacement** or the **estimated cost of a future similar inspection** as an **indication** of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

In the given case, the new turbine will produce **economic benefits** to Bharat Infrastructure Ltd. and the **cost is measurable**. Since the recognition criteria is fulfilled, the same should be **recognised as a separate item** of Property, Plant and Equipment. However, since the initial breakup of the componentsis not available, the **cost of the replacement** of ₹ 450 lakhs can be used asan **indication** based on the guidance given above, discounted at 8% for the 6-year period lapsed.

Thus, estimate of cost 6 years back = ₹ 450 lakhs ÷ 1.08^6 = ₹ 283.58 lakhs Current carrying amount of turbine (to be de-recognised) = Estimated cost ₹ 283.58 lakhs (–) SLM depreciation at 10% (useful life 10 years) for 6 years ₹ 170.15 lakhs= ₹ 113.43 lakhs.

Hence revised carrying amount of the machinery will be as under:

Particulars	₹ in lakhs
Historical Cost [₹ 1,000 lakhs (–) SLM Depreciation at 10%(10 year life) for 6 years]	400.00
Add: Cost of new turbine	450.00
Less: Derecognition of current carrying amount of oldturbine	(113.43)
New Carrying Amount of Machinery	**736.57**

18. ICAI – P.Q. 18

Preet Ltd. intends to set up a steel plant, for which it has acquired a dilapidated factor having an area of 5,000 acres at a cost of ₹ 60,000 per acre. Preet Ltd. has incurred ₹ 1.10 crores on demolishing the old Factory Building thereon. A sum of ₹ 63,00,000 (including 5% GST thereon) was realized from the sale of material salvaged from the site. Preet Ltd. incurred Stamp Duty and Registration Charges of 7% of land value, paid legal and consultancy charges ₹ 8,00,000 for land acquisition and incurred ₹ 1,25,000 on title guarantee insurance. Compute the value of the land acquired.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	₹
Purchase Price: 5,000 acres x ₹ 60,000 per acre	3,000.00
Stamp Duty and Registration Charges at 7%	210.00
Legal and Consultancy Fees	8.00
Title Guarantee Insurance	1.25
Demolition Expenses (Net of Salvage Income) [₹ 110 lakhs (–) ₹ 60 lakhs (₹ 63 lakhs x 100/105)]	50.00
Cost of Land	**3,269.25**

AS 10 – PROPERTY, PLANT AND EQUIPMENT

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	QP – JULY 21						
2	ICAI – ILLUSTRATION 11						
3	ICAI – ILLUSTRATION 15						
4	QUESTION						
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7	QUESTION						
8	QUESTION						
9	QUESTION						
10	QUESTION						
11	QUESTION						
12	QUESTION (Similar to ICAI P.Q.14)						
13	ICAI – ILLUSTRATION 1						
14	ICAI – ILLUSTRATION 5						
15	ICAI – ILLUSTRATION 8						
16	ICAI – ILLUSTRATION 9						
17	ICAI – ILLUSTRATION 12						
18	ICAI – ILLUSTRATION 4						
19	MTP – OCT 21 – SERIES 2						
20	ICAI ILLUSTRATION 2						
21	QUESTION						
22	ICAI ILLUSTRATION 3						
23	IPCC QP JAN 2021						
24	QUESTION (QP MAY 22)						
25	MTP – OCT 20						
26	INTER RTP NOV 2019 / IPCC RTP MAY 2019 / IPCC QP NOV 2019						

1. **QUESTION (QP - JULY 21)**

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?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The costs of construction and re-modelling the supermarket are **necessary** to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. However, if the cost of salaries, utilities and storage of goods are in the **nature of operating expenditure** that would be incurred if the supermarket was open, then these costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and **should be expensed.**

CONCLUSION:

Only Construction and re-modelling cost **should be capitalized** by B Ltd.

2. QUESTION (ILLUSTRATION 11 – ICAI)

Entity A has a policy of not providing for depreciation on PPE capitalized in the year until the following year, but provides for a full year's depreciation in the year of disposal of an asset. Is this acceptable?

SOLUTION

FACTS:

Entity A has a policy of not providing for depreciation on PPE capitalized in the year but in the year of disposal of an asset, it provides for a full year's depreciation.

REFERENCE:

As per **AS 10, "Property, plant and equipment,"**

The depreciable amount of an asset should be allocated on a **systematic basis over its useful life.**

Useful life means the period over which the asset is **expected to be available** for use by the entity.

ANALYSIS:

Depreciation **should commence as soon as the asset is acquired** and is available for use and not only in the year of disposal.

CONCLUSION:

The policy of Entity A is **not acceptable.**

3. QUESTION (ILLUSTRATION 15 – ICAI)

Entity B manufactures industrial chemicals and uses blending machines in the production process. The output of the blending machines is consistent from year to year and they can be used for different products. However, maintenance costs increase from year to year and a new generation of machines with significant improvements over existing machines is available every 5 years. Suggest the depreciation method to the management.

SOLUTION

FACTS:

Maintenance costs of Blending Machines increases from year to year and a new generation of machines with significant improvements are available every 5 years.

REFERENCE:

As per **AS 10, "Property, plant and equipment,"**

1. The **straight-line** depreciation method should be adopted if the **production output is consistent** from year to year.
2. Depreciation method should be **reviewed at least at each financial year-end.** If there has been a **significant change** in the expected **pattern of consumption** of the future economic benefits embodied, the **method should be changed to reflect the changed pattern.**

ANALYSIS & CONCLUSION:

The straight-line depreciation method **should be adopted,** because the production output is consistent from year to year. Factors such as maintenance costs or technical obsolescence should be **considered in determining the blending machines useful life.**

4. QUESTION

ABC Ltd. is installing a New Plant at its production facility, it provides you the following information: [P (A/c) – N 17]

Particulars	Rs.
Cost of the Plant [Cost as per Supplier's Invoice]	31,25,000
Estimated Dismantling Costs to be incurred after 5 years	2,50,000
Initial Operating Losses before commercial production	3,75,000
Interest paid to Supplier of Plant for deferred credit	2,00,000
Initial Delivery and Handling Costs	1,85,000
Cost of Site Preparation	4,50,000
Consultants used for advice on the acquisition of the Plant	6,50,000

Please advise ABC Ltd. on the costs that can be capitalized for Plant in accordance with AS-10 PPE.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	**Rs.**
Purchase Price	31,25,000
Add: Estimated Dismantling Costs	2,50,000
Initial Delivery & Handling Costs	1,85,000
Site Preparation Cost	4,50,000
Consultancy Charges	6,50,000
Total Capitalized Cost of Asset	**46,60,000**

Note: As per AS-10 PPE, **Initial Operating Losses cannot be capitalized.**

5. QUESTION

Versatile Limited purchased Machinery for Rs. 4,80,000 [inclusive of GST of Rs. 40,000]. Input Tax Credit is available for the GST paid. The Company Incurred the following other expenses for installation.

Particulars	**Rs.**
Cost of Preparation of Site for Installation	21,000
Total Labour Charges [200 out of the total 600 man hours worked, were spent for installation of the Machinery]	66,000
Spare Parts and Tools consumed in Installation.	6,000
Total Salary of Supervisor [time spent for installation was 25% of the total time worked]	24,000
Total Administrative Expenses [1/10 relates to the Plant installation]	32,000
Test Run and Experimental Production Expenses	23,000
Consultancy Charges to Architect for Plant Setup	9,000
Depreciation on Assets used for the installation	12,000

The Machine was ready for use on 15th January but was used from 1st February. Due to this delay further costs Rs. 19,000 was incurred. Calculate the value at which the Plant should be capitalized.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Cost of PPE [i.e., Machine] is calculated as under:

Particulars	Rs.
Purchase Price [Rs. 4,80,000 less GST for which Credit is available 40,000]	4,40,000
Add: Site Preparation Cost	21,000
Labour Charges Rs. 66,000 x $\frac{200}{600}$	22,000
Spares and Tools in Installation	6,000
Salary of Supervisor [24,000 x 25%]	6,000
Admin Expense attributable to Installation [Attributable Costs are included] 1/10th of 32,000	3,200
Test Run & Experimental Production [Indirect Element]	23,000
Consultancy Charges to Architect for Plant setup	9,000
Depreciation on Asset used for Installation	12,000
Expenses due to delay in use [Excluded as it is abnormal]	Nil
Total Capitalized Cost of Asset	**5,42,200**

6. QUESTION

Chandra Towers Ltd. [CTL] purchased a Plant from M/s. Tatamaco, on 30.09.2017 with a Quoted Price of Rs. 180 Lakhs. Tatamaco offer 3 months credit with a condition that discount of 1.25% will be allowed if the payment were made within one month. GST is 18% on the Quoted Price. Full Input Tax Credit is available. CTL incurred 2% on Transportation Costs and 3% on Erection

Costs of the quoted price Pre-Operative Cost amounted to Rs. 1.50 Lakhs. The Machine was ready for use on 30th December 2017; however, it was put to use only on 1st April 2018. Find out the Original Cost

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Rs. Lacs
Quoted Price of Plant	180.00
GST [no adjustment is required, since full Input Tax Credit is available.]	Nil
Transportation Cost [Cost of bringing the Asset to present location	
[180.00 x 2%]	3.60
Erection Cost [Cost of bring the Asset to present condition]	
[180.00 x 3%]	5.40
Pre-Operative Cost [assuming directly relatable to the Machinery]	1.50
Total Original Cost	190.50

7. QUESTION

Janardhan Ltd. purchased Machinery from Kusuma Ltd. on 30.9.2017. The price was Rs. 370.44 Lakhs after charging 8% GST and giving a Trade Discount of 2% on the quoted price. Transport Charges were 0.25% on the Quoted Price and installation charges 1% on the Quoted Price. Expenditure incurred on the Trial Run was Materials Rs. 35,000, Wages Rs. 25,000 and Overheads Rs.15,000. The machinery was ready for use on 01.12.2017, but it was actually put to use only on 01.05.2018. Find out the cost of the machine.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	**Computation**	**Rs. Lakhs**
Quote Price	$370.44 \times \frac{100}{108} \times \frac{100}{98}$	350.000
Less: Trade Discount at 2%	2% of 350.00	7.000
Net Price		343.000
Add: Transportation charges	0.25% on Quoted price 0.25% x 350.00	0.875
Add: Installation Charges	1.00% On Quoted Price 1.00% x 350.00	3.500
Add: Expenses on Trial run	Materials + Wages + OH – 0.350 + 0.250 + 0.150	0.750
Total Cost of Asset		**348.125**

8. QUESTION

An Entity owns a considerable number of Properties, such as Factories, Warehouses and Office Buildings in several cities. The Factories and Warehouses are located in industrial zones, whereas the Office Buildings are in the central business districts of the cities. The Entity wants to apply the Revaluation Model to the subsequent measurement of the Office Building but continue to apply the Cost Model to the Factories and Warehouses. Is this permissible?

SOLUTION

REFERENCE:

As per **AS 10**, If an item of **Property, Plat & Equipment** is revalued, the **entire class of PPE** to which that asset belongs **should be revalued.**

1) The **different characteristics of the Building** enable them to be classified as **different PPE classes.** Office Buildings can be **clearly distinguished** from the Factories & Warehouses in terms of their **function,** their **nature** and their general location.
2) **Different Measurement Models can be applied** to these classes for subsequent measurement. Hence, Office Buildings **can be measured** using Revaluation Model. However, all properties within the class of Office Buildings must, be carried at Revalued Amount. Separate disclosure of the two classes must be given.

9. **QUESTION**

An Entity acquires an item of PPE for Rs. 50,000, which is depreciated over 20 years. Three years later, the asset is revalued to Rs. 60,000. Compute the amount of Revaluation Surplus.

SOLUTION

Particulars	Rs.
Revaluation Amount	60,000
Less: Carrying Amount = Cost Rs. 50,000 – 3 years Depreciation Rs. 7,500 i.e. [Rs. 50,000 / 20] x 3 years.	[42,500]
Revaluation Surplus after 3rd Year	**17,500**

10. QUESTION

An Entity decides to revalue its Building on 1st April. On the date of revaluation, the Budling stand at a cost of Rs. 100 Lakhs and Accumulated Depreciation is Rs. 40 Lakhs. The Building is now revalued at Rs. 150 Lakhs. How should the Entity account for the Revalued Building in its books of account?

SOLUTION

<u>REFERENCE:</u>

When an item of **PROPERTY, PLANT & EQUIPMENT** is revalued, the carrying amount of that asset is adjusted to the **revalued amount**. At the date of revaluation, gross carrying amount and accumulated depreciation amount changes.

Gross carrying amount is adjusted in a manner that is **consistent** with the **revaluation** of the **carrying amount of the asset.**

Gross Carrying Amount —>

- May be restated by reference to observable market data. Or
- May be restated proportionately to the change in the carrying amount.

Accumulated Depreciation at the date of revaluation

- adjusted to equal the difference between the gross carrying amount of the asset after taking into account accumulated impairment losses.

<u>ANALYSIS / CONCLUSION:</u>

Building is revalued to ₹150 lakhs i.e., 150% increase from original cost of ₹100 Lakhs.

So, applying that ratio of 150%, the gross carrying amount will be ₹100 + ₹150 = **₹250 lakhs** and,

Accumulated depreciation will be ₹40 Lakhs + 150% = **₹60 Lakhs.**

As given above, if item of **PROPERTY, PLANT & EQUIPMENT** is revalued, the **carrying amount** of such item is **adjusted** to the **revaluation account.**

11. QUESTION

Explain the accounting treatment for Revaluations as per AS-10.

SOLUTION

As per AS 10, When an Item of **Property, Plant & Equipment** is revalued, **the Carrying Amount of that Asset is adjusted to the Revalued Amount.** At the date of the revaluation, the Asset is treated in one of the following ways –

Method I: Gross Carrying Amount is **adjusted in a manner that is consistent** with the revaluation of the Carrying Amount of the asset.

Gross Carrying Amount	• May be restated by reference to observable market data or • May be restated proportionately to the change in the carrying amount.
Accumulated Depreciation at the date of revaluation	Adjusted to equal the difference between the Gross carrying Amount & Carrying Amount of the asset after taking into account Accumulated Impairment Losses.

12. QUESTION (Similar to ICAI P.Q.14)

Argon Ltd purchased a shop at the beginning of year 1, at 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 in the middle of year 15, for 19,50,000 and the revaluation was incorporated in the accounts. Calculate:

(A) Surplus on Revaluation

(B) Depreciation to be changed in the Profit and Loss account for the year 15.

SOLUTION

Particular	₹
Original cost of Asset	8,50,000
Less: Depreciations 14.50 years (8,50,000-25,000) /30 X 14.5 years	(3,98,750)
Book value	4,51,250
Add: Revaluation Reserve to adjust Book value to ₹ 19,50,000	14,98,750
Revalued Amount = Revised Depreciable value, for balance 15,5 years	19,50,000
Less: Depreciations for remaining 6 months in year 15 (19,50,000- 25,000/15.5X ½	(62,097)
Carrying Amount at end of year 15	18,87,903
Depreciations for year 15 (8,50,000-25,000/30)X1/2 + (19,50,000-025,000/15.5X1/2)	75,847

13. QUESTION (ILLUSTRATION 1 – ICAI)

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalized or not.

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT**, the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably**.

ANALYSIS:

The expenditure in remodeling the store **will create future economic benefit** (in the form of 15% increase in sales). Moreover, the cost of remodeling can be measured reliably.

CONCLUSION:

Construction and re-modelling cost **should be capitalized** by Entity A

14. QUESTION (ILLUSTRATION 5 – ICAI)

Omega Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department 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 1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The machine was purchased at ₹ 1,58,00,000 and ₹ 50,000 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. You are required to ascertain the amount at which the Machinery should be capitalized.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars		Amount
Purchase Price	Given	1,58,00,000
Add: Site Preparation Cost	Given	1,40,000

Technical salary	Specific/Attributable overheads for 3 months (45,000×3)	1,35,000
Initial Delivery Cost	Transportation	50,000
Professional Fees for installation	Architect's Fees	30,000
Total cost of machinery		1,61,55,000

15. QUESTION (ILLUSTRATION 8 – ICAI)

Entity A exchanges land with a book value of 10,00,000 for cash of 20,00,000 and plant and machinery valued at 25,00,000. What will be the measurement cost of the assets received. (Consider that the transaction has commercial substance)?

SOLUTION

FACTS:

Entity A exchanges land with a book value of 10,00,000 for cash of 20,00,000 and plant and machinery valued at 25,00,000.

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,** cost of **an item of PPE is measured at fair value** unless:

(a) Exchange transaction lacks commercial substance; Or

(b) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

ANALYSIS:

The transaction has **commercial substance** and therefore, the plant and machinery would be recorded at the **fair value of the land** less the cash received.

CONCLUSION:

Plant and machinery would be recorded at ₹ 25,00,000, which is equivalent to the **fair value** of the land of 45,00,000 **less the cash** received of 20,00,000.

16. QUESTION [(ILLUSTRATION 9 – ICAI) (EXCHANGE OF ASSETS THAT LACK COMMERCIAL SUBSTANCE)]

Entity A exchanges car X with a book value of 13,00,000 and a fair value of 13,25,000 for cash of 15,000 and car Y which has a fair value of 13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

SOLUTION

FACTS:

Entity A exchanges car X with a book value of 13,00,000 and a fair value of 13,25,000 for cash of 15,000 and car Y which has a fair value of 13,10,000.

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

The cost of an item of PPE is measured at fair value unless:

(a) Exchange transaction **lacks commercial substance;** Or

(b) **Fair value** of neither the asset(s) received nor the asset(s) given up is reliably measurable.

ANALYSIS:

The transaction lacks commercial substance as the company's cash flows are **not expected** to change as a result of the exchange. It is in the same position as it was before the transaction.

CONCLUSION:

The entity recognizes the assets received at the book value of car X. Therefore, it recognizes **cash** of 15,000 and **car** Y as PPE with a **carrying value of 12,85,000.**

17. QUESTION [(ILLUSTRATION 12 – ICAI) (CHANGE IN ESTIMATE OF USEFUL LIFE)]

Entity A purchased an asset on 1st January 20X1 for 1,00,000 and the asset had an estimated useful life of 10 years and a residual value of nil. On 1st January 20X5, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 4 years.

Calculate the amount of depreciation for each year, if the company charges depreciation on a Straight Line basis.

SOLUTION

FACTS:

An asset had estimated useful life of 10 years as on 1st January 20X1. On 1st January 20X5, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 4 years.

REFERENCE:

As per AS 10, depreciable amount of an asset should be allocated on a **systematic basis over its useful life.**

If expected residual value and the useful life of an asset **differ from previous estimates,** the change should be accounted for as a **change in an accounting estimate** in accordance with AS 5.

ANALYSIS & CONCLUSION:

The entity has charged depreciation using the straight-line method at ₹ 10,000 per annum i.e. (1,00,000/10 years). On 1st January 20X5, the asset's net book value was [1,00,000 – (10,000 x 4)] ₹ 60,000. The remaining useful life is 4 years.

The company should amend the annual provision for depreciation to charge the unmortised cost over the revised remaining life of four years. **Consequently, it should charge depreciation for the next 4 years at ₹ 15,000 per annum i.e. (60,000 / 4 years)**

Particulars	₹
Net Book value of the asset as on 1st Jan 2005	60,000
Less: Revised Residual Value	Nil
Net Book Value of the asset	60,000
Depreciation per year = 60,000/4	15,000

18. QUESTION (ILLUSTRATION 4 – ICAI)

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of 5,00,000 to install machinery in the new location.
2. Rent of 15,00,000
3. Removal costs of 3,00,000 to transport the machinery from the old location to the temporary location. Can these costs be capitalized into the cost of the new building?

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT,** the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

Cost Of PROPERTY, PLANT & EQUIPMENT

Includes	Excludes
Purchase price	Cost of opening new business (e.g., inauguration cost)
Direct attributable costs	Cost of introducing new product or service.
Decommission, restoration and similar liabilities	Cost of conducting business in new location or with new class of people

ANALYSIS:

The costs to be incurred by the company are in the nature of costs of relocating or reorganizing operations of the company and **do not meet the requirement of AS 10.**

CONCLUSION:

The costs **cannot be capitalized.**

19. QUESTION (MTP - OCT 21 – SERIES 2)

Aarush Ltd. is installing a new plant in its factory. It provides you the following information:

Cost Of the Plant (cost as per supplier's invoice)	31,25,000
Estimated Dismantling Costs to Be Incurred After 5 Years	2,50,000
Cost Of Site Preparation	4,50,000
Initial Delivery and Handling Costs	1,85,000
Consultants used for advice on the acquisition of the plant	6,50,000

You are required to advise Aarush Ltd. on the costs that can be capitalized for the plant in accordance with AS 10 'Property, Plant and Equipment.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

According to AS 10 'Property, Plant and Equipment', following costs will be capitalized by Aarush Ltd.:

Cost Of the Plant (cost as per supplier's invoice)	31,25,000
Initial Delivery and Handling Costs	1,85,000
Cost Of Site Preparation	4,50,000
Consultants used for advice on the acquisition of the plant	6,50,000
Estimated Dismantling Costs to Be Incurred After 5 Years	2,50,000
Total cost of plant	46,60,000

20. ICAI ILLUSTRATION 2

What happens if the cost of the previous part/inspection was/ was notidentified in the transaction in which the item was acquired or constructed?

SOLUTION

As per **AS 10, Derecognition** of the carrying amount occurs regardless of whether the **cost** of the previous part / inspection was identified in the transaction in which the **item was acquired** or **constructed.**

21. QUESTION

What will be your answer in the above question, if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection?

SOLUTION

As per **AS 10,** It may use the cost of the **replacement** or the estimated cost of a **future similar inspection** as an indication of what the cost of the **replaced** part/existing inspection component was when the **item was acquired** or constructed.

22. ICAI ILLUSTRATION 3

What will be your answer in the above question, if it is not practicablefor an enterprise to determine the carrying amount of the replaced part/inspection?

SOLUTION

As per **AS 10, "Property, plant and equipment,"** The cost of **replacement** or the estimated cost of a future **similar inspection can be used** if it is not practicable for an enterprise to determine the carrying amount of the replaced part/inspection.

23.QUESTION (IPCC QP JAN 2021)

a) A Ltd purchased an assets on 1st April 2014 for ₹ 5,00,000 and assets had useful life of 8 years With NIL residual value.

On 1st April 2019, directors reviewed the estimated life of the assets and decided that the assets would probably be useful for further 2 years with residual value of 5% of the original cost.

Calculate the amount of depreciation to be charged for each year as per AS-10, if the company charges depreciation on straight line basis

b) A company manufactures a machine for its own use. The manufacturing of machine was completed on November 1st 2019.The machine was finally capable of operating as on December

15th 2019, however company started using the machinery from February 1st 2020. The company charged depreciation from February 1st 2020. Comment in context of AS-10

SOLUTION

a)

FACTS:

Asset purchased by A Ltd. has estimated useful life of 8 years as on Ist April 2014. On 1st April 2019, the directors reviewed the estimated life and decided that the asset will probably be useful for a further 2 years.

REFERENCE:

As per AS 10, depreciable amount of an asset should be allocated on a **systematic basis over its useful life.**

If expected residual value and the useful life of an asset **differ from previous estimates,** the change should be accounted for as a **change in an accounting estimate** in accordance with AS 5.

ANALYSIS & CONCLUSION:

The entity has charged depreciation using the straight-line method at ₹ 62,500 per annum for first five years, i.e (5, 00,000/8 years).

On Ist April, 2019, the asset's net book value is [5,00,000 – (62,500 x 5)] ₹ 1,87,500.

The revised remaining useful life is 2 years.

The company **should amend the annual provision** for depreciation to charge the unamortized cost over the revised **remaining life of two years** considering the revised residual value. Consequently, it should charge depreciation for the next 2 years at ₹ 81,250 per annum

Particulars	₹
Net Book value of the asset as on Ist April 2019	1,87,500
Less: Revised Residual Value – 5% of ₹5,00,000	(25,000)
Net Book Value of the asset	1,62,500
Depreciation per year = 1,62,500/2	81,250

b)

FACTS:

Machine constructed for its own use was completed on 15th December 2019 but was not used until 1st February 2020.

REFERENCE:

As per AS 10, "Property, plant and equipment,"

Depreciation of an asset begins when it **is available for use,** i.e., when it is in the location and condition necessary for it to be **capable of operating** in the manner intended by the management.

ANALYSIS:

Depreciation should commence as soon as the asset is acquired and is available for use. The fact that the machine was **not used for a period after it was ready to be used is not relevant** in considering when to begin charging depreciation.

CONCLUSION:

The entity should begin charging depreciation from the date the machine **is ready for use, i.e., 15th December 2019.**

24. QUESTION (QP MAY 22)

XYZ Limited provided you the following information for the years 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 depreciated ₹ 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 AS – 10 (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 AS-10 (Revised).

SOLUTION

(i) **REFERENCE:**

As per **AS 10, a decrease in the carrying amount** of an asset arising on revaluation should be **charged to the statement of profit and loss.** However, the decrease should be **debited directly to owners' interests** under the heading of revaluation surplus **to the extent of any credit balance** existing in the **revaluation surplus** in respect of that asset.

ANALYSIS:

Calculation of revaluation loss and its accounting treatment

		₹
Carrying value of the asset as on 31st March, 2022	a	2,16,000
Revalued amount of the asset	b	(1,90,000)
Total revaluation loss on asset	c=a-b	26,000
Adjustment of previous revaluation reserve	d	(20,000)
Net revaluation loss to be charged to the Profit and loss account	e=c-d	6,000

(ii) **REFERENCE:**

As per AS 10, the **carrying amount** of an item of property, plant and equipment is **derecognized on disposal of the asset.** It further states that the **gain or loss** arising from the derecognition of an item of property, plant and equipment **should be included in the statement of profit and loss** when the item is derecognized. Gains should also **not be classified as revenue.**

ANALYSIS:

Calculation of loss on disposal of the asset and its accounting treatment

		₹
Original cost of the asset	a	76,000
Accumulated depreciation till date	b	62,000
Carrying value of the asset as on 31st March, 2022	c=a-b	14,000
Cash received on disposal of the asset	d	4,000
Loss on disposal of asset charged to the Profit and loss account	e=c-d	10,000

25. QUESTION (MTP - OCT 20)

Omega Ltd, a supermarket chain, is renovating one of its major stores. The store will have more available space for store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers.

Decide whether Omega Ltd. can capitalize the remodelling cost or not as per provisions of AS 10 "Property plant & Equipment".

SOLUTION

REFERENCE:

As per the provisions of **AS 10 PROPERTY, PLANT & EQUIPMENT**, the cost of an item of property, plant and equipment comprises any costs **directly attributable** to bringing the **asset** to the location and **condition** necessary for it to be **capable of operating** in the manner intended by management. The cost of an item of property, plant and equipment should be **recognised** as an **asset** if, and only if -

- It is **probable that future economic benefits** associated with the item will flow to the enterprise; **and**
- The cost of the item can be **measured reliably.**

ANALYSIS:

The expenditure in remodeling the store **will create future economic benefit** (in the form of 15% increase in sales). Moreover, the cost of remodeling **can be measured reliably.**

CONCLUSION:

Construction and re-modelling cost **should be capitalized** by Omega Ltd.

26.QUESTION (INTER RTP NOV 2019 / IPCC RTP MAY 2019 / IPCC QP NOV 2019)

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.

Ascertain the amount at which the Machinery should be capitalized under AS 10 considering that IGST credit is availed by the Shristi Limited. Internally booked profits should be eliminated in arriving at the cost of the machine.

SOLUTION

REFERENCE:

As per **AS 10 "Property, Plant and Equipment,**

Directly attributable costs are those costs which are **Directly attributable** to bringing the asset to the location and condition necessary for it to be **capable of operating** in the manner intended by management. These **costs** should be **considered part** of the asset.

However, some **operations** occur in connection with the **construction** or development of an item of PPE, but it is **not necessary** to bring the item to the location and condition. These **incidental operation costs** should be **recognised in the Profit and loss account.**

ANALYSIS:

Particulars	Reference	Amount
Purchase Price	Given (1,58,34,000×100/112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technical salary	Specific/Attributable overheads for 3 months (45,000 ×3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for installation	Architect's Fees	30,000
Total cost of Asset		**1,45,00,140**

MCQs

1. As per AS 10 (Revised) 'Property, plant and equipment', which of the following costs is not included in the carrying amount of an item of PPE
   a) Costs of site preparation
   b) Costs of relocating
   c) Installation and assembly costs.
   d) Initial delivery and handling costs

2. As per AS 10 (Revised) 'Property, Plant and Equipment', an enterprise holding investment properties should value Investment property
   a) as per fair value
   b) under discounted cash flow model.
   c) under cost model
   d) under cash flow model

3. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 1,50,000 at the end of Year Subsequently, due to drop in market values, the land was determined to have a fair value of ₹ 1,30,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
   a) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
   b) Initial upward valuation of ₹ 50,000 credited to P/L. Subsequent downward revaluation of ₹ 20,000 debited to P/L.
   c) Initial upward valuation of ₹ 50,000 credited to Revaluation Reserve. Subsequent downward revaluation of ₹ 20,000 debited to Revaluation Reserve.
   d) Initial upward valuation of ₹ 50,000 debited to P/L. Subsequent downward revaluation of ₹ 20,000 credited to P/L.

4. A plot of land with carrying amount of ₹ 1,00,000 was revalued to ₹ 90,000 at the end of Year 2. Subsequently, due to increase in market values, the land was determined to have a fair value of ₹ 1,05,000 at the end of Year 4. Assuming that the entity adopts Revaluation Model, what would be the accounting treatment of Revaluation?
   a) Initial downward valuation of ₹ 10,000 debited to Revaluation Reserve. Subsequent upward revaluation of ₹ 15,000 credited to P/L.

b) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 15,000 credited to P/L.

c) Initial downward valuation of ₹ 10,000 debited to P/L. Subsequent upward revaluation of ₹ 10,000 credited to P/L and ₹ 5,000 credited to Revaluation Reserve.

d) Initial downward valuation of ₹ 10,000 credited to P/L. Subsequent upward revaluation of ₹ 10,000 debited to P/L and ₹ 5,000 debited to Revaluation Reserve.

5. On sale of an asset which was revalued upwards, what would be the treatment of Revaluation Reserve?

a) The Revaluation Reserve is credited to P/L since the profit on sale of such asset is now realized.

b) The Revaluation Reserve is credited to Retained Earnings as a movement in reserves without impacting the P/L.

c) No change in Revaluation Reserve since profit on sale of such asset is already impacting the P/L.

d) The Revaluation Reserve is reduced from the asset value to compute profit or loss.

6. A machinery was purchased having an invoice price ₹ 1,18,000 (including GST ₹ 18,000) on 1 April 20X1. The GST amount is available as input tax credit. The rate of depreciation is 10% on SLM basis. The depreciation for 20X2-X3 would be 3

a) ₹ 10,000.

b) ₹ 11,800.

c) ₹ 9,000.

d) ₹10,500.

Answers											
1.	(b)	2.	(c)	3.	(c)	4.	(c)	5.	(b)	6.	(a)

AS 11 – EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Basic Classification	Q.7	Q.15
2	Forward Contract	Q.9 (ii)	Q.16, Q.1, Q.8
3	Conversation of Trial balance	Q.3	Q.3
4	Exchange difference on Monetary item transactions	Q.5, Q.4, Q.6, Q.9 (i)	Q.12, Q.2, Q.14, Q.6, Q.11, Q.9
5	Initial Recognition		Q.5
6	Foreign Loan Journal Entries	Q.1	Q.4, Q.17
7	Special Case	Q.11, Q.2, Q.8, Q.10	Q.7
8	Miscellaneous		Q.13, Q.10

AS 11 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 3						
2	ICAI - ILLUSTRATION 5						
3	ICAI - ILLUSTRATION 7						
4	ICAI – P.Q. 7						
5	INTER QP JAN 2021						
6	QP NOV 18						
7	ICAI - ILLUSTRATION 1 / INTER RPT NOV 2018						
8	ICAI - ILLUSTRATION 6 / RTP NOV 2015 / RTP MAY 20						
9	INTER RTP NOV 2019 / INTER RTP May 2018						
10	QP MAY 2023						
11	ICAI – ILLUSTRATION 9						

1. ILLUSTRATION 3 (ICAI)

Kalim Ltd. borrowed US$ 4,50,000 on 01/01/2016, which will be repaid as on 31/07/2016. X Ltd. prepares financial statement ending on 31/03/2016. Rate of exchange between reporting currency (INR) and foreign currency (USD) on different dates are as under:

01/01/2016	1 US$ = ₹ 48.00
31/03/2016	1 US$ = ₹ 49.00
31/07/2016	1 US$ = ₹ 49.50

SOLUTION

REFERENCE:

As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'** –

- Foreign currency transaction should be recorded, on **initial recognition** in the reporting currency, by applying to the foreign currency amount, the **exchange rate** between the reporting currency and the foreign currency at **the date of the transaction.**
- At each **balance sheet date,** all foreign currency **monetary items** should be reported using the **closing rate.**
- **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 expenses** in the period in which they arise.

ANALYSIS:

Journal Entries in the Books of Kalim Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
Jan. 01, 2016	Bank Account (4,50,000 x 48)	Dr.	216,00,000	
	To Foreign Loan Account			216,00,000
Mar. 31, 2016	Foreign Exchange Difference Account	Dr.	4,50,000	
	To Foreign Loan Account [4,50,000 x(49-48)]			4,50,000
Jul. 01, 2016	Foreign Exchange Difference Account			

	[4,50,000x(49.5-49)] Dr.	2,25,000	
	Foreign Loan Account Dr.	220,50,000	
	To Bank Account		2,22,75,000

2. ILLUSTRATION 5 (ICAI)

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

SOLUTION

REFERENCE:

As per **AS 11, Forward exchange** contract means an agreement to exchange different currencies at a forward rate. Forward exchange contract **intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date,** the value of the contract is marked to its **current market value** and the gain or loss on the contract is **recognised**.

ANALYSIS:

Sale Rate	₹ 47.18
Less: Contract Rate	(₹ 47.10)
Premium on Contract	₹ 0.08
Contract Amount	US$ 1,00,000
Total Profit (1,00,000 x 0.08)	₹ 8,000

CONCLUSION:

Profit of Rs. 8,000 should be recognised in Profit and Loss Account.

3. ILLUSTRATION 7 (ICAI)

A business having the Head Office in Kolkata has a branch in UK. The following is the trial balance of Branch as at 31.03.2016:

Account Name	Amount in £	
	Dr.	Cr.
Fixed Assets (Purchased on 01.04.2013)	5,000	
Debtors	1,600	
Opening Stock	400	
Goods received from Head Office Account	6,100	
(Recorded in HO books as ₹ 4,02,000)		
Sales		20,000
Purchases	10,000	
Wages	1,000	
Salaries	1,200	
Cash	3,200	
Remittances to Head Office (Recorded in HO books as ₹ 1,91,000)	2,900	
Head Office Account (Recorded in HO books as ₹ 4,90,000)		7,400
Creditors		4,000

- Closing stock at branch is £ 700 on 31.03.2016.
- Depreciation @ 10% p.a. is to be charged on fixed assets.
- Prepare the trial balance after been converted in Indian Rupees.
- Exchange rates of Pounds on different dates are as follow:

  01.04.2013– ₹ 61; 01.04.2015– ₹ 63 & 31.03.2016 – ₹ 67

SOLUTION

Trial Balance of the Foreign Branch converted into Indian Rupees as on March 31, 2016

Particulars	£ (Dr.)	£ (Cr.)	Conversion Basis	₹ (Dr.)	₹ (Cr.)
Fixed Assets	5,000		Transaction Date Rate	3,05,000	
Debtors	1,600		Closing Rate	1,07,200	
Opening Stock	400		Opening Rate	25,200	
Goods Received from HO	6,100		Actuals	4,02,000	
Sales		20,000	Average Rate		13,00,000

Purchases	10,000		Average Rate	6,50,000	
Wages	1,000		Average Rate	65,000	
Salaries	1,200		Average Rate	78,000	
Cash	3,200		Closing Rate	2,14,400	
Remittance to HO	2,900		Actuals	1,91,000	
HO Account		7,400	Actuals		4,90,000
Creditors		4,000	Closing Rate		2,68,000
Exchange Rate Difference			Balancing Figure	20,200	
	31,400	31,400		20,58,000	20,58,000
Closing Stock	700		Closing Rate	46,900	
Depreciation	500		Fixed Asset Rate	30,500	

4. PRACTICAL QUESTION 7 (ICAI)

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.3. 20X1.

Trade receivables 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 was on 31.3. 20X1.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

However, at the **option of an entity, exchange differences** arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and **amortised over the balance period of such long-term asset/ liability, by recognition as income or expense** in each of such periods.

ANALYSIS:

Trade receivables	Foreign Currency Rate	₹
Initial recognition US $8,547 (5,00,000/58.50)	1 US $ = ₹ 58.50	5,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Gain US $ 8,547 X (61.20-58.50)		23,077
Long term Loan		
Initial recognition US $ 1,07,913.67 (60,00,000/55.60)	1 US $ = ₹ 55.60	60,00,000
Rate on Balance sheet date	1 US $ = ₹ 61.20	
Exchange Difference Loss US $ 1,07,913.67 X (61.20 – 55.60)		6,04,317
Treatment / Journal Entry: FCMITD A/C or Profit and Loss A/c Dr. ₹ 6,04,317 Credit Loan A/c ₹ 6,04,317		

CONCLUSION:

Exchange Difference on **Long term** loan amounting ₹ 6,04,317 may either be **charged to Profit and Loss A/c** or to **Foreign Currency Monetary Item Translation Difference Account** but exchange difference on **debtors** amounting ₹ 23,077 is required to be **transferred to Profit and Loss A/c.**

5. INTER QP JAN 2021

Explain briefly the accounting treatment needed in the following cases as per AS 11 as on 31.03.2020.

i. Debtors include amount due from Mr. S ₹ 9,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at US $ 1 = ₹ 72.00

US $ 1 = ₹ 73.50 on 31ST March, 2020

US $ 1 = ₹ 72.50 on 1st April, 2019

ii. Long term loan taken on 1st April, 2019 from a U.S. company amounting to ₹ 75,00,000. ₹ 5,00,000 was repaid on 31st December, 2019, recorded at US $ 1 = ₹ 70.50. Interest has been paid as and when debited by the US company.

US $ 1 = ₹73.50 on 31st March, 2020

US $ 1 = ₹72.50 on 1st April, 2019

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

However, at the **option of an entity, exchange differences** arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and **amortised over the balance period of such long-term asset/ liability, by recognition as income or expense** in each of such periods.

ANALYSIS:

	Foreign Currency Rate	₹
Initial recognition US $12,500 (9,00,000/72)	1 US $ = ₹ 72	9,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Gain US $ 12,500 X (73.50 -72)		18,750
Treatment: Credit Profit and Loss A/c by ₹ 18,750		
Long term Loan		
Initial recognition US $ 1,03,448.28 (75,00,000/72.50)	1 US $ = ₹ 73.50	75,00,000
Rate on Balance sheet date	1 US $ = ₹ 73.50	
Exchange Difference Loss after adjustment of exchange gain on repayment of ₹ 5,00,000 [82,171.88 [(US $ 96,356.08 X ₹ 73.5) - ₹ 70,00,000] less 14,184.40 [US $ 7,092.2 (5,00,000/70.5) X ₹ 2)]		67,987.48

Treatment / Journal Entry:

FCMITD A/C or Profit and Loss A/c	Dr. ₹ 67,987.48	
Credit Loan A/c		67,987.48

CONCLUSION:

Exchange Difference on **Long term loan** amounting ₹ 67,987.48 may e**ither be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation Difference Account** but exchange difference on debtors amounting ₹ 18,750 is required to be **transferred to Profit and Loss A/c.**

NOTE:

1. Exchange Difference Loss (net of adjustment of exchange gain on repayment of ₹ 5,00,000) has been calculated in the above solution. Alternative considering otherwise also possible.
2. Date of sale transaction of ₹ 9 lakhs has not been given in the question. It has been assumed that the transaction took place during the year ended 31 March 2020.

6. QP NOV 18

(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.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

However, at the **option of an entity, exchange differences** arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and **amortised over the balance period of such long-term asset/ liability, by recognition as income or expense** in each of such periods.

ANALYSIS:

Amount of Exchange difference and its Accounting Treatment

Long term Loan		Foreign Currency Rate	₹
(i)	Initial recognition ₹ (30,00,000/60) US $50,000	1 US $ = ₹ 60	30,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Loss US $ 50,000 x ₹ (62 – 60)		1,00,000
	Treatment: Credit Loan A/c and Debit FCMITD A/c or Profit and Loss A/c by ₹ 1,00,000		
	Trade receivables		
(ii)	Initial recognition (₹10,00,000/59) US $16,949.152*	1 US $ = ₹ 59	10,00,000
	Rate on Balance sheet date	1 US $ = ₹ 62	
	Exchange Difference Gain US $ 16,949.152* x ₹ (62-59)		50,847.456*
	Treatment: Credit Profit and Loss A/c by ₹ 50,847.456* And Debit Trade Receivables		

Exchange **Difference on Long term loan** amounting ₹ 1,00,000 may **either be charged to Profit and Loss A/c or to Foreign Currency Monetary Item Translation** Difference Account but exchange difference on trade receivables amounting 50,847.456 is required to be **transferred to Profit and Loss A/c.**

7. ILLUSTRATION (ICAI) 1 / INTER RPT NOV 2018

Classify the following items as monetary or non-monetary item:

Inventories

Share Capital

Trade Receivables

Investment in Equity shares

Property, Plant and Equipment.

SOLUTION

REFERENCE:

As per **AS 11' The Effects of Changes in Foreign Exchange Rates', Monetary items** are money held and **assets and liabilities** to be received or **paid in fixed** or determinable amounts of money. Foreign currency monetary items should be reported using the **closing rate** at each **balance sheet date.** However, in certain circumstances, the closing rate may **not** reflect with **reasonable accuracy** the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is **likely to be realised** from or required to disburse, such item at the balance sheet date.

Non-monetary items are assets and liabilities **other than monetary items.**

ANALYSIS:

Inventories	Non-monetary
Share Capital	Non-monetary
Trade receivables	Monetary
Investment in equity shares	Non-monetary
Property, Plant and Equipment	Non-monetary

8. ILLUSTRATION 6 (ICAI) / RTP NOV 2015 / RTP MAY 20

Assets and liabilities and income and expenditure items in respect of foreign branches (integral foreign operations) are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. Comment.

SOLUTION

- **Integral foreign operation** is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
- The **financial statements** of an integral foreign operation (for example, dependent foreign branches) should be **translated** using the principles and **procedures described in AS 11.**
- The **individual items** in the financial statements of a foreign operation are translated **as if all its transactions had been entered** into by the reporting enterprise itself.
- **Individual items** in the financial statements of the foreign operation are translated at the **actual rate** on the **date of transaction**. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period.
- The **foreign currency monetary items** (for example cash, receivables, payables) should be reported using **the closing rate at each balance sheet date.**
- **Non- monetary items** (for example, fixed assets, inventories, investments in equity shares) which are **carried in terms of historical cost** denominated in a foreign currency should be reported using the **exchange date at the date of transaction.** Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost.
- If the **fixed asset is carried at fair value,** translation should be done using the rate existed on the **date of the valuation.**
- The **cost of inventories** is **translated at the exchange rates** that existed when the cost of inventory was incurred and **realisable value is translated** applying exchange rate when realisable value is determined which is generally **closing rate.**
- **Exchange difference** arising on the **translation** of the financial statements of integral foreign operation should be **charged to profit and loss account.** Exchange difference arising on the translation of the financial statement of foreign operation may have **tax effect** which should be dealt as per **AS 22 'Accounting for Taxes on Income'.**

CONCLUSION:

The **treatment by the management** of translating all assets and liabilities, income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference **is not in consonance with AS 11.**

9. INTER RTP NOV 2019 / INTER RTP May 2018

i. Trade receivables as on 31.3.2019 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50. US $ 1 = ₹ 61.20 on 31.3.2019.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2019.

ii. Power Track Ltd. purchased a plant for US$ 50,000 on 31st October, 2018 payable after 6 months. The company entered into a forward contract for 6 months @ ₹ 64.25 per Dollar. On 31st October, 2018, 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, 2019.

SOLUTION

(i)

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

ANALYSIS:

Exchange difference on trade receivables

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $ 8,547 (5,00,000/58.50)	58.50	5,00,000
Rate on B/S date		61.20	
Exchange Difference		-2.70	₹23,077
Gain or loss Treatment	Credit to Profit & Loss A/c ₹23,077		

(ii)

REFERENCE:

As per **AS 11, Forward exchange contract** means an agreement to exchange different currencies at a forward rate. The **premium or discount** arising at the **inception** of a forward exchange contract should be **amortised as expense or income** over the life of the contract.

ANALYSIS:

Calculation of profit or loss to be recognized in the books of Power Track Limited

Particulars	₹
Forward contract rate	64.25

Less: Spot rate	(61.50)
Loss on forward contract	2.75
Forward Contract Amount	$ 50,000
Total loss on entering into forward contract = ($ 50,000 × ₹ 2.75)	₹1,37,500
Contract period	6 months
Loss for the period 1st November, 2018 to 31st March, 2019 i.e. 5 months falling in the year 2018-2019	5 months
Hence, Loss for 5 months will be 1,37,500 x 5/6 1,37,500 x 5/6	₹ 1,14,583

CONCLUSION:

The loss amounting to ₹ 1,14,583 for the period is to be recognized in the year ended 31st March, 2019.

10. QP MAY 2023

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.

SOLUTION

Option (i) Pay immediately with Cash discount of 1% on the payable

Total amount payable on 31.3.2023 (49,500 x ₹ 97)	48,50,000
Less: Cash discount (50,000 x 1 / 100)	(48,500)

	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months	3,60,112.50
If payment made immediate	₹ 51,61,612.50

Option (ii) Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1,250
	51,250
If payment made after 6 months (51,250 x 99)	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by ₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

Note: The above answer be presented in the alternative manner given as below:

Option (i) Pay immediately with Cash discount of 1% on the payable

Total amount payable on 31.3.2023	50,000
Less: Cash discount (50,000 x 1 / 100)	(500)
	49,500
49,500 x ₹ 97	48,01,500
Add: Borrowing cost @ 15% p.a. for 6 months If payment made immediate	3,60,112.50
	₹ 51,61,612.50

Option (ii) Pay after 6 months with interest @ 5% p.a. on the payable

	₹
Total amount payable on 31.3.2023	50,000
Interest for 6 months @ 5% (50,000 x 5 / 100 x 6 / 12)	1,250
If payment made after 6 months (51,250 x 99)	51,250
	50,73,750

Thus, Option (ii) is beneficial to Trower Limited as the Rupee outflow will be lower by ₹ (51,61,612 – 50,73,750) = ₹ 87,862 in option (ii).

II. ICAI – ILLUSTRATION 9

A Ltd. has borrowed USD 10,000 in foreign currency on April 1, 20X1 at 5% p.a. annual interest and acquired a depreciable asset. The exchange rates are as under:

01/04/20X1 1 US$ = ₹ 48.00

31/03/20X2 1 US$ = ₹ 51.00

You are required to pass the journal entries in the following cases:

(i) Option under Para 46A is not availed.

(ii) Option under Para 46A is availed.

(iii) The loan was taken to finance the operations of the entity (and not to procure a depreciable asset).

In all cases, assume interest accrued on 31 March 20X2 is paid on the same date.

SOLUTION

Journal Entries in the Books of A Ltd.

(i) Option under Para 46A is not availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account (P/L)	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000

In this case, since the option under Para 46A is **NOT** availed, the Exchange Loss of ₹ 30,000 is recognised as an expense in the Statement of Profit and Loss for theyear ending 31 March 20X2.

(ii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Property, Plant and Equipment	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is capitalized in the cost of Property, Plant and Equipment, which will indirectly get recognized in the Profit & Loss A/c by way of increased depreciation over the remaining useful life of the asset.

(iii) Option under Para 46A is availed

Date	Particulars		₹ (Dr.)	₹ (Cr.)
20X1				
Apr. 01	Bank Account (10,000 x 48)	Dr.	4,80,000	
	To Foreign Loan Account			4,80,000
Mar 31	Finance Cost (USD 10,000 x 5% x ₹ 51)		25,500	
	To Bank Account			25,500
Mar 31	Foreign Exchange Difference Account	Dr.	30,000	
	To Foreign Loan Account [10,000 x (51-48)]			30,000
Mar 31	Foreign Currency Monetary Item Translation Difference A/c (FCMITDA)	Dr.	30,000	
	To Foreign Exchange Difference Account			30,000

In this case, since the option under Para 46A is availed, the Exchange Loss of ₹ 30,000 is accumulated in the FCMITD A/c, which will be subsequently spread over and debited to P&L A/c over the tenure of the loan.

Reference: The students are advised to refer the full text of AS 11 "The Effects of Changes in Foreign Exchange Rates".

AS 11 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 4						
2	ICAI - ILLUSTRATION 8						
3	INTER QP Nov 2019						
4	QP MAY 18						
5	ICAI - ILLUSTRATION 2						
6	QP DEC 21						
7	ILLUSTRATION (ICAI) 2 / INTER RTP NOV 2018 / INTER RTP NOV 20						
8	QP NOV 18, RTP MAY 20						
9	OCT 20 MOCK TEST						
10	RTP NOV 2014						
11	RTP MAY 2015						
12	RTP MAY 2016						
13	RTP NOV 2016						
14	RTP MAY 2017						
15	MTP OCT 21 SERIES 2						
16	RTP NOV 21						
17	RTP MAY 22						

1. ILLUSTRATION 4 (ICAI)

Rau Ltd. purchased a plant for US$ 1,00,000 on 01st February 2016, 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 recognise the profit or loss on forward contract in the books of Rau Ltd?

SOLUTION

REFERENCE:

As per **AS 11, Forward exchange contract** means an agreement to exchange different currencies at a forward rate. The **premium or discount** arising at the **inception** of a forward exchange contract should be **amortised as expense or income** over the life of the contract.

ANALYSIS:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	₹ 30,000
Contract period	3 months
Loss for the period 1st February, 2016 to 31st March, 2016 i.e. 2 months falling in the year 2015-2016	1 month
Hence, Loss for 2 months will be (30,000 X 2/3)	₹ 20,000

CONCLUSION:

Loss to be recognised for 2016-17 (30,000/3) x 2 = ₹ 20,000. Rest ₹ 10,000 will be recognised in the following year.

2. ILLUSTRATION 8 (ICAI)

A Ltd. purchased fixed assets costing ₹ 3,000 lakhs on 1.1.2016 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.1.2016 and 31.12.2016 respectively. First instalment was paid on 31.12.2016. The entire difference in foreign exchange has been capitalised.

You are required to state, how these transactions would be accounted for.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

ANALYSIS:

Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognised as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = $\frac{3{,}000 \ lakhs}{Rs \ 40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars × (42.50 – 40.00) = **₹ 187.50 lakhs**

(including exchange loss on payment of first instalment)

CONCLUSION:

Entire loss due to **exchange differences** amounting ₹ 187.50 lakhs should be **charged to profit and loss account** for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalisation available under paragraph 46 of AS 11. However, if the company opts to avail the benefit given in paragraph 46A, then nothing is required to be done since the company has done the correct treatment.

3. INTER QP Nov 2019

Karan Enterprises having its Head Office in Mangalore, Karnataka has a branch in Greenville, USA. Following is the trial balance of Branch as at 31-3-2019:

Particulars	Amount ($) Dr.	Amount ($) Cr.
Fixed assets	8,000	
Opening inventory	800	
Cash	700	

Goods received from Head Office	2,800	
Sales		24,050
Purchases	11,800	
Expenses	1,800	
Remittance to head office	2,450	
Head office account		4,300
	28,350	28,350

(i) Fixed assets were purchased on 1st April, 2015.

(ii) Depreciation at 10% p.a. is to be charged on fixed assets on straight line method.

(iii) Closing inventory at branch is \$ 700 as on 31-3-2019.

(iv) Goods received from Head Office (HO) were recorded at ₹ 1,85,500 in HO books.

(v) Remittances to HO were recorded at ₹ 1,62,000 in HO books.

(vi) HO account is recorded in HO books at ₹ 2,84,500.

(vii) Exchange rates of US Dollar at different dates can be taken

as : 1-4-2015 ₹ 63

1-4-2018 ₹ 65

31-3-2019 ₹ 67

Prepare the trial balance after been converted into Indian rupees in accordance with AS-11.

SOLUTION

Trial Balance of Foreign Branch (converted into Indian Rupees) as on March 31, 2019

Particulars	\$ (Dr.)	\$ (Cr.)	Conversion Basis	Rate	₹ (Dr.)	₹ (Cr.)
Fixed Assets	8,000		Transaction Date Rate	63	5,04,000	
Opening Inventory	800		Opening Rate	65	52,000	
Goods Received from HO	2,800		Actuals		1,85,500	
Sales		24,050	Average Rate	66		15,87,300
Purchases	11,800		Average Rate	66	7,78,800	

Expenses	1,800		**Average Rate**	**66**	1,18,800	
Cash	700		**Closing Rate**	**67**	46,900	
Remittance to HO	2,450		**Actuals**		1,62,000	
HO Account		4,300	**Actuals**			2,84,500
Exchange Rate Difference			**Balancing Figure**		23,800	
	28,350	28,350			18,71,800	18,71,800
Closing Stock	700		**Closing Rate**	**67**	46,900	
Depreciation	800		**Fixed Asset Rate**	**63**	50,400	

4. QP MAY 18

ABC Ltd. borrowed US $ 5,00,000 on 01/07/2017, 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	1 US$ =	₹ 68.50
31/03/2017	1 US $ =	₹ 69.50
31/07/2017	1 US $ =	₹ 70.00

You are required to pass necessary journal entries in the books of ABC Ltd. as per AS 11.

SOLUTION

REFERENCE:

As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'** –

- Foreign currency transaction should be recorded, on **initial recognition** in the reporting currency, by applying to the foreign currency amount, the **exchange rate** between the reporting currency and the foreign currency at **the date of the transaction.**
- At each **balance sheet date,** all foreign currency **monetary items** should be reported using the **closing rate.**

- ***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 expenses*** *in the period in which they arise.*

ANALYSIS:

Journal Entries in the Books of ABC Ltd.

Date	Particulars		₹ (Dr.)	₹ (Cr.)
Jan. 01, 2017	Bank Account (5,00,000 x 68.50)	Dr.	342,50,000	
	To Foreign Loan Account			342,50,000
Mar. 31, 2017	Foreign Exchange Difference Account	Dr.	5,00,000	
	To Foreign Loan Account [5,00,000 x (69.50-68.50)]			5,00,000
Jul. 31, 2017	Foreign Exchange Difference Account [5,00,000 x (70-69.5)]	Dr.	2,50,000	
	Foreign Loan Account	Dr.	347,50,000	
	To Bank Account			350,00,000

5. ILLUSTRATION 2 (ICAI)

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

SOLUTION

REFERENCE:

As per **AS 11 'The Effects of Changes in Foreign Exchange Rates'**, **exchange differences** arising on reporting an enterprise's **monetary items** at rates different from those at which they were initially recorded during the period, should be **recognised as income or expenses** in the period in which they arise.

AS 11

ANALYSIS:

Exchange **differences** arising on **repayment of liabilities** incurred for the purpose of acquiring fixed assets should be recognised as income or expense.

Calculation of Exchange Difference:

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

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

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

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

Accordingly, in case Opportunity Ltd. opts for capitalising the exchange difference, then the entire amount of exchange difference of ₹ 1,00,000 will be **capitalised to 'Equipment account'**. This capitalised exchange difference will be depreciated over the useful life of the asset.

Cost of the asset on the reporting date

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

6. QP DEC 21

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 receivable 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 11b in the books of PP Ltd.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

However, at the **option of an entity, exchange differences** arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and **amortised over the balance period of such long-term asset/ liability, by recognition as income or expense** in each of such periods.

i. **Long Term Finance**

ANALYSIS:

	Foreign Currency Rate	₹
Initial recognition US \$ 56,791 (40,88,952/72)	1 US \$ = ₹ 72	40,88,952
Rate on Balance sheet date	1 US \$ = ₹ 73.60	
Exchange Difference Loss [US \$ 56,791 x (73.60 – 72)]		90,866 (rounded off)

CONCLUSION:

Treatment needed in this case: PP Ltd. can either Debit Foreign Currency Monetary Item Translation Difference (FCMITD) A/c or Debit Profit and Loss A/c by ₹ 90,866 and Credit Loan A/c

ii. **Trade Receivables**

	Foreign Currency Rate	₹
Initial recognition US \$ 27,250 (20,00,150/ 73.40)	1 US \$ = ₹ 73.40	20,00,150

Rate on Balance sheet date	1 US $ = ₹ 73.60	
Exchange Difference Gain [US $ 27,250 X (73.60-73.40)]		5,450

CONCLUSION:

As per AS 11 "The Effects of Changes in Foreign Exchange Rates", exchange differences on trade receivables amounting ₹ 5,450 is required to be transferred to Profit and Loss A/c.

7. ILLUSTRATION (ICAI) 2 / INTER RTP NOV 2018 / INTER RTP NOV 20

Particulars	Exchange Rate per $
Goods purchased on 1.1.2019 for US $ 15,000	₹ 75
Exchange rate on 31.3.2019	₹ 74
Date of actual payment 7.7.2019	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years 2018- 19 and 2019-20 as per AS 11.

SOLUTION

REFERENCE:

As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'** –

- **Foreign** currency **transaction** should be recorded, on **initial recognition** in the reporting currency, by applying to the foreign currency amount, the exchange rate between the reporting currency and the foreign currency at the da**te of the transaction.**
- At each balance sheet date, all foreign currency monetary items should be reported using the closing rate.
- 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 expenses** in the period in which they arise.

ANALYSIS:

For the year ending 31.03.2019 –	
Goods purchased on 1.1.2019 and corresponding creditors - Recorded at exchange rate on 01.01.2019 (i.e. $15,000 × ₹ 75)	₹ 11,25,000
Creditors of US $15,000 on 31.3.2019 - Reported at closing rate (i.e., $15,000 × ₹ 74)	₹ 11,10,000
Exchange profit (11,25,000 – 11,10,000) - Credited to Profit and Loss account in the year 2018-19.	₹ 15,000
For the year ending 31.03.2020 –	
On 7.7.2019, creditors of $15,000 paid at the rate of ₹ 73 (Actual rate on date of Payment)	10,95,000
Profit to be credited to Profit and Loss Account for year 2019-20 (11,10,000 – 10,95,000)	**₹ 15,000**

8. QP NOV 18, RTP MAY 20

AXE Limited purchased fixed assets costing $ 5,00,000 on 1st Jan. 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.

SOLUTION

REFERENCE:

As per **AS 11, Forward exchange contract** means an agreement to exchange different currencies at a forward rate. The **premium or discount** arising at the **inception** of a forward exchange contract should be **amortised as expense or income** over the life of the contract.

ANALYSIS:

Forward Rate	₹ 62.50
Less: Spot Rate	(₹ 60.75)
Premium on Contract	₹ 1.75
Contract Amount	US$ 5,00,000
Total Loss (5,00,000 x 1.75)	₹ 8,75,000
Contract period	6 months
Loss for the period 1st January, 2018 to 31st March, 2018 i.e. 5 months falling in the year 2017-2018	3 months
Hence, Loss for 3 months will be (8,75,000 X 3/5)	₹ 5,25,000

Contract period 5 months – out of which 3 months falling in the year 2017-18

CONCLUSION:

The **loss amounting to ₹ 5,25,000** for the period is to be recognised in the year ended 31st March 2018. Rest ₹ 3,50,000 will be recognised in the following year 2018-19.

9. OCT 20 MOCK TEST

Om Ltd. purchased an item of property, plant and equipment for US $ 50 lakh on 01.04.2019 and the same was fully financed by the foreign currency loan [US $] repayable in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $ = ₹ 60]. As on 31.03.2020 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Om Ltd. normally provides depreciation on an item of property, plant and equipment at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss, its treatment and depreciation on this item of property, plant and equipment.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

However, at the **option of an entity, exchange differences** arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a non-depreciable capital asset can be accumulated in a **"Foreign Currency Monetary Item Translation Difference Account"** in the enterprise's financial statements and **amortised over the balance period of such long-term asset/ liability, by recognition as income or expense** in each of such periods.

ANALYSIS:

As Om Ltd. has exercised the option and it is long term foreign currency monetary item, Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring an item of property, plant and equipment should be **adjusted in the carrying amount** of the respective item of property, plant and equipment.

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakh $ x ₹ 60) = **₹ 3,000 lakh**

Exchange loss on outstanding loan on 31.03.2020 = ₹ 40 lakh US $ x (62.00 - 60.00) = **₹ 80 lakh.**

₹ 80 lakh should also be added to cost of an item of property, plant and equipment with corresponding credit to outstanding loan in addition to ₹ 20 lakh on account of exchange loss on payment of instalment.

The total cost of an item of property, plant and equipment to be increased by ₹ 100 lakh.

Total **depreciation to** be provided for the year 2019 - 2020 = 20% of (₹ 3,000 lakh + 100 lakh) = **₹ 620 lakh.**

CONCLUSION:

The entire **exchange loss** due to variation of **₹ 20 lakh** on 31.03.2020 on payment of US $ 10 lakh, should be **added to the carrying amount** of an item of property, plant and equipment and not to the cost of goods sold. **Depreciation on the unamortized depreciable amount** should be provided.

10. RTP NOV 2014

A company had imported raw materials worth US Dollars 6,00,000 on 5^{th} January, 2014, when the exchange rate was ₹ 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5^{th}

April, 2014 when the exchange rate was ₹ 47 per US Dollar. However, on 31st March, 2014, the rate of exchange was ₹ 48 per US Dollar. The company passed an entry on 31st March, 2014 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US Dollar. In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

SOLUTION

REFERENCE:

As per **AS 11, 'The Effects of Changes in Foreign Exchange Rates'**, **monetary items** denominated in a **foreign currency** should be reported using the **closing rate** at each balance sheet date. The effect of **exchange difference** should be taken into **profit and loss account.**

ANALYSIS:

Trade payables is a monetary item, hence should be valued at the closing rate i.e., ₹ 48 at 31st March, 2014 irrespective of the payment for the same subsequently at lower rate in the next financial year. **The difference of ₹ 5 (₹ 48 less ₹ 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2014 and is not to be adjusted against the cost of raw materials.** In the subsequent year, the company would record an exchange gain of ₹1 per US dollar, i.e., the difference between ₹ 48 and ₹ 47 per US dollar.

CONCLUSION:

The accounting treatment adopted by the company is incorrect.

11. RTP MAY 2015

Explain briefly the accounting treatment needed in the following cases as per AS 11:

(i) Trade Receivables include amount receivable from Ted of U.S., ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at $1 = ₹ 38.70.

(ii) Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at $1 = ₹ 35.60, taking exchange rate prevailing at the date of transactions.

Exchange rates at the end of the year were as under:

$1 Receivable = ₹ 45.80

$ 1 Payable = ₹ 45.90

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

ANALYSIS:

In case the option under **para 46A** is **exercised,** the exchange differences arising on long-term foreign currency monetary items can be adjusted in the cost of the depreciable capital asset or in other cases transferred in Foreign Currency Monetary Item Translation Difference Account **(FCMITD) and amortised.**

(i) Trade Receivables

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $ 12,919.90	38.70	5,00,000
Rate on B/S date		45.80	
Exchange Difference	US $ 12,919.90	7.10	91,731
Gain or loss			Gain
Treatment	Credit to Profit & Loss A/c - ₹ 91,731		

(ii) Long Term loan

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $ 1,68,539.33	35.60	60,00,000
Rate on B/S date		45.90	
Exchange Difference	US $ 1,68,539.33	10.30	17,35,955
Gain or loss			Loss
Treatment	**Debit to Profit & Loss A/c** **₹ 17,35,955 or transfer to FCMITD A/c and amortize.**		

12. RTP MAY 2016

Trade receivables as on 31.3.2015 in the books of XYZ Ltd. include an amount receivable from Umesh ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, i.e. at US $ 1= ₹ 58.50. US $ 1 = ₹ 61.20 on 31.3.2015.

Explain briefly the accounting treatment needed in this case as per AS 11 as on 31.3.2015.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

ANALYSIS:

Exchange difference on trade receivables

Particulars	Foreign currency	Rate	Rupees
Initial recognition	US $ 8,547 (5,00,000/58.50)	58.50	5,00,000
Rate on B/S date		61.20	
Exchange Difference		-2.70	₹23,077
Gain or loss Treatment	**Credit to Profit & Loss A/c ₹23,077**		

13. RTP NOV 2016

"The company had a engineering contract with a foreign government, work to be carried out in foreign country and payments to be received in dollars. The work was completed in the year 2015, and the entire contracted amount was duly recorded in the books of the company at the prevalent exchange rate on the date of completion of the work. However, payments to the extent of ₹ 40 crores could not be released by the Foreign Government because of temporary foreign exchange crisis in that country. This ₹ 40 crores unrealized at the end, if converted at the year end rate would amount to ₹ 40.50 crores. The Company has adopted and follows the following accounting policy:

"In respect of foreign currency transactions, current assets and current liabilities are revalued at year end rates. However, if there is a net loss, due to exchange difference, the same is charged off to the P&L account, but if there is a net gain, the same is ignored in view of the prudent accounting policies of not recording unrealized gains due to exchange rate fluctuations". Comment on the appropriateness of the above.

SOLUTION

REFERENCE:

As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'** –

Foreign currency transaction should be recorded, on **initial recognition** in the reporting currency, by applying to the foreign currency amount, the exchange rate between the reporting currency and the foreign currency at the **date of the transaction**. Further AS-11 clearly mentions that net **difference** shall be **transferred to profit and loss account.**

ANALYSIS / CONCLUSION:

In given case the recoverability of ₹ 40 Crores is not doubtful or uncertain but just **deferred temporarily** hence it should be **translated using exchange rates** at the close of the year. Hence, we can say that exchange difference **favourable or unfavourable both shall be considered** at the year-end rather to ignore the gains and recording just losses.

14. RTP MAY 2017

Omega Ltd. purchased fixed assets costing ₹3,000 lakhs on 1.4.2016 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.4.2016 and 31.3.2017 respectively. First instalment was paid on 31.12.2016.

You are required to state, how these transactions would be accounted for.

SOLUTION

REFERENCE:

As per **AS 11 "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 expenses** in the period in which they arise.

ANALYSIS:

Calculation of Exchange Difference:

Foreign currency loan = $\frac{Rs.3{,}000\ lakhs}{Rs.40}$ **= 75 lakhs US Dollars**

Exchange difference = 75 lakhs US Dollars x (42.50 – 40.00) = ₹187.50 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting **₹ 187.50 lakhs** should be **charged to profit and loss account** for the year.

Note: The above answer has been given on the basis that the company has not exercised the option of capitalization available under para 46 of AS 11. The answer will change if the company exercises the option of capitalization.

15. MOCK TEST OCT 21 SERIES 2

"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 Receivable

(iii) Investments

(iv) Fixed Assets.

SOLUTION

REFERENCE:

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

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

Non-monetary items are assets and liabilities **other than monetary items.**

ANALYSIS:

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

16. RTP NOV 21

Mona Ltd. purchased a plant for US$ 1,00,000 on 01st December 2020, payable after three months. Company entered into a forward contract for three months @ ₹ 49.15 per dollar. Exchange rate per dollar on 01st December was ₹ 48.85. How will you recognize the profit or loss on forward contract in the books of Mona Ltd for the year ended 31st March, 2021?

SOLUTION

REFERENCE:

As per **AS 11, Forward exchange contract** means an agreement to exchange different currencies at a forward rate. The **premium or discount** arising at the **inception** of a forward exchange contract should be **amortised as expense or income** over the life of the contract.

ANALYSIS:

Forward Rate	₹ 49.15
Less: Spot Rate	(₹ 48.85)
Premium on Contract	₹ 0.30
Contract Amount	US$ 1,00,000
Total Loss (1,00,000 x 0.30)	**₹ 30,000**

CONCLUSION:

Total Loss ₹ 30,000 to be recognized in Profit and Loss Account in year ended 31.3.2021.

17. RTP MAY 22

Kumar Ltd. borrowed US $ 3,00,000 on 31-12-2020 which will repaid as on 30-06-2021. Kumar Ltd. prepares its financial statements ending on 31-03-2021. Rate of exchange between reporting currency (Rupee) and foreign currency (US$) on different dates are as under:

31-12-2020	1 US $ = ₹ 44.00
31-03-2021	1 US $ = ₹ 44.50
30-06-2021	1 US $ = ₹ 44.75

(i) Calculate Borrowings in reporting currency to be recognized in the books on above mentioned dates and also show journal entries for the same.

(ii) if borrowings were repaid on 28-2-2021 on which date exchange rate was 1 US $ = ₹ 44.20 then what entry should be passed?

SOLUTION

REFERENCE:

As per **AS 11 on 'The Effects of Changes in Foreign Exchange Rates'** –

- Foreign currency transaction should be recorded, on **initial recognition** in the reporting currency, by applying to the foreign currency amount, the **exchange rate** between the reporting currency and the foreign currency at **the date of the transaction.**
- At each **balance sheet date,** all foreign currency **monetary items** should be reported using the **closing rate.**
- **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 expenses** in the period in which they arise.

ANALYSIS:

On 31.12.2020 borrowings will be recorded at ₹ 1,32,00,000 (i.e., $ 3,00,000 × ₹ 44.00).

On 31.3.2021 borrowings (monetary items) will be recorded at ₹ 1,33,50,000 (i.e., $ 3,00,000 × ₹ 44.50).

Journal of Kumar Ltd.

Date	Particulars		Dr. (₹)	Cr. (₹)
31-12-2020	Bank A/c	Dr.	1,32,00,000	
	To Foreign Loan Account			1,32,00,000
31-03-2021	Foreign Exchange Difference Account A/c	Dr.	1,50,000	
	To Foreign Loan Account			1,50,000
30-06-2021	Foreign Loan Account A/c Dr.		1,33,50,000	
	Foreign Exchange Difference Account A/c	Dr.	75,000	
	To Bank A/c			1,34,25,0000

(ii) In case borrowings were repaid before Balance Sheet Date, then the entry would be as follows:

Date	Particulars		Dr. (₹)	Cr. (₹)
28-02-2021	Foreign Loan Account A/c	Dr.	1,32,00,000	
	Foreign Exchange	Dr.	60,000	
	Difference Account A/c	Dr.		
	To Bank A/c			1,32,60,000

Working Notes:

(i) **The exchange difference of ₹ 1,50,000** is arising because the transaction has been reported at different rate (₹ 44.50 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $) from the rate initially recorded (i.e., ₹ 44 = 1 US $)

(ii) **The exchange difference of ₹ 75,000** is arising because the transaction has been settled at an exchange rate (₹44.75 = 1 US$) different from the rate at which reported in the last financial statements (₹ 44.50 = 1 US$).

The exchange difference of ₹ 60,000 is arising because the transaction has been settled at a different rate (i.e., ₹ 44.20 = 1 US $) than the rate at which initially recorded (1 US $ = ₹ 44.00)

MCQs

1. As per AS 11 assets and liabilities of non-integral foreign operations should be converted at __________ rate.
   a) Opening
   b) Average
   c) Closing
   d) Transaction

2. The debit or credit balance of "Foreign Currency Monetary Item Translation Difference Account"
   a) Is shown as "Miscellaneous Expenditure" in the Balance Sheet
   b) Is shown under "Reserves and Surplus" as a separate line item
   c) Is shown as "Other Non-current" in the Balance Sheet
   d) Is shown as "Current Assets" in the Balance Sheet

3. If asset of an integral foreign operation is carried at cost, cost and depreciation of tangible fixed asset is translated at
   a) Average exchange rate
   b) Closing exchange rate
   c) Exchange rate at the date of purchase of asset
   d) Opening exchange rate

4. Which of the following can be classified as an integral foreign operation?
   a) Branch office serving as an extension of the head office in terms of operations
   b) Independent subsidiary of the parent company
   c) Branch office independent of the head office in terms of operational decisions
   d) None of the above

5. Which of the following items should be converted to closing rate for the purposes of financial reporting?
   a) Items of Property, Plant and Equipment
   b) Inventory
   c) Trade Payables, Trade Receivables and Foreign Currency Borrowings
   d) All of the above

Answers									
1.	(c)	2.	(b)	3.	(c)	4.	(a)	5.	(c)

AS 12 – ACCOUNTING FOR GOVERNMENT GRANTS			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Government Grant in the nature of promotor's Contributions	Q.6 (i), Q.7	Q.2, Q.7 (ii) (iii), Q.11 (ii)
2	Grant related to depreciable asset		Q.6, Q.18
3	Refund of grant		
	• Asset at net of grant	Q.5	Q12, Q13, Q.9 (ii), Q17
	• Deferred Income		Q.9 (i), Q.10
4	Journal Entries		
	• Deferred Income		Q.1
	• Assets at net of grant	Q.1, Q.3	Q.15, Q.19,
	• Refund	Q.10	Q.20
5	Miscellaneous	Q.2	Q.16, Q.5, Q.4, Q.14, Q.3, Q.11 (i), Q.11 (iii)
6	Special Case	Q.4, Q.8, Q.9	Q.8

AS 12 – ACCOUNTING FOR GOVERNMENT GRANTS

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 1						
2	ICAI - ILLUSTRATION 3						
3	ICAI - ILLUSTRATION 7						
4	ICAI - ILLUSTRATION 9						
5	INTER QP NOV 20						
6	QP JULY 21						
7	INTER RTP MAY 2016 / INTER RTP NOV 2019						
8	QP MAY 23						
9	ICAI - ILLUSTRATION 4						
10	ICAI - ILLUSTRATION 11						

1. ILLUSTRATION 1 (ICAI)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the asset, government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount refundable in respect of a **grant related to a specific fixed asset** should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the **book value is increased, depreciation on the revised book value** should be **provided prospectively over the residual useful life of the asset.**

Journal in the books of Z Ltd.

Year	Particulars		Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account	Dr.	50,00,000	
	To Bank Account			50,00,000
	(Being Fixed Assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Fixed Assets Account			10,00,000
	(Being grant received from the government)			
	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P/L Account)			
2nd	Depreciation Account	Dr.	7,00,000	
	To Fixed Assets Account			7,00,000
	(Being Depreciation charged on SLM)			

	Profit & Loss Account	Dr.	7,00,000	
	To Depreciation Account			7,00,000
	(Being Depreciation transferred to P/L Account)			

2. ILLUSTRATION 3 (ICAI)

Santosh Ltd. has received a grant of Rs. 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs. 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.

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants',** Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They **exclude** 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.

When government grant is **received for a specific purpose,** it should be **utilised for the same. Non-monetary assets** given free of cost are recorded at a **nominal value.**

ANALYSIS:

As per the above reference,

1. **The grant received for setting up a factory is not available for distribution of dividend.** It should be utilised only for the condition specified with the grant.
2. **Even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value.**

CONCLUSION:

The treatment of both the elements of the **grant is incorrect** as per AS 12.

3. ILLUSTRATION 7 (ICAI)

A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs. 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.

SOLUTION

<u>REFERENCE:</u>

According to **AS 12 on Accounting for Government Grants**, the amount refundable in respect of a **grant related to a specific fixed asset** should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the **book value is increased, depreciation on the revised book value** should be **provided prospectively over the residual useful life of the asset.**

Journal Entries

Year	Particulars		Rs. in lakhs	Rs. in lakhs
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2

	(Being depreciation transferred to Profit and Loss Account at the end of year 1)		
2	Fixed Asset Account Dr. To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	5	5
	Depreciation Account (W.N.2) Dr. To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	3.67	3.67
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	3.67	3.67

WORKING NOTES :

1. Depreciation of Year 1

Particulars	**Rs. in lakhs**
Cost of the Asset	20
Less : Government grant received	(8)
	12
Depreciation (12-4)/4	**2**

2. Depreciation for Year 2

Particulars	**Rs. in lakhs**
Cost of the Asset	20
Less : Government grant received	(8)
	12
Less : Depreciation for the firs year (12-4)/4	2
	10
Add : Government grant refundable	5
	15
Depreciation for the second year (15-4)/3	**3.67**

4. ILLUSTRATION 9 (ICAI)

A Ltd. purchased a machinery for Rs. 40 lakhs. (Useful life 4 years and residual value Rs. 8 lakhs) Government grant received is Rs. 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.

SOLUTION

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account :

REFERENCE:

As per AS 12, In regards to Grants Related to **Specific Fixed Assets**, under first method the **grant is shown as a deduction** from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

ANALYSIS:

	Particulars		**Rs.**	**Rs.**
I	Fixed Assets A/c	Dr.	16 lakhs	
	To Bank A/c			16 lakhs
	(Being grant refunded)			

Particulars	**Rs**
Fixed assets initially recorded in the books Rs. 40 lakhs – Rs. 16 lakhs	Rs. 24 lakhs
Depreciation p.a. = (Rs. 24 lakhs – Rs. 8 lakhs)/4 years	Rs. 4 lakhs per year
Value of fixed assets after two years but before refund of grant [Rs. 24 lakhs – (Rs. 4 lakhs x 2 years)]	Rs. 16 lakhs
Refund of Grant	Rs. 16 lakhs
Value of Fixed Asset post refund of Grant	Rs. 32 lakhs
Revised value of Depreciation for remaining 2 years (32 Lakh – 8 Lakh) / 2 years	**12 Lakhs per annum**

(2) *If the grant is credited to Deferred Grant Account:*

REFERENCE: As per **AS 12 'Accounting for Government Grants,'** income from Deferred Grant Account is **allocated to Profit and Loss** account usually over the periods and in the **proportions** in which **depreciation on related assets** is charged.

ANALYSIS: In the first two years (Rs. 16 lakhs/4 years) = Rs. 4 lakhs p.a. x 2 years = Rs. 8 lakhs were credited to Profit and Loss Account and Rs. 8 lakhs was the balance of Deferred Grant Account after two years. Therefore, on refund in the 3rd year, following entry will be passed:

	Particulars		Rs.	Rs.
I	Deferred Grant A/c	Dr.	8 lakhs	
	Profit and Loss Account	Dr.	8 lakhs	
	To Bank A/c			16 lakhs
	(Being government grant refunded)			

Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at Rs. 24 lakhs and depreciation will continue to be charged at Rs. 8 lakhs per annum for the remaining two years.

Working Note:

Balance of Fixed Assets after two years but before refund (under second alternative)

Fixed assets initially recorded in the books = **Rs. 40 lakhs**

Depreciation p.a. = (Rs. 40 lakhs – Rs. 8 lakhs)/4 years = **Rs. 8 lakhs per year**

Book value of fixed assets after two years = Rs. 40 lakhs – (Rs. 8 lakhs x 2 years) = **Rs. 24 lakhs**

5. INTER QP NOV 20

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.

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount **refundable** in respect of a grant **related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by **increasing** the book value of the asset, by the amount refundable. Where the book value is increased, **depreciation on the revised book value should be provided prospectively** over the residual useful life of the asset.

Ist April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
Ist April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
Ist April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
Ist April, 2019	Book value	174.96
Ist June, 2019	Less: Depreciation @10% for 2 months	(2.916)
	Book value	172.044
June 2019	Add: Refund of grant*	60.00
Revised book value		232.044

Depreciation @10% on the revised book value amounting to ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the machinery.

*considered refund of grant at beginning of June month and depreciation for two months already charged.

Journal Entries

Machinery Account To Bank Account Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.	60	60
Depreciation Account To Machinery Account Being depreciation charged on revised value of fixed asset prospectively for 10 months)	Dr.	19.337	19.337
Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)	Dr.	22.253	22.253

6. QP JULY 21

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".

SOLUTION

(i) **REFERENCE:** As per **AS 12 'Accounting for Government Grants',** where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

ANALYSIS: In the given case, the subsidy received from the Central Government for setting up an industrial undertaking in Medak is neither in relation to specific fixed asset nor in relation in revenue.

CONCLUSION: The amount of **₹ 120 Lacs** should be **credited to capital reserve** which can be neither distributed as dividend nor considered as deferred income.

(**Note:** Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)

(ii) **REFERENCE:** As per **AS 12 'Accounting for Government Grants',** two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

(a) The grant is shown as a **deduction from the gross value of the asset** concerned in arriving at its book value. The grant is thus **recognised** in the **profit and loss** statement **over** the **useful life** of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the **balance sheet** at a **nominal value.**

(b) Grants related to depreciable asset are **treated as deferred income** which is **recognised** in the **profit and loss statement** on **a systematic** and rational basis over the useful life of the asset.

ANALYSIS / CONCLUSION: In the given case, ₹ **15 Lacs was received as grant** from the Central Government for installation of Effluent Treatment Plant. Since the grant was received for a fixed asset, **either of the above** methods can be adopted.

(iii) **REFERENCE:** Grants related to revenue are presented as a **credit in the profit and loss** statement, either separately or under a general heading such as '**Other Income**'. Alternatively, they are deducted in reporting the related expense.

ANALYSIS / CONCLUSION: ₹ 25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant. Alternatively, ₹ 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

7. INTER RTP MAY 2016 / INTER RTP NOV 2019

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2014. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants',** where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

ANALYSIS:

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the **nature of promoter's contribution** as the grant is given with reference to the total investment in an undertaking i.e., subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the **subsidy** received **is neither** in relation to **specific fixed assets nor** in relation to **revenue.** Thus, the company **cannot recognize** the said **subsidy** as **income** in its financial statements in the given case.

CONCLUSION: It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

8. QP MAY 2023

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for 60 lakhs, which has an estimated useful life of 10 years with a salvage value of ₹ 10 lakhs. On purchase of the Plant, a grant of ₹20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

(i) If the grant amount is deducted from the value of Plant.

(ii) If the grant is treated as deferred income.

(iii) If the grant amount is deducted from the value of Plans, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions

(iv) If the grant is treated as the promoter's contribution

(Assume depreciation on the basis of Straight-Line Method)

SOLUTION

Calculation of depreciation as per AS 12 for the financial year 2022-23:

(i) If the grant amount is deducted from the value of Plant, then the amount of deprecation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10 year.

(ii) If the grant is treated as deferred income, then amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000) / 10 year.

(iii) If the grant amount is deducted from the value of plant, but at the end of the year 2022-23 grant is refunded to the extent of ₹ 4 lakh then the amount of depreciation will be ₹ 3,00,000 p.a. (₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) /10 year for year 2021-22 and for the year 2022-23 Depreciation will be ₹ 3,00,000 calculated as follows, (₹60,00,000 - ₹ 10,00,000 - ₹ 20,00,000– ₹ 3,00,000) / 10 years.

Note: It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as ₹ 3,44,444 calculated as follows, (₹ 60,00,000 - ₹10,00,000 - ₹ 20,00,000 + 4,00,000– ₹ 3,00,000 / 9 years

(iv) If the grant is treated as promoter's contribution, then the amount of depreciation will be ₹ 5,00,000 p.a. (₹ 60,00,000 -10,00,000) /10 year.

NOTE: The answer can be presented in the following alternative manner:

		(i)	(ii)	(iii)	(iv)
Date	Particulars	Grant Value deducted from Plant	Grant treated as Deferred Income	Grant Refunded	Grant is treated as Promoter's Contribution
01.04.2021	Cost of Plant	60,00,000	60,00,000	60,00,000	60,00,000
	Less: Salvage	10,00,000	10,00,000	10,00,000	10,00,000
		50,00,000	50,00,000	50,00,000	50,00,000
01.04.2021	Less: Grant	20,00,000	-	20,00,000	-
		30,00,000	50,00,000	30,00,000	50,00,000
	Useful Life (years)	10	10	10	10
31.03.2022	Depreciation FY 2021-22	3,00,000	5,00,000	3,00,000	5,00,000
1.4.2022	Cost of Plant			60,00,000	
	Less: Salvage			10,00,000	
				50,00,000	
	Less: Grant			20,00,000	
				30,00,000	
	Less: Depreciation FY 2022-23			3,00,000	
				27,00,000	
	Book value at the time of refund of grant i.e. at the end of Period				
	Add: Grant Refundable at end of 22-23 Book value available for remaining 8 years.			4,00,000	
				31,00,000	

Note:

It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as:

Cost of Plant	60,00,000
Less: Salvage	10,00,000
	50,00,000
Less: Grant	20,00,000
	30,00,000
Add: Grant Refundable	4,00,000
	34,00,000
Less: Depreciation for 2021-22	3,00,000
	31,00,000
Useful Life (years)	9
Depreciation for 2022-23	3,44,444

9. ICAI – ILLUSTRATION 4

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

You are required to pass the necessary journal entries in the books of the company for first year if the grant is:

(a) Shown separately as Other Income; and

(b) Deducted against the Salary costs.

SOLUTION

a)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			

Salary Expense Account	Dr.	30,00,000	
To Bank Account			30,00,000
(Being Salary expense paid for the year)			
Deferred Income Account	Dr.	18,00,000	
To Other Income Account			18,00,000
(Being Year I Grant income recognised in Profit &Loss)			

Note: The grant has been spread on a straight-line basis over a period of 5 years [₹90,00,000/5 years = ₹ 18,00,000].

b)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) forthe year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year I grant adjusted against Salary expensefor the year)			

10.ICAI – ILLUSTRATION 11 (New Syllabus)

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹90 lakhs to meet the salary expense for a period of next 5 years.

At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income.

SOLUTION

		₹	₹
	Deferred Grant A/c Dr.	36 lakhs	
	Profit & Loss A/c Dr.	54 lakhs	
	To Bank A/c		90 lakhs
	(Being Government grant refunded)		

Workings:

Total grant received: ₹ 90 Lakhs

Grant recognised as income for first 3 years: ₹ 18 lakhs × 3

= ₹ 54 lakhs

Remaining Deferred Income = ₹ 90 Lakhs – 54 lakhs

= ₹ 36 lakhs

Reference: The students are advised to refer the full text of **AS 12 "Accounting for Government Grants"**.

AS 12 – ACCOUNTING FOR GOVERNMENT GRANTS

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 2						
2	ICAI - ILLUSTRATION 4						
3	ICAI - ILLUSTRATION 6						
4	ICAI P. Q. 8						
5	INTER QP MAY 19						
6	INTER QP JAN 21						
7	QP MAY 2022						
8	INTER RTP NOV 2016 / INTER RTP MAY 2018						
9	INTER RTP NOV 2018						
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11	INTER RTP MAY 20, INTER RTP NOV 20, ICAI - ILLUSTRATION 5						
12	INTER QP MAY 18 / OCT 20 MOCK TEST/ MTP MARCH 2022						
13	ICAI - ILLUSTRATION 8, RTP MAY 2015						
14	RTP NOV 14, RTP NOV 17						
15	RTP NOV 2015						
16	RTP MAY 2017						
17	MTP OCT 21 SERIES 2						
18	MTP OCT 21 SERIES 1						
19	RTP MAY 2022						
20	MTP APRIL 2022						

1. ILLUSTRATION 2 (ICAI)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets, government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

SOLUTION

JOURNAL IN THE BOOKS OF Z LTD.

Year	Particulars	Rs. Dr.)	Rs. (Cr.)
Ist	Fixed Assets Account Dr. To Bank Account (Being fixed assets purchased)	50,00,000	50,00,000
	Bank Account Dr. To Deferred Government Grant Account (Being grant receive d from the government)	10,00,000	10,00,000
	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM)	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000
	Deferred Government Grants Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	2,00,000	2,00,000
2nd	Depreciation Account Dr. To Fixed Assets Account (Being depreciation charged on SLM)	9,00,000	9,00,000
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to P/L Account)	9,00,000	9,00,000

	Deferred Government Grants Account Dr. To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	2,00,000	2,00,000

2. ILLUSTRATION 4 (ICAI)

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crore in capital assets received Rs. 10 crore from the Government in January, 2017 (accounting period being 2016-2017). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2017. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants',** where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

ANALYSIS:

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, **it is inappropriate to recognise government grants in the profit and loss statement,** since they are not earned but represent an incentive provided by government without related costs.

CONCLUSION:

The accounting treatment desired by the company is **not proper.** The **correct treatment** is to **credit the subsidy to capital reserve.**

3. ILLUSTRATION 6 (ICAI)

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets, government granted it a grant for Rs. 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of Rs. 7,00,000. Pass the journal entry for refund of the grant as per the first method.

SOLUTION

	Particulars	LF	Amt	Amt
	Fixed Assets Account Dr.		7,00,000	
	To Bank Account			7,00,000
	(Being government grant on asset refunded)			

4. ICAI Practical Question 8

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1-20X2 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 20X2-20X3, 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

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants'**, Government grants sometimes become **refundable** because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

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.**

ANALYSIS / CONCLUSION:

In the present case, the **amount of refund of government grant** should be shown in **the profit & loss account** of the company as an **extraordinary item** during the year.

5. INTER QP MAY 19

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

As per the provisions of AS-12 government grants in the nature of promoter's contribution which become refundable should be reduced from the capital reserve.

SOLUTION

True: When grants in the **nature of promoters' contribution** becomes **refundable,** in part or in full to the government on non-fulfilment of some specified conditions, the **relevant amount refundable** to the government is **reduced from the capital reserve.**

6. INTER QP JAN 21

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.

You are required to calculate the amount of depreciation and grant to be recognised 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.

SOLUTION

REFERENCE:

As per **AS 12 "Accounting for government grants"**, grants related to depreciable assets, if treated as **deferred income** are **recognized in the profit and loss** statement on **a systematic** and rational basis over the **useful life of the asset.**

ANALYSIS:

Amount of depreciation and grant to be recognized in the profit and loss account each year

Depreciation per year: ₹in lakhs

Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year(70lakhs/4)	**17.50**

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

7. QP MAY 2022

Suraj Limited provides you the following information:

i) It received a Government Grant @ 40% towards the acquisitions of Machinery Worth ₹ 25 Crores.

ii) It received a Capital Subsidy of ₹ 150 Lakhs form Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region.

iii) It received ₹ 50 Lakhs form Government for setting up a project for supply of arsenic free water in a notified area.

iv) It received ₹ 5 Lakhs form the Local Authority for providing Corona Vaccine free of charges to its employees and their families.

v) It also received a performance award of ₹ 500 Lakhs form Government with a conditions of major renovations 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.

SOLUTION

(i) <u>REFERENCE:</u> **As per AS 12 'Accounting for Government Grants'**, two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

(a) The **grant is shown as a deduction** from the gross value of the asset concerned in arriving at its book value. The grant is thus **recognised in the profit and loss** statement **over** the **useful life** of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the **asset is shown in the balance sheet at a nominal value.**

(b) Grants related to depreciable asset are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

<u>**ANALYSIS:**</u> Under the first alternative, the **grant of ₹ 10 crores** (40% of 25 crores) is **shown as a deduction from the gross value of the asset** concerned in arriving at its book value. The grant is thus **recognized the profit and loss statement** over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under second alternative method, **grant amounting ₹ 10 crores** is **treated as deferred income** which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

(ii) <u>**REFERENCE:**</u> As per **AS 12 'Accounting for Government Grants'**, where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

<u>**ANALYSIS:**</u> In the given case, the **grant amounting ₹ 150 lakhs** received from the Central Government for setting up a plant in notified backward area may be considered as in the **nature of promoters' contribution.**

<u>**CONCLUSION:**</u> Amount of ₹ 150 lakhs should be **credited to capital reserve** and the plant will be shown at ₹ 300 lakhs.

(iii) REFERENCE: As per **AS 12 'Accounting for Government Grants'**, where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

ANALYSIS: **₹ 50 lakhs** received from Govt. for setting up a project for supply of arsenic free water in notified area should be **credited to capital reserve.**

Alternatively, if it is assumed that the project consists of capital asset only, then the amount of ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water should either be **deducted from cost of asset** of the project concerned in the balance sheet or **treated as deferred income** which is recognized in the **profit and loss** statement on a **systematic** and rational basis **over the useful life** of the asset.

(iv) REFERENCE: As per **AS 12, Grants related to revenue** are presented as a credit in the profit and loss statement, either separately or under a general heading such as **'Other Income'.** Alternatively, they are deducted in reporting the related expense.

ANALYSIS: ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a **grant received in nature of revenue grant.** Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading **'Other Income'.** Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

(v) **₹ 500 Lakhs** will be **reduced** from the **renovation cost** of power plant or will be **treated** as **deferred income** irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non-compliance of conditions attached to the grant.

8. INTER RTP NOV 2016 / INTER RTP MAY 2018

D Ltd. acquired a machine on 01-04-2012 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2012-13- to 2014-15 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)

Balance	(8,00,000)

How should the company deal with this asset in its accounts for 2015-16? Can it charge depreciation or negative depreciation for 2015-16? Can it credit ₹ 8,00,000 to Capital Reserve?

SOLUTION

REFERENCE:

As per AS **12 'Accounting for Government Grants'**, for grants related to **specific fixed assets**, it is shown as a **deduction from the gross value of the asset** concerned in arriving at its book value. The grant is thus **recognised in the profit and loss statement over the useful life** of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

ANALYSIS:

From the above account, it is inferred that the Company follows **Reduction Method** for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c.

The **balance** ₹ 8,00,000 may be **credited to P&L A/c**, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is **no need to provide depreciation** for **2015-16** or 2016-17 as the depreciable amount is now Nil.

In respect of **Depreciable Assets, AS-12 does not permit** the crediting of the grant or any part thereof to Capital Reserve A/c.

9. INTER RTP NOV 2018

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, 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 ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 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 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12 .

SOLUTION

(i) ***REFERENCE:*** As per **AS 12, 'Accounting for Government Grants'**, "**the amount refundable** in respect of a grant related to **specific fixed asset** should be **recorded by** reducing the **deferred income balance**. To the extent the amount refundable exceeds any such deferred credit, the amount should be **charged to profit and loss statement.**

ANALYSIS: In this case the grant refunded is ₹ 15 lakhs and **balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18.** There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) ***REFERENCE:*** According to **AS 12 on Accounting for Government Grants**, the amount **refundable** in respect of a grant **related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by **increasing** the book value of the asset, by the amount refundable. Where the book value is increased, **depreciation on the revised book value should be provided prospectively** over the residual useful life of the asset.

ANALYSIS:

Date	Particulars	(₹ in lakhs)
1/4/2017	Book Value of Asset	56
	Add: Refund of grant	15
	Revise book value	71

Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

10. INTER RTP MAY 2019

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014-15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, 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. 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 2017-18 in profit and loss account?

SOLUTION

REFERENCE:

As per **AS 12, 'Accounting for Government Grants'**, "**the amount refundable** in respect of a grant related to **specific fixed asset** should be **recorded by** reducing the **deferred income balance**. To the extent the **amount refundable exceeds** any such **deferred credit,** the amount should be **charged to profit and loss statement.**

ANALYSIS:

In this case the grant refunded is ₹ 30 lakhs and **balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2017-18.** There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

11. INTER RTP MAY 20, INTER RTP NOV 20, ICAI ILLUSTRATION 5

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.

SOLUTION

(i) **REFERENCE:** As per **AS 12, Grants** related to revenue are presented as a credit in the profit and loss statement, either separately or under a general heading such as **'Other Income'**. Alternatively, they are deducted in reporting the related expense.

ANALYSIS: ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. **It should be presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.**

(ii) **REFERENCE:** As per **AS 12 'Accounting for Government Grants'**, where the government grants are in the **nature of promoters' contribution** i.e., 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, the **grants are treated as capital reserve** which can be **neither distributed as dividend nor considered as deferred income.**

ANALYSIS: In the given case, the **subsidy** received from the Central Government for setting up a unit in notified backward area is **neither in relation to specific fixed asset nor in relation to revenue.**

CONCLUSION: Amount of **₹ 100 lakhs** should be **credited to capital reserve.**

(iii) **REFERENCE:** As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

(a) The grant is shown as a **deduction from the gross value** of the asset concerned in arriving at its book value. The grant is thus **recognised** in the **profit and loss statement over the useful life** of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

(b) Grants **related to depreciable asset** are treated as deferred income which is **recognised** in the **profit and loss statement** on a **systematic** and rational **basis over** the **useful life** of the asset.

ANALYSIS: ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to specific fixed asset. ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

12. INTER QP MAY 18 / OCT 20 MOCK TEST/ MTP MARCH 2022

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 assets. 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?

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount **refundable** in respect of a grant **related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by **increasing** the book value of the asset, by the amount refundable. Where the book value is increased, **depreciation on the revised book value should be provided prospectively** over the residual useful life of the asset.

ANALYSIS:

Date	Particulars	(₹ in lakhs)
1st April, 2014	Acquisition cost of machinery (₹ 500 – ₹ 100)	400.00
31st March, 2015	Less: Depreciation @ 20%	(80)
1st April, 2015	Book value	320.00
31st March, 2016	Less: Depreciation @ 20%	(64)
1st April, 2016	Book value	256.00
31st March, 2017	Less: Depreciation @ 20%	(51.20)
1st April, 2017	Book value	204.80

2nd April, 2017	Add: Refund of grant	100.00
	Revised book value	**304.80**

Depreciation @ 20% on the revised book value amounting ₹ 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

13.ILLUSTRATION 8 (ICAI) , RTP MAY 2015

On 1.4.2014, ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of machinery costing Rs. 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 2017 due to non-fulfilment of certain conditions. How you would deal with the refund of grant in the books of ABC Ltd.?

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount **refundable** in respect of a grant **related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by **increasing** the book value of the asset, by the amount refundable. Where the book value is increased, **depreciation on the revised book value should be provided prospectively** over the residual useful life of the asset.

ANALYSIS:

Date	Particulars	Rs. in lakhs
1st April, 2014	Acquisition cost of machinery (Rs. 1,500 – Rs. 300)	1,200.00
31st March, 2015	Less: Depreciation @ 20%	(240.00)
31st March, 2016	Book value	960.00
31st March, 2017	Less: Depreciation @ 20%	(192.00)
1st April, 2017	Book value	768.00
May, 2017	Less: Depreciation @ 20%	(153.60)
	Book value	614.40
	Add: Refund of grant	300.00
	Revised book value	**914.40**

CONCLUSION:

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset.

14. RTP NOV 2014, RTP NOV 2017

S Ltd. received a grant of ₹ 5,000 lakhs during the last accounting year (2012-13) 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 2013-14, 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 correct accounting treatment, with reference to the provisions of AS 12.

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants',** Government grants sometimes become **refundable** because certain conditions are not fulfilled. A government grant that becomes refundable is **treated as an extraordinary item** as per AS 5.

The amount refundable in respect of a government grant related to revenue is **applied first against any unamortised deferred credit remaining in respect of the grant.** To the extent that the amount refundable exceeds any such deferred credit, or **where no deferred credit exists, the amount is charged immediately to profit and loss statement.**

ANALYSIS / CONCLUSION:

In the present case, the amount of **refund of government grant** should be **shown in the profit** and **loss account** of the company as an extraordinary item during the year 2013-14.

15. RTP NOV 2015

White Ltd. A fixed asset is purchased for ₹ 25 lakhs. Government grant received towards it is ₹ 10 lakhs. Residual Value is ₹ 5 lakhs and useful life is 5 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 6 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount refundable in respect of a **grant related to a specific fixed asset** should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the **book value is increased, depreciation on the revised book value** should be **provided prospectively over the residual useful life of the asset.**

Journal Entries

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account To Bank Account (Being fixed asset purchased)	Dr.	25	25
	Bank Account To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	Dr.	10	10
	Depreciation Account (W.N.1) To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))	Dr.	2	2
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	Dr.	2	2
2	Fixed Asset Account To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	Dr.	6	6

	Depreciation Account (W.N.2) Dr. To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)		3.5	3.5
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)		3.5	3.5

Working Notes:

1. **Depreciation for Year I**

Particulars	**₹ in lakhs**
Cost of the Asset	25
Less: Government grant received	(10)
	15
Depreciation [15-5]/5	2

2. **Depreciation for Year 2**

Particulars	**₹ in lakhs**
Cost of the Asset	25
Less: Government grant received	(10)
	15
Less: Depreciation for the first year [15-5]/5	2
	13
Add: Government grant refundable	6
	19
Depreciation for the second year [19-5]/4	3.5

16.RTP MAY 2017

P Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.03.2016. You are required to advise the company on the following item from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards:

The company purchased on 01.04.2015 special purpose machinery for ₹25 lakhs. It received a Central Government Grant for 20% of the price. The machine has an effective life of 10 years.

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants'**, two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

(a) The grant is shown as a **deduction from the gross value of the asset** concerned in arriving at its book value. The grant is thus **recognised in the profit and loss statement** over the **useful life** of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

(b) Grants related to depreciable asset are **treated as deferred income** which is **recognised in** the **profit and loss statement** on a **systematic** and rational **basis over** the **useful life** of the asset.

ANALYSIS:

Under the **first method,** the grant of ₹ 5,00,000 can be shown as a **deduction from the gross book value** of the machinery in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.

Under the **second method,** it can be treated as **deferred income** which should **be recognised in the profit and loss statement over the useful life** of 10 years in the proportions in which depreciation on machinery will be charged. The deferred income pending its apportionment to profit and loss account should be disclosed in the balance sheet with a suitable description e.g., 'Deferred government grants' to be shown after 'Reserves and Surplus' but before 'Secured Loans'.

The following should also 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 the financial statement of ₹ 5 lakhs is required to be credited to the profit and loss statement of the current year.

17.MOCK TEST OCT 21 SERIES 2

Caseworker Limited received a specific grant of ₹ 6 crore for acquiring the plant of ₹ 30 crore during financial year 2015-2016 having useful life of 10 years. During the financial year 2020-2021, due to non-compliance of conditions laid down for the grant of ₹ 6 crore, the company had to refund the grant to the Government. What should be the treatment of the refund if grant was deducted from the cost of the plant during financial year 2015-2016? Assume depreciation is charged on fixed assets as per Straight Line Method.

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount **refundable** in respect of a grant **related to a specific fixed asset** (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by **increasing** the book value of the asset, by the amount refundable. Where the book value is increased, **depreciation on the revised book value should be provided prospectively** over the residual useful life of the asset.

ANALYSIS:

Period	Particulars	(₹ in Crore)
2015-16	Acquisition cost of plant (30 – 6)	24
	Depreciation as per SLM for 5 Years [(24/10) X 5]	12
	Book Value	12
	Add: Refund of grant	6
	Revise book value	18

The increased cost of ₹ 18 crore of the plant should be amortised prospectively over remaining 5 years of useful residual life. Depreciation charge in the year 2020-2021 would be ₹ 18 crore / 5 years = ₹ 3.6 crore instead of earlier ₹ 2.4 crore.

18. MOCK TEST OCT 21 SERIES I

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.

You're 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.

SOLUTION:

REFERENCE:

As per **AS 12 "Accounting for government grants"**, grants related to depreciable assets, if treated as **deferred income** are **recognized in the profit and loss** statement on **a systematic** and rational basis over the **useful life of the asset.**

ANALYSIS:

Amount of depreciation to be recognized in the profit and loss account each year

	₹ in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70 lakhs / 4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017 to 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year:

40 lakhs / 4 years = **₹ 10 Lakhs** for the year ending 31st March, 2017 to 31st March, 2020.

19.RTP MAY 2022

A fixed asset is purchased for ₹ 30 lakhs. Government grant received towards it is ₹ 12 lakhs. Residual Value is ₹ 6 lakhs and useful life is 4 years. The company charges depreciation based on Straight-Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 7.5 lakhs due to non-compliance with certain conditions. You are required to give necessary journal entries for second year.

SOLUTION

REFERENCE:

According to **AS 12 on Accounting for Government Grants**, the amount refundable in respect of a **grant related to a specific fixed asset** should be recorded by increasing the book value of the asset or by reducing deferred income balance, as appropriate, by the amount refundable. Where the **book value is increased, depreciation on the revised book value** should be **provided prospectively over the residual useful life of the asset.**

Journal Entries

Year	Particulars	in lakhs (Dr.)	in lakhs (Cr.)
2nd	Fixed Asset Account Dr. To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	7.5	7.5
	Depreciation Account (W.N.) Dr. To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	5.5	5.5
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	5.5	5.5

Working Note:

Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	30
Less: Government grant received	(12)
	18
Less Depreciation for the first year (18-6)/4	3
	15
Add: Government grant refundable	7.5
	22.5
Depreciation for the second year (22.5-6)/3	**5.5**

20. MTP APRIL 2022

Ram Ltd. purchased machinery for ₹ 80 lakhs (useful life 4 years and residual value ₹ 8 lakhs). Government grant received was ₹ 32 lakhs. The grant had to be refunded at the beginning of third year. 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 the g rant had been credited to Deferred Grant A/c.

SOLUTION

REFERENCE:

As per **AS 12 'Accounting for Government Grants,'** income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged.

Accordingly, in the first two years (₹ 32 lakhs /4 years) = ₹ 8 lakhs x 2 years= ₹ 16 lakhs will be credited to Profit and Loss Account and ₹ 16 lakhs will be the balance of Deferred Grant Account after two years. Therefore, on refund of grant, following entry will be passed:

		₹ lakhs	₹ lakhs
Deferred Grant A/c	Dr.	16	
Profit & Loss A/c	Dr.	16	

To Bank A/c		32
(Being Government grant refunded)		

1. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books = ₹ 80 lakhs

Depreciation for each year = (₹ 80 lakhs – ₹8 lakhs)/4 years = **₹ 18 lakhs** per year

Book value of fixed assets after two years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = **₹ 44 lakhs**

2. **Value of Fixed Assets after refund of grant**

On refund of grant the **balance of deferred grant** account will become **nil**. The fixed assets will continue to be shown in the books at **₹ 44 lakhs.**

3. **Amount of depreciation for remaining two years**

Depreciation will continue to be charged at **₹ 18 lakhs** per annum for the remaining two years.

MCQs

1. To encourage industrial promotion, IDCI offers subsidy worth ₹ 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?
   a) Credit it to capital reserve
   b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations
   c) Both (a) and (b) are permitted
   d) Credit it to general reserve

2. 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, should be
   a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.
   b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.
   c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.
   d) disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item

3. Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?
   a) Credit the grant immediately to Income statement
   b) Show the grant as part of Capital Reserve
   c) Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liability side of the Balance Sheet.
   d) Show the grant as part of general Reserve

4. X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:
   a) ₹ 10 crore
   b) ₹ 6 crore
   c) ₹ 2 crore

d) ₹ 8 crore

5. X Ltd has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of other income to be to be recognised in Profit and Loss Statement will be:

a) ₹ 10 crore

b) ₹ 6 crore

c) ₹ 2 crore

d) ₹ 8 crore

Answers									
1.	(a)	2.	(c)	3.	(c)	4.	(b)	5.	(c)

AS 13 – ACCOUNTING FOR INVESTMENTS			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Carrying amount of investment		
	• Classification & Valuation	Q.5, Q.6, Q.1	Q.2, Q.9, Q.10, Q.4
	• Provision for diminution	Q.7	Q.14, Q.5, Q.13
2	Reclassification	Q.4, Q.2, Q.3, Q.18	Q.7, Q.1, Q.3, Q.12
3	Right Shares Issue	Q.14, Q.12, Q.11, Q.17	
4	Bonus Issue	Q.10, Q.9	
5	Disposal of Investment	Q.16, Q.15, Q.8	
6	Miscellaneous	Q.13	Q.11, Q.8, Q.6

AS 13 – ACCOUNTING FOR INVESTMENT

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 3						
2	ICAI ILLUSTRATION 4						
3	ICAI QUESTION 9						
4	INTER QP MAY 19						
5	QP DEC 21						
6	INTER RTP NOV 2018						
7	ICAI ILLUSTRATION 1						
8	ICAI ILLUSTRATION 5						
9	ICAI ILLUSTRATION 6						
10	ICAI ILLUSTRATION 7						
11	ICAI ILLUSTRATION 8						
12	ICAI ILLUSTRATION 9						
13	ICAI P.Q. 9						
14	ICAI P.Q. 10						
15	ICAI P.Q. 11						
16	ICAI P.Q. 12						
17	ICAI P.Q. 13						
18	ICAI P.Q. 14						

1. ICAI ILLUSTRATION 3

M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 20X3 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, 20X1. Market value as on 31st March, 20X4 of above investments are as follows:

Particulars	₹
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, 20X4 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

1. For **investment in shares** – The investment should be carried at **lower of cost and fair value,** i.e., in case of shares, at lower of cost (₹ 2,50,000) and market value (₹ 2,25,000) as on 31 March 20X4, i.e., **₹ 2,25,000.**

2. **Gold and silver** are generally purchased with an **intention to hold it for long term period** (more than one year) until and unless given otherwise. the investment in Gold and Silver (purchased on 1st March, 20X1) should continue to be **shown at cost** (since there is no 'other than temporary' diminution) as on 31st March, 20X4, i.e., **₹ 4,00,000 and ₹ 2,00,000 respectively,** though their market values have been increased.

CONCLUSION:

Total investment will be valued at ₹ 8,25,000 for the year ending on 31st March, 2017 as per AS 13.

Shares	₹ 2,25,000
Gold	₹ 4,00,000
Silver	₹ 2,00,000
Total Investment	**₹ 8,25,000**

2. ICAI ILLUSTRATION 4

ABC Ltd. wants to re-classify its investments in accordance with AS 13 (Revised). Decide and state on the amount of transfer, based on the following information:

1. A portion of current investments purchased for ₹ 20 lakhs, to be reclassified as long term investment, 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 reclassified 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 reclassified as current investments. The original cost of these was ₹ 18 lakhs but had been written down to ₹ 12 lakhs to recognise other than temporary decline as per AS 13 (Revised).

SOLUTION

REFERENCE:

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

1. **ANALYSIS:** The market value of the investment is ₹ 25 lakhs is higher than its cost i.e. ₹ 20 lakhs.

   CONCLUSION: The transfer to long term investments **should be carried at cost i.e. ₹ 20 lakhs.**

2. **ANALYSIS:** The market value of the investment is ₹ 6.5 lakhs is lower than its cost i.e. ₹ 15 lakhs.

   CONCLUSION: 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.

3. **ANALYSIS:** The book value of the investment is ₹ 12 lakhs is lower than its cost i.e. ₹ 18 lakhs.

   CONCLUSION: The transfer **should be at carrying amount** and hence this re-classified current investment **should be carried at ₹ 12 lakhs.**

3. ICAI QUESTION 9

Blue-chip Equity Investments Ltd., wants to re-classify 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 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 recognise 'other than temporary' 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.

SOLUTION:

REFERENCE:

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

(i) **ANALYSIS:** Carrying amount of investment on the date of transfer is less than the cost.

CONCLUSION: The re-classified current investment **should be carried at ₹ 6.5 lakhs** in the books.

(ii) **ANALYSIS:** The carrying / book value of the long term investment is same as cost i.e. ₹ 7 lakhs.

CONCLUSION: The long term investment will be reclassified as current investment **at book value of ₹ 7 lakhs only.**

(iii) **ANALYSIS:** The cost of current investment 10 Lakhs is less than its market value of ₹ 12 lakhs.

CONCLUSION: Reclassification of current investment into long-term investments will be **made at ₹ 10 lakhs**

4. INTER QP MAY 19

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 recognize '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 recognize '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

SOLUTION

REFERENCE:

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

(i) **ANALYSIS:** Carrying amount of investment on the date of transfer is less than the cost by 2 Lakhs

CONCLUSION: The re-classified current investment **should be carried at ₹ 12 lakhs** in the books.

(ii) **ANALYSIS:** Carrying amount of investment (5 Lakhs) on the date of transfer is less than the cost (7 Lakhs).

CONCLUSION: The re-classified current investment **should be carried at ₹ 5 lakhs** in the books.

(iii) **ANALYSIS:** Reclassification of current investment into long-term investments is to be made at lower of cost (₹ 7 lakhs) and its fair value (₹ 8.5 lakhs) on the date of transfer.

CONCLUSION: The re-classified long term investment **should be carried at ₹ 7 lakhs.**

(iv) **ANALYSIS:** Market value (considered as fair vale) is ₹ 3.8 lakhs on the date of transfer which is lower than the cost of ₹ 4 lakhs.

CONCLUSION: The reclassification of current investment into long-term **investments will be made at ₹ 3.8 lakhs.**

5. QP DEC 21

Mr. Mohan has invested some money in various Mutual Funds. Following Information in this regard is given:

Mutual Fund	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

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

Mutual Funds	Classification	Cost (₹)	Market value (₹)	Carrying value (₹)
A	Long-term Investment	50,220	48,225*	50,220
B	Current Investment	25,175	24,220	24,220
C	Current Investment	75,375	78,190	75,375
D	Current Investment	70,325	65,880	65,880
Total				**2,15,695**

Note: *The **reduction in value of Mutual fund A is considered to be temporary.** If reduction in Market value is assumed as other than temporary in nature, then the carrying value of ₹48,225 will be considered.

6. **INTER RTP NOV 2018**

Active Builders Ltd. invested in the shares of another company on 31st October, 2016 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, 2014. Market values as on 31st March, 2017 of the above investments 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 account of Active Builders Ltd. for the year ending 31st March, 2017 as per the provision of AS-13?

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

1. For **investment in shares** – The investment should be **carried at lower of cost and fair value,** i.e., in case of shares, at lower of cost (₹ 4,50,000) and market value (₹ 3,75,000) as on 31 March 2020, **i.e., ₹ 3,75,000.**

2. **Gold and silver** are generally purchased with an intention to hold it for long term period (more than one year) until and unless given otherwise. The investment in gold and silver (purchased on 31st March, 2014) shall **continue to be shown at cost** as on 31st March, 2017 **i.e.,₹ 5,00,000 and ₹ 2,25,000 respectively,** though their realizable values have been increased.

CONCLUSION:

Total investment will be **valued at ₹ 11,00,000** for the year ending on **31st March, 2017** as per AS 13.

Shares	₹ 3,75,000
Gold	₹ 5,00,000
Silver	₹ 2,25,000
Total Investment	**₹ 11,00,000**

7. ICAI ILLUSTRATION 1

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, 20X1 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 20X1?

SOLUTION

REFERENCE:

As per **AS 13 - Accounting for Investments,** Investments classified as long term investments **should be carried in the financial statements at cost.** However, **provision for diminution should be made to recognise a decline,** other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. It further states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

ANALYSIS:

As it is stated that financial statements for the year ended 31st March, 20X1 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. Also, the fall in value of investments has been considered on account of conditions existing on the balance sheet date.

CONCLUSION:

The **provision for diminution should be made to reduce the carrying amount** of long term investment to ₹ 20,000 in the financial statements for the year ended 31st March, 20X1.

8. ICAI ILLUSTRATION 5

In 20X1, M/s. Wye Ltd. issued 12% fully paid debentures of ₹ 100 each, interest being payable half yearly on 30th September and 31st March of every accounting year.

On 1st December, 20X2, M/s. Bull & Bear purchased 10,000 of these debentures at ₹ 101 ex-interest price, also paying brokerage @ 1% of ex-interest amount of the purchase. On 1st March, 20X3 the firm sold all these debentures at ₹ 103 ex-interest price, again paying brokerage @ 1 % of ex-interest amount. Prepare Investment Account in the books of M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3.

SOLUTION

In the books of M/s Bull & BearInvestment Account for the period from 1st December 20X2 to 1st March, 20X3(Scrip: 12% Debentures of M/s. Wye Ltd.)

Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)	Date	Particulars	Nominal Value (₹)	Interest	Cost (₹)
1.12.20X2	To Bank A/c (W.N.1)	10,00,000	20,000	10,20,100	1.03.20X3	By Bank A/c (W.N.2)	10,00,000	50,000	10,19,700
1.3.20X3	To Profit & loss A/c* (b.f.)	-	30,000		1.3.20X3	By Profit & loss A/c (b.f.)			400
		10,00,000	50,000	10,20,100			10,00,000	50,000	10,20,100

* This represents income for M/s. Bull & Bear for the period 1st December, 20X2 to 1st March, 20X3, i.e., interest for three months- 1st December, 20X2 to 28 February, 20X3).

Working Notes:

1.	Cost of 12% debentures purchased on 1.12.20X2		₹
	Cost Value (10,000 X ₹ 101)	=	10,10,000
	Add: Brokerage (1% of ₹ 10,10,000)	=	10,100

	Total	=	10,20,100
2.	Sale proceeds of 12% debentures sold		₹
	Sales Price (10,000 X ₹103)	=	10,30,000
	Less: Brokerage (1% of ₹10,30,000)	=	(10,300)
	Total	=	10,19,700

9. ICAI ILLUSTRATION 6

On 1.4.20X1, Mr. Krishna Murty purchased 1,000 equity shares of ₹ 100 each in TELCO Ltd. @ ₹ 120 each from a Broker, who charged 2% brokerage. He incurred 50 paise per ₹ 100 as cost of shares transfer stamps. On 31.1.20X2, Bonus was declared in the ratio of 1: 2. Before and after the record date of bonus shares, the shares were quoted at ₹ 175 per share and ₹ 90 per share respectively. On 31.3.20X2, Mr. Krishna Murty sold bonus shares to a Broker, who charged 2% brokerage.

Show the Investment Account in the books of Mr. Krishna Murty, who held the shares as Current assets and closing value of investments shall be made at Cost or Market value whichever is lower.

SOLUTION

In the books of Mr. Krishna Murty Investment Account for the year ended 31st March, 20X2

(Scrip: Equity Shares of TELCO Ltd.)

Date	Particulars	Nominal Value (₹)	Cost (₹)	Date	Particulars	Nominal Value (₹)	Cost (₹)
1.4.20X1	To Bank A/c (W.N.1)	1,00,000	1,23,000	31.3.20X2	By Bank A/c (W.N.2)	50,000	44,100
31.1.20X2	To Bonus shares (W.N.5)	50,000	-	31.3.20X2	By Balance c/d (W.N.4)	1,00,000	82,000
31.3.20X2	To Profit & loss A/c (W.N.3)	-	3,100				
		1,50,000	1,26,100			1,50,000	1,26,100

Working Notes:

1. Cost of equity shares purchased on 1.4.20X1 = (1,000 X₹ 120) + (2% of ₹1,20,000) + (½% of ₹1,20,000) = ₹1,23,000
2. Sale proceeds of equity shares (bonus) sold on 31st March, 20X2= (500 X₹ 90) – (2% of ₹45,000) = ₹44,100.
3. Profit on sale of bonus shares on 31st March, 20X2

   = Sale proceeds – Average costSale proceeds

   = ₹44,100

   Average cost = ₹(1,23,000 /1,50,000) x 50,000 = ₹41,000Profit

   = ₹44,100 – ₹41,000 = ₹3,100.
4. Valuation of equity shares on 31st March, 20X2

   Cost = (₹1,23,000/1,50,000) x 1,00,000 = ₹82,000

   Market Value = 1,000 shares × ₹90 = ₹90,000

   Closing balance has been valued at ₹ 82,000 being lower than the marketvalue.
5. Bonus shares do not have any cost.

10. ICAI ILLUSTRATION 7

Mr. X purchased 500 equity shares of ₹ 100 each in Omega Co. Ltd. for ₹ 62,500 inclusive of brokerage and stamp duty. Some years later the company resolved to capitalise its profits and to issue to the holders of equity shares, one equity bonus share for every share held by them. Prior to capitalisation, the shares of Omega Co. Ltd. were quoted at ₹ 175 per share. After the capitalisation, the shares were quoted at ₹ 92.50 per share. Mr. X. sold the bonus shares and received at ₹ 90 per share.

Prepare the Investment Account in X's books on average cost basis.

SOLUTION

In the books of X Investment Account
[Scrip: Equity shares in Omega Co. Ltd.]

Particulars	Nominal Value ₹	Cost ₹	Particulars	Nominal Value ₹	Cost ₹
To Cash	50,000	62,500	By Cash - Sale (500 x 90)	50,000	45,000
To Bonus shares (W.N.1)	50,000	-	By Balance c/d (W.N. 3)	50,000	31,250
To P & L A/c (W.N. 2)	-	13,750			
	1,00,000	76,250		1,00,000	76,250
To Balance b/d	50,000	31,250			

Working Notes:

1. Bonus shares do not have any cost.
2. Profit on sale of bonus shares = Sales proceeds – Average cost

Sales proceeds = ₹45,000

Average Cost = 500/1000 X 62,500 = ₹ 31,250

Profit = ₹ 45,000 - ₹ 31,250 = ₹ 13,750.

3. Valuation of Closing Balance of Shares at the end of yearThe total cost of 1,000 share including bonus is ₹62,500

Therefore, cost of 500 shares (carried forward) is 500/1000 X 62,500 = ₹ 31,250

Market price of 500 shares = 92.50 x 500 = ₹46,250

Cost being lower than the market price, therefore shares are carried forward atcost.

II. ICAI ILLUSTRATION 8

On 1st April, 20X1, Rajat has 50,000 equity shares of P Ltd. at a book value of ₹ 15 per share (nominal value ₹ 10 each). He provides you the further information:

(1) On 20th June, 20X1 he purchased another 10,000 shares of P Ltd. at ₹ 16 per share.

(2) On 1st August, 20X1, P Ltd. issued one equity bonus share for every six sharesheld by the shareholders.

(3) On 31st October, 20X1, the directors of P Ltd. announced a right issue which entitles the holders to subscribe three shares for every seven shares at ₹ 15 per share. Shareholders can transfer their rights in full or in part.

Rajat sold 1/3rd of entitlement to Umang for a consideration of ₹ 2 per share andsubscribed the rest on 5th November, 20X1.

You are required to prepare Investment A/c in the books of Rajat for the year ending 31st March, 20X2.

SOLUTION

In the books of Rajat Investment Account (Equity shares in P Ltd.)

Date	Particulars	No. of shares	Amount (₹)	Date	Particulars	No. of shares	Amount (₹)
1.4.X1	To Balance b/d	50,000	7,50,000	31.3.X2	By Balance c/d (Bal. fig.)	90,000	12,10,000
20.6.X1	To Bank A/c	10,000	1,60,000				
1.8.X1	To Bonus issue (W.N.1)	10,000	-				
5.11.X1	To Bank A/c (right shares) (W.N.4)	20,000	3,00,000				
		90,000	12,10,000			90,000	12,10,000

Working Note:

1. Bonus Shares = 50,000 + 10,000 /6 = 10,000 Shares
2. Right Shares = 50,000 + 10,000 + 10,000/ 7 X 3 = 30,000 Shares
3. Sale of rights = 30,000 Shares 1/3 X ₹2 = ₹ 20,000 to be credited to statement of profit and loss
4. Rights Subscribed = 30,000 Shares X 2/3 X ₹15 = ₹ 3,00,000

12. ICAI ILLUSTRATION 9

On 1.4.20X1, Sundar had 25,000 equity shares of 'X' Ltd. at a book value of ₹ 15 per share (Nominal value ₹ 10). On 20.6.20X1, he purchased another 5,000 shares of the company at ₹16 per share. The directors of 'X' Ltd. announced a bonus and rights issue.No dividend was payable on these issues. The terms of the issue are as follows:

Bonus basis 1:6 (Date 16.8.20X1).

Rights basis 3:7 (Date 31.8.20X1) Price ₹ 15 per share. Due date for payment 30.9.20X1. Shareholders were entitled to transfer their rights in full or in part. Accordingly, Sundar sold 33.33% of his entitlement to Sekhar for a consideration of ₹ 2 per share.

Dividends: Dividends for the year ended 31.3.20X1 at the rate of 20% were declared by X Ltd. and received by Sundar on 31.10.20X1. Dividends for shares acquired by him on 20.6.20X1 are to be adjusted against the cost of purchase.

On 15.11.20X1, Sundar sold 25,000 equity shares at a premium of ₹ 5 per share. You are required to prepare in the books of Sundar.

(1) Investment Account

(2) Profit & Loss Account.

For your exercise, assume that the books are closed on 31.12.20X1 and shares are valued at average cost.

SOLUTION

Books of Sundar

Investment Account

(Scrip: Equity Shares in X Ltd.)

		No.	Amount ₹			No.	Amount ₹
1.4.20X1 20.6.20X1	To Bal b/d To Bank	25,000 5,000	3,75,000 80,000	31.10.20X1	By Bank (dividend	—	10,000
16.8.20X1 30.9.20X1	To Bonus (W.N.1) To Bank (Rights Shares) (W.N.3)	5,000 10,000	— 1,50,000		on shares acquired on 20/6/20X1) (W.N.4)		
15.11.20X1	To Profit (on sale of shares)		44,444	15.11.20X1	By Bank (Sale of shares)	25,000	3,75,000

				31.12.20X1	By Bal. c/d (W.N.6)	20,000	2,64,444
		45,000	6,49,444			45,000	6,49,444

Profit and Loss Account (An extract)

To Balance c/d	1,04,444	By Profit transferred	44,444
		By Sale of rights (W.N.3)	10,000
		By Dividend (W.N.4)	50,000
	1,04,444		1,04,444

Working Notes:

1. **Bonus Shares =** (25,000 + 5000) / 6 = 5,000 Shares
2. **Right Shares =** (25,000 + 5,000 + 5,000) / 7 X 3 = 15,000 Shares
3. **Right shares renounced** = 15,000×1/3 = 5,000 shares Sale of right shares = 5,000 x 2 = ₹10,000

   Right shares subscribed = 15,000 – 5,000 = 10,000 shares

   Amount paid for subscription of right shares = 10,000 x 15 = ₹1,50,000
4. **Dividend received** = 25,000 (shares as on 1st April 20X1) × 10 × 20% = ₹50,000

   Dividend on shares purchased on 20.6.20X1 = 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c
5. **Profit on sale of 25,000 shares**

   = Sales Proceeds – Average Cost

   Sales Proceeds = ₹ 3,75,000

   Average Cost = (3,75,000 + 80,000 + 1,50,000 – 10,000) / 45,000 X 25,000 = ₹3,30,556

   Profit = ₹3,75,000 - ₹3,30,556 = ₹ 44,444
6. **Cost of shares on 31.12.20X1**

   (3,75,000 + 80,000 + 1,50,000 – 10,000) / 45,000 X 20,000 = ₹2,64,444

Reference: The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments".

13. ICAI P.Q.9

Mr. X acquires 200 shares of a company on cum-right basis for ₹ 70,000. He subsequently receives an offer of right to acquire fresh shares in the company in the proportion of 1:1 at ₹ 107 each. He does not subscribe but sells all the rights for ₹ 12,000. The market value of the shares after their becoming ex- rights has also gone down to ₹ 60,000. What should be the accounting treatment in this case?

SOLUTION

As per **AS 13,** where the investments are acquired on **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 rights to **reduce the carrying amount** of such investments to the market value. In this case, the amount of the ex-right market value of 200 shares bought by X immediately after the declaration of rights falls to ₹ 60,000. In this case, out of sale proceeds of ₹ 12,000, ₹ 10,000 may be applied to reduce the carrying amount to bring it to the market value and ₹ 2,000 would be **credited to the profit and loss account.**

14. ICAI P.Q.10

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book valueof ₹ 15 per share (nominal value ₹ 10 per share). On 1st June, 20X1, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹ 1,00,000. ABC Ltd. announced a bonus and right issue.

a. Bonus was declared, at the rate of one equity share for every five shares held, on 1st July 20X1.
b. Right shares are to be issued to the existing shareholders on 1st September 20X1. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.
c. Dividend for the year ended 31.3.20X1 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 20X1.

XY Ltd.

(i) Took up half the right issue.

(ii) Sold the remaining rights for ₹ 8 per share.

(iii) Sold half of its shareholdings on 1st January 20X2 at ₹ 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the yearended 31st March 20X2 assuming the shares are being valued at average cost.

SOLUTION

In the books of XY Ltd.

Investment in equity shares of ABC Ltd. for the year ended 31st March, 20X2

Date	Particulars	No.	Dividend ₹	Amount ₹	Date	Particulars	No.	Dividend ₹	Amount ₹
20X1 April 1	To Balance b/d To Bank A/c To Bonus Issue (W.N. 1)	15,000	-	2,25,000	20X1 Oct. 31	By Bank A/c (W.N. 5)	-	30,000	10,000
June 1		5,000	--	1,00,000	20X2 Jan. 1	By Bank A/c (W.N.4)	13,000	-	2,12,355
July 1		4,000	-	-	March 31	By Balance c/d (W.N. 6)	13,000	-	1,69,500
Sept.1	To Bank A/c (W.N. 2)	2,000	-	24,000					
20X2 Jan 1	To P & L A/c (W.N. 4)	-	-	42,855					
"20X2 March 31	To P & L A/c	-	30,000	-					
		26,000	30,000	3,91,855			26,000	30,000	3,91,855

Working Notes:

1. **Calculation of no. of bonus shares issued**

Bonus Shares = (15,000 shares+5,000 shares / 5) x 1= 4,000 shares

2. **Calculation of right shares subscribed**

Right Shares = (15,000 shares+5,000 shares+ 4,000 shares / 6) = 4,000 shares

Shares subscribed by XY Ltd. = (4,000 / 2) = 2,000 shares

Value of right shares subscribed = 2,000 shares @ ₹ 12 per share = ₹ 24,000

3. **Calculation of sale of right entitlement**

2,000 shares x ₹ 8 per share = ₹ 16,000

Amount received from sale of rights will be credited to statement of profit and loss.

4. **Calculation of profit on sale of shares**

Total holding = 15,000 shares original

5,000 shares purchased
4,000 shares bonus
2,000 shares right shares
26,000 shares

50% of the holdings were sold
i.e. 13,000 shares (26,000 x1/2) were sold.
Cost of total holdings of 26,000 shares (on average basis)
= ₹ 2,25,000 + ₹ 1,00,000 + ₹ 24,000– ₹ 10,000 = ₹ 3,39,000
Average cost of 13,000 shares would be
= (3,39,000 / 26,000) ×13,000 = ₹ 1,69,500

5. Dividend received on investment held as on 1st April, 20X1

= 15,000 shares x ₹ 10 x 20%

= ₹ 30,000 will be transferred to Profit and Loss A/c Dividend received on shares purchased on 1st June, 20X1

= 5,000 shares x ₹ 10 x 20% = ₹10,000 will be adjusted to Investment A/c

Note: It is presumed that no dividend is received on bonus shares as bonus shares are declared on 1st July, 20X1 and dividend pertains to the year ended 31.3.20X1.

6. Calculation of closing value of shares (on average basis) as on 31st March, 20X2

13,000 × (3,39,000 / 26,000) = ₹ 1,69,500

15. ICAI P.Q.11

The following information is presented by Mr. Z (a stock broker), relating to hisholding in 9% Central Government Bonds.

Opening balance (nominal value) ₹ 1,20,000, Cost ₹ 1,18,000 (Nominal value ofeach unit is ₹ 100).

1.3.20X1	Purchased 200 units, ex-interest at ₹ 98.
1.7.20X1	Sold 500 units, ex-interest out of original holding at ₹ 100.
1.10.20X1	Purchased 150 units at ₹ 98, cum interest.
1.11.20X1	Sold 300 units, ex-interest at ₹ 99 out of original holdings.

Interest dates are 30th September and 31st March. Mr. Z closes his books every 31st December. Show the investment account as it would appear in his books. Mr. Z follows FIFO method.

SOLUTION

In the Books of Mr. Z

9% Central Government Bonds (Investment) Account

Particulars		Nominal Value	Interest	Principal	Particulars		Nominal Value	Interest	Principal
20X1		₹	₹	₹	20X1		₹	₹	₹
Jan.1	To Balance b/d	1,20,000	2,700	1,18,000	Mar. 31	By Bank A/c (W.N.3)	-	6,300	-
	(W.N.1)								
March	To Bank A/c				July 1	By Bank A/c			
1	(W.N.2)	20,000	750	19,600		(W.N.4)	50,000	1,125	50,000
July 1	To P&L A/c (W.N.5)	-	-	833	Sept. 30	By Bank A/c (W.N.6)	-	4,050	-
Oct. 1	To Bank A/c (150 x 98)	15,000	-	14,700	Nov. 1	By Bank A/c (W.N.7)	30,000	225	29,700
Nov. 1	To P&L A/c (W.N.8)	-	-	200	Dec. 31	By Balance c/d (W.N. 9	75,000	1,688	73,633
						& W.N.10)			
Dec.	To P&L A/c								
31	(b.f.) (Transfer)		9,938						
		1,55,000	13,388	1,53,333			1,55,000	13,388	1,53,333

Working Note:

1. Interest element in opening balance of bonds = 1,20,000 x 9% x 3/12 = ₹ 2,700

2. Purchase of bonds on 1. 3.20X1

Interest element in purchase of bonds = 200 x 100 x 9% x 5/12 = ₹ 750

Investment element in purchase of bonds = 200 x 98 = ₹ 19,600

3. Interest for half-year ended 31 March = 1,400 x 100 x 9% x 6/12 = ₹ 6,300

4. Sale of bonds on 1.7.20X1

Interest element = 500 x 100 x 9% x 3/12 = ₹ 1,125

Investment element = 500 x 100 = ₹ 50,000

5. Profit on sale of bonds on 1.7.20X1

Cost of bonds = (1,18,000/ 1,200) x 500 = ₹ 49,167

Sale proceeds = ₹ 50,000

Profit element = ₹ 833

6. Interest for half-year ended 30 September

= 900 x 100 x 9% x 6/12 = ₹ 4,050

7. Sale of bonds on 1.11.20X1

Interest element = 300 x 100 x 9% x 1/12 = ₹ 225

Investment element = 300 x 99 = ₹ 29,700

8. Profit on sale of bonds on 1.11.20X1

Cost of bonds = (1,18,000/ 1,200) x 300 = ₹ 29,500

Sale proceeds = ₹ 29,700

Profit element = ₹ 200

9. Closing value of investment

Calculation of closing balance:	**Nominal value**		**₹**
Bonds in hand remained in hand at 31st December 20X1			
From original holding (1,20,000 – 50,000 – 30,000) =	40,000	(1,18,000 / 1,20,000)4,000	39,333
Purchased on 1st March	20,000		19,600
Purchased on 1st October	15,000		14,700
	75,000		73,633

10. Interest element in closing balance of bonds = 750 x 100 x 9% x 3/12 = ₹ 1,688

16. ICAI P.Q.12

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹ 100 each) of P Ltd., held as Current assets:

1.4.20X1	Opening balance – Nominal value ₹ 1,20,000, Cost ₹ 1,18,000
1.7.20X1	100 Debentures purchased ex-interest at ₹ 98
1.10.20X1	Sold 200 Debentures ex-interest at ₹ 100
1.1.20X2	Purchased 50 Debentures at ₹ 98 ex-interest
1.2.20X2	Sold 200 Debentures ex-interest at ₹99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.20X2. Brokerage at 1% is to be paid for each transaction (at ex-interest price). Show Investment account as it would appear in his books. Assume FIFO method.

Market value of 8% Debentures of P Limited on 31.3.20X2 is ₹ 99.

SOLUTION

Investment A/c of Mr. Purohit
for the year ending on 31-3-20X2
(Scrip: 8% Debentures of P Limited)
(Interest Payable on 30th September and 31st March)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
			₹	₹				₹	₹
1.4.20X1	To Balance b/d	1,20,000	-	1,18,000	30.9.20X1	By Bank (1,300 x 100 x 8% x 6/12)	-	5,200	-
1.7.20X1	To Bank (ex-Interest) (W.N.1)	10,000	200	9,898	1.10.20X1	By Bank (W.N.4)	20,000	-	19,800
1.10.20X1	To Profit & Loss A/c (W.N.4)			133	1.2.20X2	By Bank (ex-Interest) (W.N.5)	20,000	533	19,602
1.1.20X2	To Bank (ex-Interest) (W.N.2)	5,000	100	4,949	1.2.20X2	By Profit & Loss A/c (W.N.5)			64
31.3.20X2	To Profit & Loss A/c (Bal. fig.)	-	9,233		31.3.20X2	By Bank (950 x 100x 8% x 6/12)	-	3,800	-
					31.3.20X2	By Balance c/d (W.N.3)	95,000	-	93,514
		1,35,000	9,533	1,32,980			1,35,000	9,533	1,32,980

Working Notes:

1. **Purchase of debentures on 1.7.20X1**

Interest element = 100 x 100 x 8% x 3/12 = ₹ 200

Investment element = (100 x 98) + [1% (100 x 98)] = ₹ 9,898

2. **Purchase of debentures on 1.1.20X2**

Interest element = 50 x 100 x 8% x 3/12 = ₹ 100

Investment element = {(50 x 98) + [1%(50 x 98)]} = ₹ 4,949

3. **Valuation of closing balance as on 31.3.20X2:**

Market value of 950 Debentures at ₹ 99 = ₹ 94,050

Cost of

800 Debentures cost = (1,18,000 / 1,20,000) x 80,000 = 78,667

100 Debentures cost = 9,898

50 Debentures cost = 4,949

93,514

Value at the end = ₹ 93,514, i.e., whichever is less

4.Profit on sale of debentures as on 1.10.20X1

	₹
Sales price of debentures (200 x ₹100)	20,000
Less: Brokerage @ 1%	(200)
	19,800
Less: Cost of Debentures (1,18,000 / 1,20,000) x 20,000 =	(19,667)
Profit on sale	133

5. Loss on sale of debentures as on 1.2.20X2

	₹
Sales price of debentures (200 x ₹99)	19,800
Less: Brokerage @ 1%	(198)
	19,602
Less: Cost of Debentures (1,18,000 / 1,20,000) x 20,000 =	(19,666)
Loss on sale	64
Interest element in sale of investment = 200 x 100 x 8% x 4/12	₹ 533

17. ICAI P.Q.13

On 1st April, 20X1, Mr. Vijay had 30,000 Equity shares in X Ltd. at a bookvalue of ₹ 4,50,000 (Face Value ₹ 10 per share). On 22nd June, 20X1, he purchased another 5000 shares of the same company for ₹ 80,000.

The Directors of X Ltd. announced a bonus of equity shares in the ratio of one share for seven shares held on 10th August, 20X1.

On 31st August, 20X1 the Company made a right issue in the ratio of three shares for every eight shares held, on payment of ₹ 15 per share. Due date for the payment was 30th September, 20X1, Mr. Vijay subscribed to 2/3rd of the right shares and sold the remaining of his entitlement to Viru for a consideration of ₹ 2 per share.

On 31st October, 20X1, Vijay received dividends from X Ltd. @ 20% for theyear ended 31st March, 20X1. Dividend for the shares acquired by him on 22nd June, 20X1 to be adjusted against the cost of purchase.

On 15th November, 20X1 Vijay sold 20,000 Equity shares at a premium of ₹ 5 per share.
You are required to prepare Investment Account in the books of Mr. Vijay forthe year ended 31st March, 20X2 assuming the shares are being valued at average cost.

SOLUTION

Investment Account in Books of Vijay
(Scrip: Equity Shares in X Ltd.)

		No.	Amount			No.	Amount
			₹				₹
1.4.20X1 22.6.20X1	To Bal b/dTo Bank	30,000 5,000	4,50,000 80,000	31.10.20X1	By Bank(dividend on sharesacquired on 22.6.20X1)	—	10,000
10.8.20X1	To Bonus	5,000	–				
30.9.20X1	To Bank(Rights Shares)	10,000	1,50,000				
15.11.20X1	To P&L A/c(Profit on sale of shares)		32,000	15.11.20X1	By Bank (Sale of shares)	20,000	3,00,000
				31.3.20X2	By Bal. c/d	30,000	4,02,000
		50,000	7,12,000			50,000	7,12,000

Working Notes:

(1) **Bonus Shares** = (30,000 + 5,000) / 7 = 5,000 shares

(2) **Right Shares** = [(30, 000 +5, 000 + 5, 000) / 8] x 3 = 15,000 shares

(3) **Rights shares sold** = 15,000×1/3 = 5,000 shares

(4) **Dividend received** = 30,000×10×20% = ₹ 60,000 will be taken to P&L statement

(5) **Dividend on shares purchased on 22.6.20X1** = 5,000×10×20% = ₹ 10,000 is adjusted to Investment A/c

(6) **Profit on sale of 20,000 shares**

= Sales proceeds – Average cost

Sales proceeds = ₹ 3,00,000

Average cost = [(4, 50, 000 + 80, 000 + 1, 50, 000 - 10, 000)/ 50, 000] × 20, 000 = ₹ 2,68,000

Profit = ₹ 3,00,000– ₹ 2,68,000= ₹ 32,000.

(7) **Cost of shares on 31.3.20X2**

[(4, 50, 000 + 80, 000 + 1, 50, 000 - 10, 000)/ 50, 000]× 30, 000 = ₹ 4,02,000

(8) Sale of rights amounting ₹ 10,000 (₹ 2 x 5,000 shares) will not be shown in investment A/c but will directly be taken to P & L statement.

18. ICAI P.Q.14

Blue-chip Equity Investments Ltd., wants to re-classify its investments in accordance with AS 13 (Revised). State the values, at which the investmentshave 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 recognise 'other than temporary' 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.

SOLUTION

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

I. **ANALYSIS:** Carrying amount of Investment on the date of transfer is less than the cost
CONCLUSION: Hence reclassified Current Investment should be carried at **6.5 Lakhs** in the books.

II. **ANALYSIS:** The carrying value of the long term investment is same as cost
CONCLUSION: Long term investment reclassified as Current investment should be carried at book value of **Rs. 7 lakhs**

III. **ANALYSIS:** Cost of current investment is less than its market value
CONCLUSION: Reclassification of Current investment into Long term investment should be carried at **Rs. 10 Lakhs**

AS 13 – ACCOUNTING FOR INVESTMENT

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	INTER QP JAN 21						
2	IPCC QP NOV 20, INTER QP NOV 20						
3	IPCC MAY 19						
4	ICAI ILLUSTRATION 2/ INTER RTP NOV 20 / IPCC RTP NOV 20/ RTP MAY 2015						
5	INTER RTP MAY 2018 / INTER RTP MAY 2019 / IPCC RTP MAY 2019						
6	INTER RTP MAY 2017 / INTER RTP NOV 2019 / IPCC RTP NOV 2019						
7	INTER RTP MAY 20 / IPCC RTP MAY 20						
8	IPCC OCT 20 MOCK TEST						
9	RTP NOV 2014						
10	RTP NOV 2015						
11	RTP NOV 16, RTP NOV 17						
12	RTP Nov 16, RTP Nov 17						
13	MTP OCT 21 SERIES I						
14	RTP MAY 22						

1. INTER QP JAN 21

Kunal Securities Ltd. Wants to reclassify its investment 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 be re-classified as long term investment. The market value on the date of reclassification is ₹ 16.5 lakhs.

SOLUTION

<u>REFERENCE:</u>

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

(i) <u>ANALYSIS:</u> The market value of investment on the date of transfer is ₹ 9.3 Lakhs which is less than the cost i.e., 14 Lakhs

<u>CONCLUSION:</u> The re-classified current investment should be carried at ₹ 14 lakhs in the books.

(ii) <u>ANALYSIS:</u> The fair value of investment on the date of transfer is ₹ 16 Lakhs which is more than the cost i.e., 9 Lakhs

<u>CONCLUSION:</u> Long-term investment will be reclassified as current investment at **book value of ₹ 14 lakhs.**

(iii) **ANALYSIS:** The market value of investment on the date of transfer is ₹ 13.5 Lakhs which is more than the cost i.e., 12 Lakhs

CONCLUSION: Reclassification of current investment into long-term **investments will be made at ₹ 12 lakhs.**

(iv) **ANALYSIS:** Market value of the investment is ₹ 16.5 lakhs, which is lower than its cost i.e., ₹ 18 lakhs.

CONCLUSION: The transfer to long term investments should be done in the books **at the market value i.e., ₹ 16.5 lakhs.**

2. IPCC QP NOV 20, INTER QP NOV 20

M/s. Gowtham Ltd. Invested in shares of another company (with the intention to hold the shares for short term period) on 30th Nov 19 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 17.

Market values as on 31st March 20 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 Ltd. For the year ending 31st March 20 as per the provisions of AS 13.

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

1. For **investment in shares -** if the investment is purchased with an intention to hold for short-term period (less than one year), then it will be classified as current investment and to be carried at **lower of cost and fair value,** i.e., in case of shares, at lower of cost (₹ 4,25,000) and market value (₹ 3,50,000) as on 31 March 2020, i.e., **₹ 3,50,000.**
2. **Gold and silver** are generally purchased with an **intention to hold it for long term period** (more than one year) until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 31st March, 2017) should **continue to be shown at cost** (since there is no 'other than temporary' diminution) as on 31st March, 2020, **i.e., ₹ 8,00,000 and ₹3,50,000 respectively,** though their market values have been increased.

CONCLUSION:

Total investment will be valued at ₹ 15,00,000 for the year ending on 31st March, 2020 as per AS 13.

Shares	₹ 3,50,000
Gold	₹ 8,00,000
Silver	₹ 3,50,000
Total Investment	**₹ 15,00,000**

3. IPCC MAY 19

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.

SOLUTION

REFERENCE:

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

(i) ANALYSIS: The market value of the investments is ₹ 30 lakhs , which is higher than its cost i.e., ₹ 25 lakhs.

CONCLUSION: The transfer to long term investments **should be made at cost i.e., ₹ 25 lakhs**

(ii) ANALYSIS: The market value of the investment is ₹ 12.5 lakhs , which is lower than its cost i.e. ₹ 20 lakhs.

CONCLUSION: The transfer to long term investments **should be made in the books at the market value i.e., ₹ 12.5 lakhs.** The loss of ₹ 7.50 lakhs (20-12.5) should be charged to Profit and Loss account.

(iii) ANALYSIS: The book value of the investments is ₹ 11 lakhs, which is lower than its cost, i.e. ₹ 15 lakhs. The transfer should be at carrying amount.

CONCLUSION: The re-classified current investment **should be carried at ₹ 11 lakhs.**

4. ICAI ILLUSTRATION 2/ INTER RTP NOV 20 / IPCC RTP NOV 20/ RTP MAY 2015

X Ltd. on 1-1-20X1 had made an investment of ₹ 600 lakhs in the equity shares of Y Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realisable value of all such investment on 31-3-20X1 became ₹ 200 lakhs as Y Ltd. lost a case of copyright. From the given market conditions, it is apparent that the reduction in the value is not temporary in nature. How will you recognise the reduction in financial statements for the year ended on 31 -3-20X1?

SOLUTION

FACTS:

X Ltd. invested ₹ 600 lakhs in the equity shares of Y Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. ₹ 300 lakhs and remaining as temporary (current) investment i.e. ₹ 300 lakhs.

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be **held for not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

In the given situation, the realisable value of all such investments on 31.3.20X1 became ₹ 200 lakhs i.e. ₹ 100 lakhs in respect of current investment and ₹ 100 lakhs in respect of long term investment.

1. The carrying value of investment held as temporary investment **should be shown at realisable value** i.e., at ₹ 100 lakhs.
2. Y Ltd. lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run.
3. It will be appropriate to **reduce the carrying amount** of long term investment by ₹ 200 lakhs and show the investments at ₹ 100 lakhs, since the downfall in the value of shares **is other than temporary.**

CONCLUSION:

The reduction of ₹ 200 lakhs in the carrying value of current investment followed by reduction of ₹ 200 lakhs in the carrying value of long term investment will be **charged to the profit and loss account.**

5. INTER RTP MAY 2018 / INTER RTP MAY 2019 / IPCC RTP MAY 2019

How you will deal with the following in the financial statements of the Paridhi Electronics Ltd. as on 31.3.17 with reference to AS-13?

Paridhi Electronics Ltd. invested in the shares of another unlised 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 January, 2017 reveals that the company has incurred cash losses with decline in market share and investment of Paridhi Electronics Ltd. may not fetch more than ₹ 45,000.

SOLUTION

REFERENCE:

As per **AS 13, "Accounting for Investments"** Investments classified as **long term investments should be carried in the financial statements at cost.** However, **provision for diminution shall be made to recognise a decline, other than temporary,** in the value of the investments, such reduction being determined and made for each investment individually. The standard also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

ANALYSIS & CONCLUSION:

On this basis, the facts of the case given in the question clearly suggest that the **provision for diminution should be made** to reduce the carrying amount of shares to **₹ 45,000** in the financial statements for the year ended 31st March, 2017 and **charge the difference of loss** of ₹ 2,55,000 to **profit and loss account.**

6. INTER RTP MAY 2017 / INTER RTP NOV 2019 / IPCC RTP NOV 2019

Z Bank has classified its total investment on 31-3-2016 into three categories (a) held to maturity (b) available for sale (c) held for trading as per the RBI Guidelines.

'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. 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?

SOLUTION

REFERENCE:

As per **AS 13 'Accounting for Investments'**, the **accounting standard is not applicable to Bank, Insurance Company, Mutual Funds.** For banks, the RBI has issued guidelines for classification and valuation of its investment.

ANALYSIS / CONCLUSION:

In this case, **Z Bank is a bank,** therefore, **AS 13 does not apply** to it. Z Bank **should comply with those RBI Guidelines/Norms.** Therefore, though Z 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.

7. INTER RTP MAY 20 / IPCC RTP MAY 20

Omega 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) 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.

(iii) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these investments was ₹ 18 lakhs but had been written down to ₹ 12 lakhs to recognize permanent decline as per AS 13.

SOLUTION

REFERENCE:

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

(i) **ANALYSIS:** Carrying amount (6.5 Lakh) of investment on the date of transfer is less than the cost (8.5Lakh)

CONCLUSION: The re-classified current investment **should be carried at ₹ 6.5 lakhs** in the books.

(ii) **ANALYSIS:** Cost ₹ 10 lakhs is less than the market value of investment of ₹ 12 lakhs.

CONCLUSION: Reclassification of current investment into long-term **investments will be made at ₹ 10 lakhs.**

(iii) **ANALYSIS:** The book value of the investment is ₹ 12 lakhs, which is lower than its cost i.e. ₹ 18 lakhs.

CONCLUSION: The transfer should be at carrying amount and hence this re-classified current investment **should be carried at ₹ 12 lakhs.**

8. IPCC OCT 20 MOCK TEST

Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13. If not, what should have been the accounting treatment in such a situation? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any. Explain in brief.

SOLUTION

The accounting treatment 'at cost' under the head 'Long Term Investment' in the financial statements of the company without providing for any diminution in value is **correct** and is in accordance with the provisions of AS 13 **provided that there is no decline, other than temporary, in the value of investment. If the decline** in the value of investment is, other than temporary, compared to the time when the shares were purchased, **provision is required to be made.** The reduction in market value **should not be considered, in isolation** to determine the decline, other than temporary. The amount of the provision for diminution in the value of investment **may be ascertained considering the factors** indicated in AS 13.

9. RTP NOV 2014

Albert Ltd. has made the following investments:

(i) Purchased the following equity shares from stock exchange on 1st June, 2013:

Particulars	Cost
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

(ii) Purchased government securities at a cost of ₹ 5,00,000 on 1st April, 2013.

How will you treat these investments as per applicable AS in the books of the company for the year ended on 31st March, 2014, if the values of these investments are as follows:

Shares	₹	₹
Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	70,000	3,00,000
Government securities		7,00,000

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

If the investment in shares is intended to be held as current investment, then scrip

Particulars	Cost	Market Value as on 31.03.2014	Carrying Value
Scrip X	1,80,000	1,90,000	1,80,000
Scrip Y	50,000	40,000	40,000
Scrip Z	1,70,000	70,000	70,000
Total	4,00,000	3,00,000	2,90,000

Assuming Government securities have been purchased for long term, they should be valued at cost.

CONCLUSION:

(i) The total loss of ₹ 1,10,000 (₹ 4,00,000 – ₹ 2,90,000) on **scrip's** purchased on 1st June, 2013 is to be **charged to profit and loss account** for the year ended 31st March, 2014.

(ii) Value **of government securities** (purchased on 1st April, 2013) is to be **shown at cost of ₹ 5,00,000** in the balance sheet as on 31.3.2014.

10. RTP NOV 2015

M/s. Naren Garments Company Limited invested in the shares of another company on 1st November, 2014 at a cost of ₹ 3,00,000. It also earlier purchased Gold of ₹ 3,50,000 and Silver of ₹1,50,000 on 1st April, 2014. Market value as on 31st March, 2015 of the above investments is as follows:

Particulars	₹
Shares	2,50,000
Gold	5,00,000
Silver	2,80,000

How the above investments will be shown in the books of accounts of M/s Naren Garments Company Limited for the year ending 31st March, 2015 as per the provisions of AS-13 Accounting for Investments?

SOLUTION

REFERENCE:

The investments are **classified into two categories** as per **AS 13**, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be held for **not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.

ANALYSIS:

1. For **investment in shares** - if the investment is purchased with an **intention to hold for short-term period** (less than one year), then it will be classified as current investment and to be carried at **lower of cost and fair value,** i.e., in case of shares, at lower of cost (₹ 3,00,000) and realizable value (₹ 2,50,000) as on 31 March 2015, i.e., **₹ 2,50,000.**

2. **Gold and silver** are generally purchased with an **intention to hold it for long term period** (more than one year) until and unless given otherwise. Hence, the investment in Gold and silver (purchases on 1st April 2014 shall continue to be **shown at cost** as on 31st March 2015 **i.e. ₹ 3,50,000 and ₹1,50,000** respectively, though their realizable values have been increased. **If held as short term** then it should be **valued at lower of cost or fair value** (Market price)

CONCLUSION:

Total investment will be **valued at ₹ 15,00,000** for the year ending on **31st March, 2020** as per AS 13.

Shares	₹ 2,50,000
Gold	₹ 3,50,000
Silver	₹ 1,50,000
Total Investment	**₹ 7,50,000**

11. RTP NOV 2016, RTP NOV 2017

Give your comments on the following situations, each being independent of the other.

1. Current Investments are valued at ₹60 Lakhs, being the cost of acquisition, fair value of these investments on the Balance Sheet date is ₹ 48 Lakhs.
2. Current investments were acquired at a cost of ₹ 86 lakhs whereas their fair market value as on the Balance Sheet Date was ₹ 90 lakhs. Due to insufficiency of profits from operations, the Company would like to recognize the profit on these investments for 'improving' its Financial Statements.

SOLUTION

REFERENCE:

As per AS 13 Accounting for Investments, current investments should be **carried at cost or fair value, whichever is lower.**

1. **ANALYSIS / CONCLUSION:** The current Investment **should be carried at fair value** of ₹ 48 Lakhs, being the lower of ₹ 60 Lakhs (cost) or ₹ 48 Lakhs (fair value). The **difference** of ₹ 12 Lakhs should be **charged to profit and loss account.**
2. **ANALYSIS:** In the given case, the current investments **should be carried at cost** of ₹ 86 Lakhs, being the lower of ₹ 86 Lakhs (cost) or ₹ 90 Lakhs (fair value).

   CONCLUSION: The **contention of company** to recognize the profit on these investments for 'improving' its Financial Statements is **incorrect.**

12. RTP Nov 2016, RTP Nov 2017

Paridhi Electronics Ltd. has current investment (X Ltd.'s shares) purchased for ₹ 5 lakhs, which the company want to reclassify as long term investment on 31.3.2018. The market value of these investments as on date of Balance Sheet was ₹ 2.5 lakhs. How will you deal with this as on 31.3.18 with reference to AS-13?

SOLUTION

REFERENCE:

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

ANALYSIS:

In the given case, the market value of the investment (X Ltd. shares) is ₹ 2.50 lakhs, which is lower than its cost i.e., ₹ 5 lakhs.

CONCLUSION:

The **transfer** to long term investments should be made **at cost of ₹ 2.50 lakhs.** The **loss** of ₹ 2.50 lakhs should be **charged to profit and loss account.**

13. MOCK TEST OCT 21 SERIES I

Paridhi Ltd. invested in the shares of another company on 1st May 2019 at a cost of ₹ 3,00,000 with the intention of holding for more than a year. The published accounts of Nidhi Ltd. received in March, 2021 reveals that the company has incurred cash losses with decline in market share and investment of Nidhi Ltd. may not fetch more than ₹ 45,000. How you will deal with the above in the financial statements of the Paridhi Ltd. as on 31.3.21 with reference to AS-13?

SOLUTION

FACTS:

Paridhi Ltd. invested in shares with **intention of holding for more than a year.** The shares have declined and market value is not more than 45,000.

REFERENCE:

As per AS 13, "Accounting for Investments" Investments classified as **long term investments should be carried in the financial statements 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 recognise the decline. AS 13 also states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment.

ANALYSIS / CONCLUSION:

On the basis of the facts and reference, the **provision for diminution should be made** to reduce the carrying amount of shares to ₹ 45,000 in the financial statements for the year ended 31st March, 2021 and **charge the difference of loss of ₹ 2,55,000 to profit and loss account.**

14. RTP MAY 22

JVR Limited has made investment of ₹ 97.84 Crores in Equity Shares of QSR Limited in 2016-17. The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to re-assess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investment for the year ended 31st March, 2021. Discuss whether the connection of JVR Limited to bring down the carrying Amount of investment in QSR Limited is in accordance with Accounting Standards.

SOLUTION

FACTS:

JVR Ltd. had made investment in QSR Ltd. which is in continuous losses from 2years. JVR Ltd. **wish to provide for diminution** in value of investment.

REFERENCE:

The investments are classified into **two categories** as per AS 13, viz., Current Investments and Long-term Investments.

a. A **current Investment** is an investment that is by its nature readily realizable and is intended to be **held for not more than one year** from the date on which such investment is made. The carrying amount for current investments is the **lower of cost and fair value.** Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.

b. A **long - term investment** is an investment **other than a current investment.** 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.**

ANALYSIS:

As per the above reference, **if the decline in value of investment is permanent** in QSR Ltd., JVR Ltd. **can bring down the value of investment.** The **reduction** in carrying amount may be **charged to the statement of profit and loss.** The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

CONCLUSION:

The **contention of the company** to bring down the value of investment is **correct.**

MCQs

1. The cost of Right shares is
   a) added to the cost of investments.
   b) subtracted from the cost of investments.
   c) no treatment is required.
   d) added to cost of investments at market value.

2. Long term investments are carried at
   a) fair value.
   b) cost less 'other than temporary' decline.
   c) Cost and market value whichever is less.
   d) Cost and market value whichever is higher.

3. Current investments are carried at
   a) Fair value.
   b) cost.
   c) Cost and fair value, whichever is less.
   d) Cost and fair value, whichever is higher.

4. A Ltd. acquired 2,000 equity shares of Omega Ltd. on cum-right basis at ₹ 75 per share. Subsequently, omega Ltd. made a right issue of 1:1 at ₹ 60 per share, which was subscribed for by A. Total cost of investments at the year-end will be ₹
   a) 2,70,000.
   b) 1,50,000.
   c) 1,20,000.
   d) 1,70,000.

5. Cost of investment includes
   a) Purchase costs.
   b) Brokerage and Stamp duty paid.
   c) Both (a) and (b).
   d) none of the above.

Answers									
1.	(a)	2.	(b)	3.	(c)	4.	(a)	5.	(c)

AS 16 – BORROWING COST			
Sr. No.	Concept	Question Bank	
		Section A	Section B
1	Interest Treatment	Q.3, Q.1	Q.2, Q.3, Q.6, Q.7, Q.12
2	General & Specific Borrowing	Q.2, Q.4	Q.4
3	Foreign Currency	Q.5	Q.11
4	Income from Specific Borrowings		Q.8, Q.10
5	Cessation of Capitalisation		Q.9, Q.14, Q.5, Q.13
6	Identification of Qualifying Asset	Q.6	Q.1
7	Special Case	Q.7, Q.8, Q.9	

AS 16 – BORROWING COSTS

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ILLUSTRATION 1 (ICAI)						
2	ILLUSTRATION 2 (ICAI)						
3	ILLUSTRATION 3 (ICAI)						
4	INTER QP MAY 19						
5	IPCC QP MAY 18						
6	INTER RTP NOV 2018, MTP APRIL 2022						
7	ILLU. 5 RTP MAY 13 SIMILAR Q. – MAY 16 – 5 MARKS & ICAI – P.Q. 11						
8	MOCK TEST OCT 21 SERIES 2						
9	QP MAY 2023						

1. ILLUSTRATION 1 (ICAI)

PRM Ltd. obtained a loan from a bank for ₹ 50 lakhs on 30-04-2016. It was utilised as follows:

Particulars	Amount (₹ in lakhs)
Construction of a shed	50
Purchase of a machinery	40
Working Capital	20
Advance for purchase of truck	10

Construction of shed was completed in March 2017. The machinery was installed on the date of acquisition. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-2017 was ₹ 18 lakhs. Show the treatment of interest.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

Purpose	Qualifying Assets	Interest to be Capitalised ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Construction of a shed	Yes	18 X 50 / 120 = 7.5	
Purchase of a Machinery	No		18 X 40 / 120 = 6
Working Capital	No		18 X 20 / 120 = 3
Advance for truck	No		18 X 10 / 120 = 1.5
TOTAL		7.5	10.5

2. ILLUSTRATION 2 (ICAI)

X Ltd. began construction of a new building on 1st January, 2016. It obtained ₹1 lakh special loan to finance the construction of the building on 1st January, 2016 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

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

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

Particulars		₹
January	2016	2,00,000
April	2016	2,50,000
July	2016	4,50,000
December	2016	1,20,000

Building was completed by 31st December, 2016. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalised and pass one Journal Entry for capitalising the cost and borrowing cost in respect of the building.

SOLUTION

(i) Computation of average accumulated expenses

Particulars	₹
₹ 2,00,000 x 12 / 12	2,00,000
₹ 2,50,000 x 9 / 12	1,87,500
₹ 4,50,000 x 6 / 12	2,25,000
₹ 1,20,000 x 1 / 12	10,000
	6,22,500

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

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
5,00,000	11%	55,000
9,00,000	13%	1,17,000
14,00,000		1,72,000
Weighted average rate of Interest (1,72,000 / 14,00,000) X 100		12.285% (approx)

Interest on average accumulated expenses

Particulars	₹
Specific borrowings (₹ 1,00,000 x 10%)	10,000
Non-specific borrowings ([₹ 6,22,500 – ₹ 1,00,000] x 12.285%)	64,189
Amount of interest to be capitalised	74,189

(iii) Total expenses to be capitalised for building

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

(iv) Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.12.2016	Building account Dr.	10,94,189	
	To Bank account		10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalised)		

3. ILLUSTRATION 3 (ICAI)

The company has obtained Institutional Term Loan of ₹ 580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2017 amounted to ₹ 406 lakhs, ₹ 58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 2016-2017 on the entire Institutional Term Loan of ₹ 580 lakhs.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

The treatment for total interest amount of ₹ 52.20 lakhs can be given as:

Purpose	Qualifying Assets	Interest to be Capitalised ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Modernisation and renovation of plant and machinery	Yes	**$52.20 \times \frac{406}{580} = 36.54$	
Advance to supplies for additional assets	Yes	**$52.20 \times \frac{58}{580} = 5.22$	
Working Capital	No		$52.20 \times \frac{116}{580} = 10.44$
TOTAL		41.76	10.44

* A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

** It is assumed in the above solution that the modernisation and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 52.20 lakhs will be recognised as expense in the profit and loss account for year ended 31st March, 2017.

4. INTER QP MAY 19

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.

SOLUTION

(i) Computation of average accumulated expenses

		₹
₹ 3,00,000 x 12 / 12		3,00,000
₹ 2,40,000 x 10 / 12		2,00,000
₹ 4,00,000 x 8 / 12		2,66,667

₹3,60,000 x 3 / 12		90,000
		8,56,667

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

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
4,00,000	9%	36,000
5,00,000	12%	60,000
3,00,000	14%	42,000
		1,38,000
Weighted Average rate of Interest (1,38,000/12,00,000) X 100		11.5%

(iii) Amount of interest to be capitalized

	₹
Interest on average accumulated expenses:	
Specific borrowings (₹ 2,00,000 x 8%)	16,000
Non-specific borrowings [8,56,667 – 2,00,000] X 11.5%	75,517
Amount of interest to be capitalised	**91,517**

(iv) Total expenses to be capitalised for building

	₹
Cost of building ₹ (3,00,000 + 2,40,000 + 4,00,000 + 3,60,000)	13,00,000
Add: Amount of interest to be capitalized	91,517
	13,91,517

(v) Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.2018	Building A/c Dr.	13,91,517	
	To Building WIP A/c		13,00,000
	To Borrowing costs A/c		91,517
	(Being amount of cost of building andborrowing cost thereon capitalised)		

Note: Considering ₹ 13 Lakh was debited to Building WIP Account earlier.)

5. IPCC QP MAY 18

Rutu Builders Limited has borrowed a sum of US$ 20,00,000 at the beginning of Financial year 2017-18 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 61 per US $ and the rate as on 31st March, 2018 was 65 per US \$. If Rutu Builders Limited had borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been @ 10.50%.

SOLUTION

REFERENCE:

As per **AS 16, Exchange differences** arising from **foreign currency borrowing** and **considered** as **borrowing costs** are those **exchange differences** which arise on the amount of principal of the foreign currency borrowings to **the extent of the difference between interest on local currency** borrowings and interest on foreign **currency borrowings**. The remaining exchange difference, if any, is accounted for under **AS 11, The Effect of Changes in Foreign Exchange Rates.** For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

ANALYSIS:

i. Interest for the period 2017-18
= US \$ 20 lakhs x 4% × ₹ 65 per US \$ = **₹ 52 lakhs**

ii. Increase in the liability towards the principal amount
= US \$ 20 lakhs × ₹ (65 - 61) = **₹ 80 lakhs.**

iii. Interest that would have resulted if the loan was taken in Indian currency
= US \$ 20 lakhs × ₹ 61 x 10.5% = **₹ 128.1 lakhs**

iv. Difference between interest on local currency borrowing and foreign currency borrowing=
₹ 128.1 lakhs - ₹ 52 lakhs = **₹ 76.1 lakhs.**

Therefore, out of ₹ 80 lakhs increase in the liability towards principal amount, only ₹ 76.1 lakhs will be considered as the borrowing cost.

Interest on Foreign Borrowings	₹ 52 lakhs
The **exchange difference** to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing	₹ 76.1 lakhs
Total Borrowing Cost	**₹128.1 lakhs**

CONCLUSION:

₹ 128.1 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 **"Borrowing Costs"** and the **remaining ₹ 3.9 lakhs** (₹ 80 lakhs– ₹ 76.1 lakhs) would be considered as the **exchange difference** to be accounted for as per **AS 11 "The Effects of Changes in Foreign Exchange Rates"**.

6. INTER RTP NOV 2018, MTP APRIL 2022

A company incorporated in June 2017, has setup a factory within a period of 8 months with borrowed funds. The construction period of the assets had reduced drastically due to usage of technical innovations by the company. Whether interest on borrowings for the period prior to the date of setting up the factory should be capitalized although it has taken less than 12 months for the assets to get ready for use. You are required to comment on the necessary treatment with reference to AS 16.

SOLUTION:

REFERENCE:

As per **AS 16 'Borrowing Costs', a qualifying asset** is an asset that necessarily takes **a substantial period of time** to get ready for **its intended use** or sale. Further AS 16 states that what constitutes a substantial period of time **primarily depends** on the **facts and circumstances** of each case. However, ordinarily, a period of **twelve months** is considered as **substantial period** of time **unless** a **shorter** or longer **period** can be **justified** on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

ANALYSIS:

It may be implied that there is a rebuttable **presumption that a 12 months period** constitutes **substantial period of time.** Under present circumstances where construction period has reduced drastically due to technical innovation, the 12 months period should at best be looked at as a benchmark and not as a conclusive yardstick. It **may** so **happen** that an **asset** under normal circumstances may take **more than 12 months** to complete. However, an enterprise that completes the asset in 8 months should not be penalized for its efficiency by denying it interest capitalization and vice versa.

The substantial period criteria ensures that enterprises do not spend a lot of time and effort capturing immaterial interest cost for purposes of capitalization.

CONCLUSION: If the factory is **constructed in 8 months** then it shall be **considered as a qualifying asset.** The interest on borrowings for the same shall **be capitalised** although it has taken **less than 12 months for the asset** to get ready to use.

7. ILLUSTRATION 5 RTP MAY 2013 SIMILAR QUESTION – MAY 2016 – 5 MARKS & ICAI – P.Q. 11

Vidya Ltd. is establishing an integrated steel plant consisting of four phases. It is expected that the full plant will be established over several years, but pending that, Phase I and Phase II would be started as soon as they are completed. Following is the detail of the work done on the different phases of the plant during the current year.

Particulars	Phase I	Phase II	Phase III	Phase IV
Cash expenditure	Rs. 20,00,000	Rs. 35,00,000	Rs. 25,00,000	Rs. 40,00,000
Plants Purchased	28,00,000	40,00,000	30,00,000	48,00,000
Total expenditure	**48,00,000**	**75,00,000**	**55,00,000**	**88,00,000**
Total expenditure				2,66,00,000
Loan taken @ 16%				2,40,00,000

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

SOLUTION

Option I – The loan amount is apportioned in the ratio of expenditure:

Particulars	Phase I	Phase II	Phase III	Phase IV
Total expenditure				
Apportionment of loan amount in the ratio of expenditure				
Interest @ 16%				
	Charge to P&L A/c.		Capitalised	

Option II – Loan amount apportioned at the discretion of the management.

Particulars	Phase I	Phase II	Phase III	Phase IV
Total Expenditure	48,00,000	75,00,000	55,00,000	88,00,000
Apportion at the discretion of mgt. 2,40,00,000	22,00,000 (Bal. figure)	75,00,000	55,00,000	88,00,000
Interest @ 16%	3,52,000	12,00,000	8,80,000	14,08,000
	Charge to P&L A/c. 15,52,000		**Capitalised 22,88,000**	

Note: It is assumed that phase I & Phase II became operational at the beginning of the year.

8. MOCK TEST OCT 21 SERIES 2

ABC limited has started construction of an asset on 1st December, 2020, which continues till 31st march, 2021 (and is expected to go beyond a year). the entity has not taken any specific borrowings to finance the Construction of the asset but has incurred finance costs on its general borrowings during the construction period. the directly attributable expenditure at the beginning of the month on this asset was ₹ 10 lakh in December 2020 and ₹ 4 lakh in each of the months of January to march 2021. at the beginning of the year, the entity had taken inter corporate deposits of ₹ 20 lakh at 9% rate of interest and had an overdraft of ₹ 4 lakh, which increased to ₹ 8 lakh on 1st march, 2021. Interest was paid on the overdraft at 10% until 1st January, 2021 and then the rate was increased to 12%. you are required to calculate the annual capitalization rate for computation of borrowing cost in accordance with as 16 'borrowing costs'.

SOLUTION

Calculation of capitalization rate on borrowings other than specific borrowings

nature of general borrowings	period of outstanding balance	amount of loan (₹)	Rate of interest p.a.	weighted average amount of interest (₹)
	a	b	c	d = [(b x c) x (a/12)]
9% debentures	12 months	20,00,000	9%	1,80,000
bank overdraft	9 months	4,00,000	10%	30,000
	2 months	4,00,000	12%	8,000
	1 month	8,00,000	12%	8,000
		36,00,000		**2,26,000**

weighted average cost of borrowings

= {20,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)} = **24,33,334**

capitalization rate = [(weighted average amount of interest / weighted average of general borrowings) x 100] = [(2,26,000 / 24,33,334) x 100] = **9.29% p.a.**

9. QP MAY 2023

On 1 April, 2022 Workhouse Limited took a loan from a Financial 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 Lone	₹ 30,00,000
(iii)	10% Other Loans	₹ 18,00,000

The Company has utilised the above funds in constructions / purchases of the following assets:

(i)	Building	₹ 70,00,000
(ii)	Furniture	₹ 22,00,000
(iii)	Plant and 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.

SOLUTION

(i) Weighted Average interest rate for non-specific borrowings

Particulars	Amount of loan (a)	Rate of interest (b)	Amount of interest (c) = (a) x (b)
Debentures	15,00,000	8%	1,20,000
Term loan	30,00,000	15%	4,50,000
Other loans	18,00,000	10%	1,80,000
	63,00,000		**7,50,000**

\# Weighted Average Rate of Interest

= 7,50,000 / 63,00,000 x 100 = **11.9048%**

(ii)

	Particulars	Qualifying asset	Expenses Incurred ₹	Share in borrowings ₹	Interest-Capitalized ₹	Interest-charged to P&L A/c ₹
i.	Building	Yes	45,00,000	7,50,000 x	1,68,750	-

				45/200		
ii.	Furniture	No	22,00,000	7,50,000 x 22/200	-	82,500
iii.	Plant & Machinery	Yes	90,00,000	7,50,000 x 90 /200	3,37,500	-
iv.	Factory shed	Yes	43,00,000	7,50,000 x 43 / 200	1,61,250	-
	Total		**2,00,00,000**		**6,67,500**	**82,500**

(iii) Interest to be Capitalized (on qualifying asset)

	Particulars	Computation	₹
a	On specific Borrowings	25,00,000x12%	3,00,000
b	On non-specific borrowings	(ii)	6,67,500
c	Amount of interest to be Capitalised	(a+b)	9,67,500

(iv) Interest transferred to P&L (on non-qualifying asset)

	Particulars	Computation	₹
i.	On non-specific Borrowings	(ii)	82,500

AS 16 – BORROWING COSTS

SECTION B (EXAM ORIENTED)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 4						
2	ICAI P. Q. 11						
3	INTER QP NOV 20						
4	QP MAY 22						
5	INTER RTP MAY 2018 / INTER RTP NOV 2019 / RTP NOV 21						
6	INTER RTP MAY 2019						
7	INTER RTP MAY 20						
8	INTER RTP NOV 20 , MOCK TEST 1 & 2 (SIMILAR)						
9	INTER RTP NOV 20						
10	RTP MAY 2017, RTP NOV 19						
11	ICAI - ILLUSTRATION 14 /RTP MAY 2016						
12	MOCK TEST OCT 21 SERIES 1						
13	RTP MAY 22						
14	RTP MAY 22						

1. ILLUSTRATION 4 (ICAI)

Take Ltd. has borrowed ₹ 30 lakhs from State Bank of India during the financial year 2016- 2017. The borrowings are used to invest in shares of Give Ltd., a subsidiary company of Take Ltd., which is implementing a new project, estimated to cost ₹ 50 lakhs. As on 31st March, 2017, since the said project was not complete, the directors of Take Ltd. resolved to capitalise the interest accruing on borrowings amounting to ₹4 lakhs and add it to the cost of investments. Comment.

SOLUTION

REFERENCE:

As per **AS 13 "Accounting for Investments"**, the **cost of investment includes** acquisition charges such as **brokerage, fees and duties.**

Further, as per **AS 16 "Borrowing Costs"**, a **qualifying asset** is an asset that necessarily takes a **substantial period** of time to get ready for its **intended use or sale.**

ANALYSIS:

In the present case, Take Ltd. has used borrowed funds for purchasing shares of its subsidiary company Give Ltd. **₹ 4 lakhs interest payable by Take Ltd. to State Bank of India cannot be called as acquisition charges,** therefore, cannot be constituted as cost of investment.

Shares are ready for its intended use at the time of sale, it cannot be considered as qualifying asset that can enable a company to add the borrowing cost to investments.

CONCLUSION:

The **directors of Take Ltd. cannot capitalise the borrowing cost** as part of cost of investment. Rather, it has to be charged to the Statement of Profit and Loss for the year ended 31st March, 2017.

2. ICAI Practical Question 11

On 1st April, 20X1, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilised as under:

1	Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels)	₹ 25 crores
2	Purchase of equipment's and machineries	₹ 3 crores
3	Working capital	₹ 2 crores

4	Purchase of vehicles	₹ 50,00,000
5	Advance for tools/cranes etc.	₹ 50,00,000
6	Purchase of technical know-how	₹ 1 crores
7	Total interest charged by the bank for the year ending 31st March, 20X2	₹ 80,00,000

Show the treatment of interest by Amazing Construction Ltd.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

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

Purpose	**Qualifying Asset**	**Interest to be capitalised ₹**	**Interest to be charged to Profit & Loss A/c ₹**
Construction of sea-link	Yes	62,50,000 [80,00,000x(25/32)]	
Purchase of equipment's and machineries	No		7,50,000 [80,00,000x(3/32)]
Working capital	No		5,00,000 [80,00,000x(2/32)]
Purchase of vehicles	No		1,25,000 [80,00,000x(0.5/32)]
Advance for tools, cranes etc.	No		1,25,000 [80,00,000x(0.5/32)]

Purchase of technical know-how	No		2,50,000 [80,00,000x(1/32)]
Total			**17,50,000**

3. INTER QP NOV 20

On 15th April 2019 RBM Ltd. Obtained a Term Loan from the Bank for ₹ 320 lakhs to be utilised as under

Particulars	₹ (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 Cost', show the treatment of interest and also explain the nature of assets.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

Purpose	Qualifying Assets	Interest to be Capitalised ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Construction for factory shed	Yes	40 X 240 / 320 = 30	
Machinery	No		40 X 30 / 320 = 3.75
Working Capital	No		40 X 24 / 320 = 3
Vehicle	No		40 X 12 / 320 = 1.5
Advances for tools/ cranes	No		40 X 8 / 320 = 1
Know how	No		40 X 6 / 320 = .75
TOTAL		30	10

Note: Assumed that construction of factory shed completed on 31st March, 2020.

4. QP MAY 22

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 constructions 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.

SOLUTION

(i) Computation of Average Accumulated Expenses:

1st April, 2021	10,00,000 x 12/12	10,00,000
1st August, 2021	10,00,000 x 12/12 14,00,000 x 8/12	10,00,000 9,33,333
1st January, 2022	4,00,000 x 3/12	1,00,000
		30,33,333

(ii) Interest on average accumulated expenses

Particulars	Rs.
Specific Borrowings (20,00,000 X 10%)	2,00,000
Non Specific Borrowings (30,33,333 – 20,00,000) X 12%	1,24,000
Amount of Interest to be Capitalised	**3,24,000**

NOTE: Since specific borrowings are earmarked for construction of a particular qualifying asset, it cannot be used for construction of any other qualifying asset except for temporary investment. Therefore, once the commencement of capitalization of borrowing cost criteria are met, actual borrowing cost incurred on specific borrowing shall be capitalized irrespective of the fact that amount had been utilized in parts.

(iii) Total expenses to be capitalized for borrowings as per AS 16 "Borrowing Costs": ₹

Cost of Plant (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalized (W.N.)	3,24,000
	41,24,000

(iv) Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.03.2022	Plant account Dr. To Bank account (Being amount of cost of plant and borrowing cost thereon capitalised)	41,24,000	 41,24,000

5. INTER RTP MAY 2018 / INTER RTP NOV 2019 / RTP NOV 21

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

SOLUTION

REFERENCE:

As per **AS 16, Capitalisation of borrowing costs** should **cease** when **substantially** all the **activities** necessary to prepare the **qualifying asset** for its intended use or sale **are complete**

ANALYSIS:

The construction was **completed** in January, 2017 and the building was **put to its use** immediately thereafter. Interest payable **upto January 2017** was ₹ 18 lakhs so it can be capitalized. It **cannot be extended** to ₹ 25 lakhs.

CONCLUSION:

Interest to be capitalized as per AS 16 – 18 Lakhs.

6. INTER RTP MAY 2019

Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ 1 crore
(v)	Advances for tools/cranes etc.	₹ 1 crore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31st March, 2018	₹ 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

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

Purpose	Qualifying Asset	Interest to be capitalized ₹ in crores	Interest to be charged to Profit & Loss A/c ₹ in crores
Construction of hill road*	Yes	1.25 1.6/64 x 50	
Purchase of equipment and machineries	No		0.15 1.6/64 x 6
Working capital	No		0.10 1.6/64 x 4
Purchase of vehicles	No		0.025 1.6/64 x 1
Advance for tools, cranes etc.	No		0.025 1.6/64 x 1
Purchase of technical know- how	No		0.05 1.6/64 x 2
Total		1.25	0.35

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

7. INTER RTP MAY 20

Govind Ltd. issued 12% secured debentures of ₹ 100 Lakhs on 01.04.2018, to be utilized as under:

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

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was ₹ 12,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of ₹ 3,00,000.

You are required to show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

ANALYSIS:

Eligible borrowing cost = ₹ 12,00,000 – ₹ 3,00,000 = ₹ 9,00,000

Sr. No.	Particulars	Qualifying assets	Interest to be capitalized (₹)	Interest to be charged to Profit & Loss Account (₹)
i	Construction of factory building	Yes	9,00,000x40/100 = ₹ 3,60,000	NIL
ii	Purchase of Machinery	No	NIL	9,00,000x35/100 = ₹ 3,15,000
iii	Working Capital	No	NIL	9,00,000x25/100 = ₹ 2,25,000
	Total		₹ 3,60,000	₹ 5,40,000

8. INTER RTP NOV 20 , MOCK TEST 1 & 2 (SIMILAR)

Vital Limited borrowed an amount of ₹150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. Capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

SOLUTION

REFERENCE:

AS 16 'Borrowing Costs' states that to the extent the funds are **borrowed specifically** for the purpose of obtaining a **qualifying asset,** the amount of borrowing costs eligible for capitalization on that asset should be determined as the **actual borrowing costs** incurred on that borrowing during the period **less** any **income on the temporary investment** of those borrowings. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

ANALYSIS:

Treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2019-20 should be calculated as follows:

Actual interest for 2019-20 (10% of ₹ 150 crores)	₹ 15.00 crores
Less: **Income on temporary investment** from specific borrowings	(₹ 1.50 crores)
Borrowing costs to be capitalized during year 2019-2020	₹ 13.50 crores

9. INTER RTP NOV 20

When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

SOLUTION

1. **Capitalization** of borrowing costs should **cease** when **substantially** all the **activities** necessary to prepare the **qualifying asset** for its **intended use** or sale are **complete.**
2. An **asset** is normally **ready for its intended use** or sale when its **physical construction** or production is complete **even though routine administrative work** might still continue.
3. If **minor modifications** such as the decoration of a property to the user's specification, are all that are **outstanding,** this **indicates** that substantially **all the activities are complete**.
4. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to a part should **cease** when **substantially all the activities** necessary to prepare that part for its **intended use** or sale are **complete.**

10. RTP MAY 2017, RTP NOV 19

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

SOLUTION

REFERENCE:

AS 16 'Borrowing Costs' states that to the extent the funds are **borrowed specifically** for the purpose of obtaining a **qualifying asset,** the amount of borrowing costs eligible for capitalization on that asset should be determined as the **actual borrowing costs** incurred on that borrowing during the period **less** any **income on the temporary investment** of those borrowings. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

ANALYSIS:

Treatment of accountant of Rainbow Ltd. **is incorrect.** The amount of borrowing costs capitalized for the financial year 2016-2017 should be calculated as follows:

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

11. ILLUSTRATION 14 RTP MAY 2016

Tip top Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2014-15 for its residential project at 4 %. 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 was ₹ 62 per US $. If Tip top 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

SOLUTION

REFERENCE:

As per **AS 16, Exchange differences** arising from **foreign currency borrowing** and **considered** as **borrowing costs** are those **exchange differences** which arise on the amount of principal of the foreign currency borrowings to **the extent of the difference between interest on local currency** borrowings and interest on foreign **currency borrowings**. The remaining exchange difference, if any, is accounted for under **AS 11, The Effect of Changes in Foreign Exchange Rates.** For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

ANALYSIS:

a. Interest for the period 2014-15

= US $ 10 lakhs x 4% × ₹ 62 per US$ = **₹ 24.80 lakhs**

b. Increase in the liability towards the principal amount

US $ 10 lakhs × ₹(62 - 56) = **₹ 60 lakhs**

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

= US $ 10 lakhs × ₹ 56 x 10.5% = **₹ 58.80 lakhs**

d. Difference between interest on local currency borrowing and foreign currency borrowing

= ₹58.80 lakhs - ₹24.80 lakhs = **₹34 lakhs.**

Therefore, out of ₹ 60 lakhs **increase in the liability towards principal amount,** only ₹ 34 lakhs will be considered as the borrowing cost.

Interest on **Foreign Borrowings**	₹ 24.80 lakhs
The **exchange difference** to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing	₹ 34 lakhs
Total Borrowing Cost	₹58.8 lakhs

CONCLUSION:

₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the **exchange difference** to be accounted for as per AS 11.

12. MOCK TEST OCT 21 SERIES 1

U Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernization of its Factory on 1st April, 2020. Plant and Machinery was acquired under the modernization scheme and installation was completed on 30th April, 2021. An expenditure of ₹ 564 lacs was incurred on this Plant and Machinery and the balance loan of ₹ 56 lacs has been used for working capital purposes. The company has paid total interest of ₹ 68.20 lacs during financial year 2020-2021 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 2021?

SOLUTION

REFERENCE:

According to **AS 16 'Borrowing costs'**, qualifying asset is an asset that **necessarily takes substantial period** of time to get ready for its intended use. As per the standard, borrowing costs that are **directly attributable** to the acquisition, construction or **production** of a **qualifying asset** should be **capitalized** as part of the cost of that asset. **Other borrowing costs** should be **recognized** as an **expense** in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

(i) When construction of asset completed on 30th April, 2021

The treatment for total borrowing cost of ₹ 68.20 lakhs will be as follows:

Purpose	Qualifying asset	Interest to be capitalized ₹ in lakhs	Interest to be charged to profit and loss account ₹ in lakhs
Plant and machinery under Modernization and renovation Scheme	Yes	[68.20 x (564/620)] = 62.04	
Working Capital	No		[68.20 x (56/620)] = 6.16
		62.04	6.16

(ii) When construction of assets is completed by 28th February, 2019

In this scenario, when the **process** of renovation gets **completed in less than 12 months,** the plant and machinery will **not be considered as qualifying assets** (until and unless the entity specifically considers that the asset took substantial period of time for completing their construction) and the whole of interest will be required to be charged off / expensed off to Profit and loss account.

13. RTP MAY 22

An enterprise has constructed a complex piece of equipment (qualifying asset) that is to be installed on the production line of a manufacturing plant. The equipment has been constructed over a period of 15 months. However, on installation, certain calibrations are required to achieve *the desired level of production before it is finally commissioned. This process is expected to take approximately 2 months during which test runs will be made. Should the borrowing costs attributable to borrowings pertaining to the 2 months test run period be capitalized?*

SOLUTION

REFERENCE:

As per **AS 16, Capitalisation of borrowing costs** should **cease** when **substantially** all the **activities** necessary to prepare the **qualifying asset** for its intended use or sale **are complete**

ANALYSIS:

On installation of the equipment, an evaluation has to be made to conclude whether substantially all the activities necessary to prepare the asset are complete. After an equipment has been installed it is usually tested and adjusted for commercial production before it is finally commissioned. The calibrations and adjustments required during this period are performed in order to bring the equipment up to the stage at which it is ready to commence commercial production. **Until the asset reaches the stage when it is ready to support commercial levels of production, it is not appropriate to conclude that substantially all the activities necessary to prepare the asset are complete.**

CONCLUSION:

The borrowing cost incurred during the normal period of test runs (after the installation) are required to be capitalized.

14. RTP MAY 22

Should capitalization of borrowing costs be continued when the qualifying asset has been constructed but marketing activities to sell the asset are still in progress?

SOLUTION

REFERENCE:

As per provisions of AS 16, capitalization of **borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.** Further, the standard also explains that "An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might sill continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete".

ANALYSIS:

The emphasis in the Standard is on "to **prepare the qualifying** asset for its **intended use or sale" and not the actual activity of sale.** Therefore, where the physical construction of the asset is complete, substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

CONCLUSION:

The **borrowing costs pertaining** to the period during which the **marketing activities** to sell the **asset are still in progress should not be capitalized as** part of the **cost of the asset.**

MCQs

1. As per AS 16, all the following are qualifying assets except
   a) Manufacturing plants and Power generation facilities
   b) Inventories that require substantial period of time
   c) Assets those are ready for sale.
   d) None of the above

2. Which of the following statement is correct:
   a) Entire exchange gain is reduced from the cost of the Qualifying asset.
   b) Entire exchange loss is added to the cost of a Qualifying asset.
   c) No adjustment is done for the exchange loss while computing cost of Qualifying asset.
   d) None of the above

3. Capitalisation rate considers:
   a) Borrowing costs on general borrowings only.
   b) Borrowing costs on general and specific borrowings both.
   c) Borrowing costs on specific borrowings only
   d) None of the above

4. If the amount eligible for capitalisation in case of inventory as per AS 16 is ₹ 12,000 and cost of inventory is ₹ 40,000 and its net realizable value is ₹ 45,000; What amount can be capitalised as a part of inventory cost.
   a) ₹ 12,000.
   c) ₹ 7,000.
   b) ₹ 5,000.
   d) ₹ 10,000.

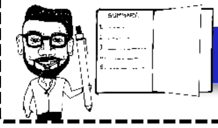
5. X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:
   i. 15th May, 20X1: Loan interest relating to the project starts to be incurred
   ii. 2nd June, 20X1: Technical site planning commences
   iii. 19th June, 20X1: Expenditure on the project started to be incurred
   iv. 18th July, 20X1: Construction work commences

Identify the commencement date for capitalisation under AS 16.
   a) 15th May, 20X1.
   c) 18th July, 20X1.
   b) 19th June, 20X1.
   d) 2nd June, 20X1

Answers									
1.	(c)	2.	(c)	3.	(a)	4.	(b)	5.	(b)

AS 4 - CONTINGENCIES & EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION 1				
2	ICAI ILLUSTRATION 2, RTP Nov 2015				
3	ICAI ILLUSTRATION 3				
4	ICAI ILLUSTRATION 4				
5	ICAI ILLUSTRATION 5				
6	ICAI ILLUSTRATION 6, Nov 2018 RTP				
7	ICAI ILLUSTRATION 7				
8	RTP May 2018 / RTP MAY 20				
9	QP Nov 18				
10	INTER RTP May 2019				
11	INTER QP MAY 2019 / ICAI PRACTICAL QUESTION 15				
12	RTP NOV 18				
13	RTP NOV 20				
14	RTP MAY 21				
15	RTP NOV 21				
16	QP JULY 21				
17	Mock test OCT 21 Series 1				
18	Mock test OCT 21 Series 2 / INTER RTP NOV 19				
19	QP DEC 21				
20	RTP May 22				
21	MTP March 2022 Test Series 1				
22	RTP Nov 22				
23	MTP Sep 22 (Series 1)				
24	Exam Nov 22				



Let's Get Started....With Class Work

1. ICAI ILLUSTRATION 1

In X Co. Ltd., theft of cash of ₹ 5 lakhs by the cashier in January, 20X1 was detected only in May, 20X1. The accounts of the company were not yet approved by the Board of Directors of the company.

Decide Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.3.20X1.

SOLUTION

FACTS:

X Co. Ltd has detected a theft which has occurred in January 20X1 before approval of accounts by Board of Directors.

REFERENCE:

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. 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.

ANALYSIS:

In light of the facts above, the event of detection of theft has happened before the approval of accounts by Board of Directors and it was a condition existing at the balance sheet date, making the amount of theft being required to be adjusted in the accounts of the company.

CONCLUSION:

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, 20X1.

2. ICAI ILLUSTRATION 2, RTP Nov 2015

An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.20X2. The accounting year of the company ended on 31.3.20X2. The accounts were approved on 30.6.20X2. 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.

SOLUTION

FACTS:

ACO Ltd. has suffered has suffered a loss of ₹ 30 lakhs due to earthquake on 20.05.2022

REFERENCE:

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.

However, 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.

ANALYSIS:

The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e., 31.3.20X2. However, 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 for the financial year 20X1-20X2.

CONCLUSION:

The loss occurred due to earthquake is not to be recognised in financial statement. Disclosure of estimated loss and fact about earthquake should be disclosed to enable users of financial statements to make proper evaluation and decisions.

3. ICAI ILLUSTRATION 3

A company has filed a legal suit against the debtor from whom ₹ 15 lakh is recoverable as on 31.3.20X1. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 20X1. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss.

SOLUTION

FACTS:

Legal suit has been filed for recovery of ₹ 15 lakh from debtor for which the recovery chances are not good as per the legal opinion received in April 20X1.

REFERENCE:

As per AS 4 (Revised) "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.

ANALYSIS:

As per the facts and reference above, the condition of recovery from debtors existed at the Balance sheet date. Hence, the company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 20X1 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements.

CONCLUSION:

Provision for doubtful debts should be made for the year ended on 31st March, 20X1.

4. ICAI ILLUSTRATION 4

In preparing the financial statements of R Ltd. for the year ended 31st March, 20X1, you come across the following information. State with reasons, how you would deal with this in the financial statements:

The company invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company doing similar business, the negotiations for which had started during the year.

SOLUTION

FACTS:

R Ltd. has invested 100 lakhs in April, 20X1 before approval of Financial Statements by the Board of directors in the acquisition of another company.

REFERENCE:

AS 4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company.

AS 4 (Revised) states that the 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.

ANALYSIS:

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, 20X1. However, the disclosure should be made in the report of the approving authority.

CONCLUSION:

R Ltd. should disclose the investment of ₹ 100 lakhs in April, 20X1 in the acquisition of another company in the report of the Approving Authority to enable users of financial statements to make proper evaluations and decisions.

5. ICAI ILLUSTRATION 5

A Limited Company closed its accounting year on 30.6.20X1 and the accounts for that period were considered and approved by the board of directors on 20th August, 20X1. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.20X1 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.20X1.

SOLUTION

FACTS:

A limited has its accounts approved on 20th August 20X1. The extra cost of ₹ 80 lakhs during boring work has been identified on 01.09.20X1.

REFERENCE:

AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'.

ANALYSIS:

In the case of A Limited, the incidence which was expected to push up cost, became evident after the date of approval of the accounts. So it is not an 'event occurring after the balance sheet date'.

CONCLUSION:

A Limited is not required to adjust or disclose the details relating to event causing extra cost in financial statements for the year ended 30.6.20X1.

6. ICAI ILLUSTRATION 6, Nov 2018 RTP

While preparing its final accounts for the year ended 31st March, 20X1 a company made a provision for bad debts @ 5% of its total trade receivables. In the last week of February, 20X1 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, 20X1 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, 20X1?

SOLUTION

FACTS:

The Debtor of the company has suffered heavy losses due to an earthquake in February 20X1 and they have been declared as bankrupt in April 20X1.

REFERENCE:

As per AS 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.

ANALYSIS:

As the Balance sheet date of the company is 31st March 20X1 which is after the date of earthquake, the event can be considered as a condition existing at the balance sheet date.

Had the earthquake taken place after 31st March, 20X1, then mere disclosure required as per AS 4 (Revised), would have been sufficient.

CONCLUSION:

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.

7. ICAI ILLUSTRATION 7

During the year 20X1-20x2, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 20X2. On 18th May, 20X2, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 20X2, and approved by the board on 30th May, 20X2.

SOLUTION

FACTS:

Raj Ltd. has been sued for infringement of a trademark during the year 20X1-20X2. Court decision has been received on 18th May 20X2 and Financial Statements have been approved by Board of Directors on 30th May 20X2.

REFERENCE:

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

ANALYSIS:

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 20X1-X2 for which the provision was also made by it, the decision of the Court on 18th May, 20X2, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements.

CONCLUSION:

Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

"Had the judgment of the court been delivered on 1st June 20X2, it would be considered as an event occurring after the approval of the financial statements which is not covered by AS 4 (Revised). In that case, no adjustment in the financial statements of 20X1-X2 would have been required.

8. RTP May 2018 / RTP MAY 20

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

SOLUTION

REFERENCE:

According to AS 4 on 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, 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. "Contingencies" used in the Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

ANALYSIS (i):

Fire has occurred after the balance sheet date and also the loss is totally insured. Therefore, the event becomes immaterial.

CONCLUSION:

The event is a non-adjusting event.

ANALYSIS (ii):

The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency.

CONCLUSION:

The event is a non-adjusting event.

9. QP Nov 18

The accounting year of Dee Limited ended on 31^{st} March, 2018 but the accounts were approved on 30th April, 2018. On 15^{th} 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).

SOLUTION

FACTS:

The fire has occurred in the factory and office premises of Dee Ltd after 31st March, 2018 but before approval of financial statement of 30.4.18. The loss by fire is of such a magnitude that it is not reasonable to expect the Dee Ltd. to start operations again.

REFERENCE:

As per AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date", an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that **the fundamental accounting assumption of going concern is no longer appropriate.**

ANALYSIS:

Since the fire occurred after 31/03/18, the loss on fire is not a result of any condition existing on 31/03/18. But as per the facts stated about operations not being resumed, the going concern assumption is not valid in case of Dee Ltd. Hence, the loss due to fire is an adjusting event.

CONCLUSION:

The entire accounts of Dee Ltd. should be prepared on a liquidation basis with adequate disclosures by way of note in its financial statements in the following manner:
"Major fire occurred in the factory and office premises on 15th April, 2018 which has made impossible for the enterprise to start operations again. Therefore, the financial statements have been prepared on liquidation basis."

10. INTER RTP May 2019

The Board of Directors of 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 dividend 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.

SOLUTION

FACTS:

New Graphics Ltd. has recommended a dividend of ₹ 2 per equity share for the year ended 31st March, 2017. It will be paid if it is approved on 18th June, 2017 in Annual General Meeting. Financial Statements have been approved on 18th April, 2017 in Board Meeting.

REFERENCE:

As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.
However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time.

ANALYSIS:

The dividend of ₹ 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17.

CONCLUSION:

No, provision for proposed dividends is not required to be made. Proposed dividends for 2016-27 is required to be disclosed in the notes to financial statements.

11. INTER QP MAY 2019 / ICAI PRACTICAL QUESTION 15

The financial statements of Alpha Ltd. for the year 20X1-20X2 were approved by the Board of Directors on 15th July, 20X2. The following information was provided:

i. A suit against the company's advertisement was filed by a party on 20th April, 20X2 claiming damages of ₹ 25 lakhs.

ii. The terms and conditions for acquisition of business of another company had been decided by March, 20X2. But the financial resources were arranged in April, 20X2 and amount invested was ₹ 50 lakhs.

iii. Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 20X2, was detected on 16th July, 20X2.

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

SOLUTION

FACTS:

Financial statements of Alpha Ltd. for the year 20X1-20X2 were approved by the Board of Directors on 15th July, 20X2.

REFERENCE:

As per AS 4, To decide whether, the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date.

Further, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

ANALYSIS (i):

Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20th April after the balance sheet date.

CONCLUSION:

The suit will have no effect on financial statement of 20X1-20X2 and will be a non-adjusting event.

ANALYSIS (ii):

Terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 20X2. Hence, necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 20X2.

CONCLUSION:

The acquisition of business will be an adjusting event.

ANALYSIS (iii):

Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure. In the given case, as the theft of cash was detected on 16th July, 20X2 i.e., after approval of financial statements, it will not require adjustment nor disclosure.

CONCLUSION:

The theft will be a non-adjusting event and no adjustment in financial statement is required.

12. RTP NOV 18

While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹ 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 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, 2017? You are required to advise the company in line with AS 4.

SOLUTION

FACTS:

The Debtor of the company has suffered heavy losses due to an earthquake in February 2017 and they have been declared as bankrupt in April 2017.

REFERENCE:

As per AS 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.

ANALYSIS:

As the Balance sheet date of the company is 31st March 2017 which is after the date of earthquake, the event can be considered as a condition existing at 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.

CONCLUSION:

Full provision for bad debt amounting to ₹ 20 lakhs should be made to cover the loss arising due to the insolvency in the Final Accounts for the year ended 31st March, 2017.

13. RTP NOV 20

A fire, on 2nd April, 2020, completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March, 2020, the financial statements were approved by their approving authority on 15th June, 2020. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020.

SOLUTION

FACTS:

Omega Ltd.'s manufacturing plant has been destroyed by fire on 2nd April 2020 and the expected loss is ₹ 10 million. Omega Ltd. expects that the loss of ₹ 10 million would be fully covered by the insurance company.

REFERENCE:

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. However, 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.

ANALYSIS:

The event occurred after the year-end and does not relate to the conditions existing at the year-end. Since it is said that the loss would be fully recovered by the insurance company, the going concern assumption having regard to the extent of insurance cover is valid.

CONCLUSION:

The event will be a non-adjusting event. But the fact of fire and insurance cover should be disclosed by way of a note to the financial statements.

14. RTP MAY 21

A case is going on between ABC Ltd. and Tax department on claiming the exemption for certain items, for the year 2019-2020. The court has issued the order on 15th April and rejected the claim of the company. Accordingly, company is liable to pay the additional tax. The financial statements were approved on 31st May, 2020. Shall company account for such tax in the year 2019-2020 or shall it account for in the year 2020-2021?

SOLUTION

FACTS:

ABC Ltd.'s claim has been rejected by the court order on 15th April. The financial statements were approved on 31st May, 2020.

REFERENCE:

As per AS 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.

ANALYSIS:

The Court order is conclusive evidence which has been received before approval of the financial statements since the liability is related to earlier year. This satisfies both the conditions for classification of the event as an adjusting event.

CONCLUSION:

The event will be considered as an adjusting event and accordingly the amount will be adjusted in accounts of 2019-2020.

15. RTP NOV 21

XYZ Ltd. operates its business into various segments. Its financial year ended on 31st March, 2020 and the financial statements were approved by their approving authority on 15th June, 2020. The following material events took place:

a) A major property was sold (it was included in the balance sheet at ₹ 25,00,000) for which contracts had been exchanged on 15th March, 2020. The sale was completed on 15th May, 2020 at a price of ₹ 26,50,000.

b) On 2nd April, 2020, a fire completely destroyed a manufacturing plant of the entity. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company.

c) A claim for damage amounting to ₹ 8 million for breach of patent had been received by the entity prior to the year-end. It is the director's 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.

You are required to state with reasons, how each of the above items should be dealt with in the financial statements of XYZ Ltd. for the year ended 31st March, 2020.

SOLUTION

FACTS:

XYZ Ltd.'s financial statements for 31st March 2020 are approved by the approving authority on 15th June 2020. It operates its business into various segments.

REFERENCE:

As per AS 4, Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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, and, by the corresponding approving authority in the case of any other entity.

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 or that indicate that the fundamental accounting assumption of going concern is not appropriate.

'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. However, it may be disclosed with the nature of contingency, being a contingent liability.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

ANALYSIS (a):

As the contract for sale asset has been exchanged on 15th March, 2020 it is a condition existing on balance sheet date. Also, the sale has been completed on 15th May 2020 which is before the approval of financial statements. Hence, The effect of the sale should be reflected in the financial statements ended on 31.3.2020.

CONCLUSION:

The sale of property should be treated as an adjusting event and the profit on sale of property ₹ 1,50,000 would be considered.

ANALYSIS (b):

The destruction of plant by fire occurred on 2nd April which is after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover.

CONCLUSION:

The event of destruction of plant by fire is a non-adjusting event. Since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

ANALYSIS (c):

On the basis of legal advice and director's opinion, the claim against the company will not succeed. Thus, ₹ 8 million should not be provided in the account.

CONCLUSION:

It should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

16. QP JULY 21

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.

SOLUTION

REFERENCE:

As per AS 4, Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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, and by the corresponding approving authority in the case of any other entity.

'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur. However, it may be disclosed with the nature of contingency, being a contingent liability.

ANALYSIS (i):

As per the above reference of AS 4, Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 5th April after the balance sheet date. This event does not pertain to conditions on the balance sheet date.

CONCLUSION:

The suit will have no effect on financial statements and it will be a non-adjusting event.

ANALYSIS (ii):

The proposal to sell an immovable property was made before 31st March, 2021 but the final deed was registered on 15th April. Sale cannot be shown in the financial statements for the year ended 31st March, 2021.

CONCLUSION:

Sale of immovable property is an event occurring after the balance sheet date and is a non-adjusting event. 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, 2021.

ANALYSIS (iii):

The terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts but transaction for payment of financial resources was effected in April, 2021. The finalization of terms and conditions amount to significant event before Balance sheet date.

CONCLUSION:

Acquisition of business is an adjusting event and necessary adjustment to assets and liabilities for acquisition of business is necessary in the financial statements for the year ended 31st March 2021.

ANALYSIS (iv):

The theft of cash was detected after approval of financial statements. As per AS 4, only those events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

CONCLUSION:

No adjustment is required for the theft in F Y 2020-21. It is a non-adjusting event.

17. Mock test OCT 21 Series I

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31 March 2020 are to be approved by the approving authority on 30 June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

(i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31 March 2020. On 31 March 2020 the company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realisable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during this month at a price of ₹ 4,000 per machine.

(ii) A fire has broken out in the company's godown on 15 April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

(iii) The company has entered into a sale agreement on 30 March 2020 to sell a property for a consideration of ₹ 7,50,000 which is being carried in the books at ₹ 5,50,000 at the year end. The transfer of risk and reward and sale is complete in the month of May 2020 when conveyance and possession get completed.

(iv) The company has received, during the year 2018-2019, a government grant of ₹ 15 lakhs for purchase of a machine. The company has received a notice for refund of the said grant on 15 June, 2020 due to violation of some of the conditions of grant during the year 2019-2020.

You are required to state with reasons, how the above transactions will be dealt with in the financial statement for the year ended 31st March 2020.

SOLUTION

REFERENCE:

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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, and by the corresponding approving authority in the case of any other entity.

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 or that indicate that the fundamental accounting assumption of going concern is not appropriate.

In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

ANALYSIS:

Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realisable value at the end of the reporting period.

CONCLUSION:

Inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = ₹ 2,00,000.

(i) A fire took place after the balance sheet date i.e. during 2020 -2021 financial year. Hence, corresponding financials of 2019-2020 financial year should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements. Otherwise, disclosure be given.

(ii) Since the transfer of risk and reward and sale was complete in the month of May, 2020 when conveyance and possession got complete, no revenue should be recognised with respect to it in the financial statements of 2019-2020. However, a disclosure for the same should be given by the entity.

(iii) Since the notice has been received after 31 March but before 30 June 2020 (approval date), the said grant shall be adjusted in the financial statements for financial year 2019 -2020 because the violation of the conditions took place in the financial year 2019 -2020 and the company must be aware of it.

18. Mock test OCT 21 Series 2 / INTER RTP NOV 19

An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2021. The accounting year of the company ended on 31.3.2021. The accounts were approved on 30.6.2021. The loss from earthquake is estimated at ₹ 25 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.

SOLUTION

FACTS:

PQR Ltd. has estimated a loss of ₹25 Lakhs due to the earthquake on 30.04.2021. The accounts were approved on 30.06.2021.

REFERENCE:

AS 4 "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.

ANALYSIS:

The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2021. Therefore, loss occurred due to earthquake is not to be recognized in the financial year 2020-2021.

However, 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.

CONCLUSION:

The fact of earthquake together with an estimated loss of ₹ 25 lakhs should be disclosed in the Report of the Directors for the financial year 2020-2021.

19. QP DEC 21

As per provision of AS 4, you are required to state with reason whether the following transaction 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 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 23.05.2021. Loss was estimated to be ₹ 81,00,000.

SOLUTION

In the books of NEW Ltd., classification of events as per AS 4 is as follows:

i)

FACTS:

Equity Dividend for year 2020-21 was declared on 15.05.2021.

REFERENCE:

If dividends are declared after the balance sheet date but before the financial statements are approved, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise.

ANALYSIS:

As per the above provision of As 4, no liability for dividends should be recognized in financial statements for financial year ended 31st March, 2021. Dividends are disclosed in the notes.

CONCLUSION:
Declaration of dividend is non-adjusting event.

ii)
FACTS:
Cashier has incurred a fraud by collecting the cash but not depositing it ₹ 53,000
REFERENCE:
As per AS 4 '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 such events relate to conditions existing at the balance sheet date.
ANALYSIS:
Fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss.
CONCLUSION:
Loss amounting ₹ 53,000 should be adjusted in the accounts of the company for the year ended 31st March, 2021 as it is adjusting event.

iii)
FACTS:
Estimated loss due to Fire is ₹ 81,00,000 which occurred on 23.05.2021.
REFERENCE:
AS 4 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. However, 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.
ANALYSIS:
The damage of one building due to fire did not exist on the balance sheet date i.e. 31.3.2021. As per the information given in the question, the fire has caused major destruction; therefore, fundamental accounting assumption of going concern would have to be evaluated.
CONCLUSION:
Loss occurred due to fire is not to be recognized in the financial year 2020-2021 as it is non-adjusting event. Considering that the going concern assumption is still valid, the fact of fire together with an estimated loss of ₹ 81 lakhs should be disclosed in the report of

the approving authority for financial year 2020 -21 to enable users of financial statements to make proper evaluations and decisions.

20.RTP May 22

Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:

i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of 4,000 per machine.

ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.

iii) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

SOLUTION

FACTS:

Tee Ltd.'s financial statements for 31st March 2020 are approved by the approving authority on 30 June 2020.

REFERENCE:

As per AS 4, Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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, and, by the corresponding approving authority in the case of any other entity. 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 or that indicate that the fundamental accounting assumption of going concern is not appropriate.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:

ANALYSIS (i):

On 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period.

CONCLUSION:

Inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines x ₹ 4,000 = 2,00,000.

ANALYSIS (ii):

A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.

CONCLUSION:

The event will be considered as non-adjusting event and no disclosure of the same is required in the financial statements.

ANALYSIS (iii):

The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency.

CONCLUSION:

The event will be classified as a non-adjusting event.

21. MTP March 2022 Test Series I

The financial statements of Alpha Ltd. for the year 2019-2020 were approved by the Board of Directors on 15th July, 2020. The following information was provided:

i) A suit against the company's advertisement was filed by a party on 20th April, 2020 claiming damages of ₹ 25 lakhs.

ii) The terms and conditions for acquisition of business of another company had been decided by March, 2020. But the financial resources were arranged in April, 2020 and amount invested was ₹ 50 lakhs.

iii) Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2020, was detected on 16th July, 2020.

iv) The company started a negotiation with a party to sell an immovable property for ₹ 40 lakhs in March, 2020. The book value of the property is ₹ 30 lakh on 31st March, 2020. However, the deed was registered on 15th April, 2020.

v) A major fire had damaged the assets in a factory on 5th April, 2020. However, the assets were fully insured.

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

SOLUTION

i)

FACTS:

A suit has been filed by a party on 20th April, 2020 claiming damages of ₹ 25 lakhs

REFERENCE:

As per AS 4, 'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

ANALYSIS:

Suit filed against the company is a contingent liability but it was not existing as on date of balance sheet date as the suit was filed on 20th April which is after the balance sheet date.

CONCLUSION:

The suit will have no effect on financial statement and will be a non-adjusting event.

ii)

FACTS:

Alpha Ltd. has invested ₹ 50 lakhs in April 2020 for acquisition of another company for which the terms and conditions had been decided by March, 2020. Financial Statements were approved by Board of Directors on 15th July 2020.

REFERENCE:

AS4 (Revised) defines "Events Occurring after the Balance Sheet Date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Approving Authority in the case of a company.

ANALYSIS:

As the terms and conditions for acquisition of business were finalized before the balance sheet date and carried out before the closure of the books of accounts, the event will be classified as an Adjusting event. Even though the transaction for payment of financial resources was effected in April, 2020.

CONCLUSION:

Adjustment should be made to assets and liabilities for acquisition of business in the financial statements for the year ended 31st March 2020.

iii)

FACTS:

Theft of cash of ₹ 5 lakhs by the cashier on 31st March, 2020, was detected on 16th July, 2020.

REFERENCE:

As per AS 4, events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

ANALYSIS:

In the given case, the theft of cash was detected on 16th July, 2020 i.e., after approval of financial statements by Board of Directors. Financial Statements were approved by Board of Directors on 15th July 2020.

CONCLUSION:

The theft will be a non-adjusting event as per AS 4.

iv)

FACTS:

Alpha Ltd.'s property sale deed was registered on 15th April, 2020.

REFERENCE:

As per AS 4, 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.

AS 4 (Revised) further states that the 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.

ANALYSIS:

In the given case, sale of immovable property was under proposal stage (negotiations only started) on the balance sheet date, and was not finalized.

CONCLUSION:

The event will be classified as non-adjusting event. Therefore, adjustment to assets for sale of immovable property is not necessary in the financial statements for the year ended 31st March, 2020. Disclosure may be given in Report of approving Authority.

v)

FACTS:

Aplha Ltd.'s assets in the factory have been damaged by fire on 5th April, 2020. The assets were fully insured.

REFERENCE:

As per AS 4, 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.

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

ANALYSIS:

The condition of fire occurrence was not existing on the balance sheet date. Since it is said that the loss would be fully recovered by the insurance company, the going concern assumption having regard to the extent of insurance cover is valid.

CONCLUSION:

The event of loss by fire will be classified as a non-adjusting event. Only the disclosure regarding fire and loss, being completely insured may be given in the report of approving authority.

22. RTP Nov 22

Explain accounting treatment of Contingent Gains as per AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

SOLUTION

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

23. MTP Sep 22 (Series I)

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2022 (accounts were approved on 25th July, 2022):

1. Negotiations with another company for acquisition of its business was started on 21st January, 2022. Hari Ltd. invested ₹ 40 lakh on 22nd April, 2022.
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 2022, 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, 2022 the debtor became bankrupt.
3. During the year 2021-22, 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, 2022. On 26th May, 2022, 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. Cheques dated 31st March, 2022 collected in the month of April, 2022. All cheques are presented to the bank in the month of April, 2022 and are also realized in the same month in the normal course after deposit in the bank.

SOLUTION

Financial statements of Hari Ltd. for the year ended 31st March, 2022 were approved on 25th July, 2022. As per which the below events would be dealt as follows:

1.

FACTS:

Hari Ltd has invested ₹ 40 lakh on 22nd April, 2022 for acquisition for which negotiations were initiated in January 2022

REFERENCE:

As per AS 4'Contingencies and Events Occurring After the Balance Sheet Date', 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.

ANALYSIS:

As the investment was made before the approval of Financial Statements and the investment amounts to a material change and commitments that can affect the financial position, it should be disclosed in Financial Statements dated 31st March 2022.

CONCLUSION:

The investment of ₹ 40 lakhs should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

2.

FACTS:

The Debtor of the company liable for ₹ 2.5Lakhs have become bankrupt in May due to an earthquake in March. 5% provision for Bad debts was made by the company.

REFERENCE:

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

ANALYSIS:

The loss suffered by Debtor is not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in May, 2022 (after the balance sheet date) is only an additional information related to the existing condition on the balance sheet date.

CONCLUSION:

Full provision for bad debts amounting ₹ 2,50,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2022.

3.

FACTS:

Hari Ltd. has to pay the aggrieved party a sum of ₹ 12 lakhs as per the court's order on 26th May 2022.

REFERENCE:

As per AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

ANALYSIS:

In the given case, since Hari Ltd. was sued by a competitor for infringement of a trademark during the year 2021- 22 for which the provision was also made by it, the decision of the Court on 26th May 2022, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements.

CONCLUSION:

Hari Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

4.

FACTS:

Hari Ltd. has collected cheques dated 31st March, 2022 in the month of April, 2022 and they are realized in the same month in the normal course after deposit in the bank.

REFERENCE:

As per AS 4, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

ANALYSIS:

Collection of cheques after balance sheet date is not an adjusting event even if the cheques bear the date of 31st March. 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.

CONCLUSION:

No disclosure of collection of cheques is required in the Directors' Report. It is not an adjusting event.

24. Exam Nov 22

MN Limited operated 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 has been received by the entity prior to the year end. It is the director's 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 has been exchange 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, haw 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.

SOLUTION

FACTS:

MN Ltd. financial statements for 31st March 2022 are approved by the approving authority on 15th June 2022. It operates its business into various segments.

REFERENCE:

As per AS 4, Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, 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, and, by the corresponding approving authority in the case of any other entity. 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 or that indicate that the fundamental accounting assumption of going concern is not appropriate.

'Contingencies' is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2022:

ANALYSIS (a):

The destruction of plant by fire occurred on 7th April which is after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover.

CONCLUSION:

The event of destruction of plant by fire is a non-adjusting event. Since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

ANALYSIS (b):

On the basis of legal advice and director's opinion, the claim against the company will not succeed. Thus, ₹ 12 crore should not be provided in the account.

CONCLUSION:

It should be disclosed by means of a contingent liability with full details of the facts. Provision should be made for legal fee expected to be incurred to the extent that they are not expected to be recovered.

ANALYSIS (c):

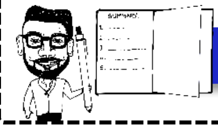
As the contract for sale asset has been exchanged on 15th March, 2022. It is a condition existing on balance sheet date. Also, the sale has been completed on 15th May 2020 which is before the approval of financial statements. Hence, the effect of the sale should be reflected in the financial statements ended on 31.3.2022.

CONCLUSION:

The sale of property should be treated as an adjusting event and the profit on sale of property ₹ 2,25,000 would be considered.

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

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION 1				
2	ICAI ILLUSTRATION 2				
3	ICAI ILLUSTRATION 3, RTP May 2017				
4	ICAI ILLUSTRATION 4, RTP Nov 2015, RTP Nov 2017				
5	RTP May 2018, RTP Nov 2016, RTP Nov 22				
6	RTP Nov 2018 / Inter RTP Nov 2019				
7	QP May 2018, RTP May 2019				
8	INTER RTP MAY 2019				
9	RTP MAY 20				
10	RTP NOV 20				
11	RTP MAY 21				
12	QP JAN 21				
13	RTP Nov 2014, RTP May 2017				
14	RTP NOV 21				
15	RTP NOV 21				
16	RTP MAY 22				
17	MAY 22 EXAM				
18	MTP April 2022 Series 2				
19	MTP SEP 22 (SERIES 1)				
20	MTP OCT 22 (SERIES 2)				
21	EXAM NOV 22				



Let's Get Started....With Class Work

1. ICAI ILLUSTRATION 1

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of ₹ 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.

SOLUTION

FACTS:

Fuel surcharge bill was received and paid in February 20X8 but it was accounted in the year 20X8-X9.

REFERENCE:

As per AS 5, 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. Prior period items are normally included in the determination of net profit or loss for the current period.

An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

ANALYSIS:

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9.

CONCLUSION:

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5.

It should be treated as Prior period item. The fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

2. ICAI ILLUSTRATION 2

I. During the year 20X1-20X2, 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 1.9.20X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?

SOLUTION

REFERENCE:

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"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."

Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(i) **ANALYSIS:**

Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance.

Conclusion: The write down of inventory is required to be disclosed separately as per AS 5.

(ii) **ANALYSIS:**

It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore, wages payable for the half year from 1.10.20X2 to 31.3.20X3 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages are an expense arising from the ordinary activities of the company

CONCLUSION:

It does not qualify as an extraordinary item hence no separate disclosure is required. Additional wages liability of 7,50,000 (for 1½ years @ 5,00,000 per annum) should be included in current year's wages.

3. ICAI ILLUSTRATION 3, RTP May 2017

The company finds that the inventory sheets of 31.3.20X1 did not include two pages containing details of inventory worth ₹ 14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X2.

SOLUTION

REFERENCE:

AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' defines Prior Period items as 'Income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.'

ANALYSIS / CONCLUSION:

Rectification of error in inventory valuation is a prior period item vide provisions of AS 5. ₹ 14.5 lakhs must be added to the opening inventory of 1/4/20X1. It is also necessary to show ₹ 14.5 lakhs as a prior period adjustment in the Profit and loss Account. Separate disclosure of this item as a prior period item is required as per AS 5.

4. ICAI ILLUSTRATION 4, RTP Nov 2015, RTP Nov 2017

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.

SOLUTION

REFERENCE:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will **not be considered as a change in accounting policy.**

(i) **ANALYSIS:**

Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

CONCLUSION:

Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(ii) **ANALYSIS:**

As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

Since it is an adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

CONCLUSION:

The introduction of new pension scheme is **not a change in accounting policy.**

5. RTP May 2018, RTP Nov 2016, RTP Nov 22

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of ₹10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at ₹ 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of ₹ 2 lakhs was disclosed as net profit from sale of assets. You are required to **examine** the treatment and disclosure done by the company and advise the company in line with AS 5.

SOLUTION

REFERENCE:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

ANALYSIS:

In the given case, selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

CONCLUSION:

Bela Ltd. disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

6. RTP Nov 2018 / Inter RTP Nov 2019

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. You are required to advise him in the following situations in accordance with the provisions of AS 5

(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.

SOLUTION

REFERENCE:

As per AS 5, Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

(i) **ANALYSIS:** Mobile limited created 2% provision for doubtful debts till 31st March, 2016. In 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. This change will affect only current year.

CONCLUSION: Change in rate of provision of doubtful debt is **change in estimate and is not change in accounting policy.**

(ii) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(iii) **ANALYSIS:** Till 2015-16, the furniture was depreciated on straight line basis over a period of 5 years. In 2016-17, useful life of furniture has been changed from 5 years to 3 years. It is a change in estimate.

CONCLUSION: Change in useful life is **not a change in accounting policy.**

(iv) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(v) **ANALYSIS:** Change in cost formula used in measurement of cost of inventories change would result in a more appropriate presentation of the financial statements.

CONCLUSION: Change in Cost formula is a **change in accounting policy.**

7. QP May 2018, RTP May 2019

PQR Ltd. is in the process of finalizing 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 extraordinary item or prior period item?

SOLUTION

i) **REFERENCE:** As per the provisions of AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, 'Prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods.'

ANALYSIS: In the given case, it is clearly a case of error/omission in preparation of financial statements for the year 2015-16 for not recording the loss due to flood.

CONCLUSION: Claim received in the financial year 2017- 18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

Note: As per my understanding, the claim was not approved till March 2018 due to which there is no event which requires the recording of claim received in Year 2015-16. As it became definite in March 2018, the claim should have been recorded in 2017-18. It should not be a prior period item.

ii) **REFERENCE:** As per AS 5, the revision in rate of provision for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item.

ANALYSIS: PQR Ltd. created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimate based on the changed circumstances and wants to create 8% provision. It is a change in estimate.

CONCLUSION: The effect of the change should be shown in the profit and loss account for the year ending 31st March, 2018.

8. INTER RTP MAY 2019

Goods of ₹ 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 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 accounts for the year ended 31st March, 2018.

SOLUTION

REFERENCE:

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

ANALYSIS:

It is a case of error in preparation of financial statements for the year 2015-16 as the loss due to fire should have been recorded in 2015.

CONCLUSION:

Claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

Note: As per my understanding, the claim was not approved till March 2018 due to which there is no event which requires the recording of claim received in Year 2015-16. As it became definite in March 2018, the claim should have been recorded in 2017-18. It should not be a prior period item.

9. RTP MAY 20

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 organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

SOLUTION

REFERENCE:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(ii) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

CONCLUSION: The introduction of new pension scheme **is not a change in accounting policy.**

10. RTP NOV 20

The Accountant of Virush Limited has sought your opinion, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

(i) Till the previous year the machinery 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.

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

SOLUTION

REFERENCE:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) **ANALYSIS:** Till March 2019, the machinery was depreciated on straight line basis over a period of 5 years. In 2019-20, useful life of machinery has been changed from 5 years to 3 years. It is a change in estimate.

CONCLUSION: Change in useful life is not a **change in accounting policy.**

(ii) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

11. RTP MAY 21

XYZ Ltd. is in the process of finalizing its account for the year ended 31st March, 2020. The company seeks your advice on the following:

The company's tax assessment for assessment year 2017-18 has been completed on 14th February, 2020 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.

SOLUTION

Since the company is not appealing against the addition of ₹ 1.70 crore (₹ 5.40 crore less ₹ 3.70 crore), therefore, the same should be provided/ expensed off in its accounts for the year ended on 31st March, 2020. However, the amount paid under protest can be kept under the heading 'Long-term Loans & Advances / Short-term Loans and Advances' as the case may be alongwith disclosure as contingent liability of ₹ 3.70 crore.

12. QP JAN 21

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.

SOLUTION

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy

(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Extra -ordinary Items
(iv)	Treating operating lease as financelease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

13. RTP Nov 2014, RTP May 2017

The company finds that the inventory sheets of 31.3.2013 did not include two pages containing details of inventory worth ₹ 20 lakhs.

State, how you will deal with the above matter in the accounts of Lemon Ltd. for the year ended 31st March, 2014 with reference to Accounting Standards.

SOLUTION

REFERENCE:

AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as 'Income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.'

ANALYSIS / CONCLUSION:

Rectification of error in inventory valuation is a prior period item vide provisions of AS 5. ₹ 20 lakhs must be added to the opening inventory of 1/4/2013. It is also necessary to show ₹ 20 lakhs as a prior period adjustment in the Profit and loss Account. Separate disclosure of this item as a prior period item is required as per AS 5.

14. RTP NOV 21

There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.

SOLUTION:

REFERENCE:

AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' defines Prior Period items as 'Income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.'

ANALYSIS:

Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020–2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year.

CONCLUSION:

The adjustments are required to be made in the current year as 'Prior Period Items'. The adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived.

Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2021.

15. RTP NOV 21

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

SOLUTION

REFERENCE:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

ANALYSIS:

As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

CONCLUSION:

The introduction of new pension scheme is not a change in accounting policy.

16. RTP MAY 22

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, 2021. 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, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 3%.

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 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, 2021, there was change in cost formula in measuring the cost of inventories.

SOLUTION

REFERENCE:

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

(i) **ANALYSIS:** 2% provision for doubtful debts was created till 31st March, 2020. Subsequently in 2020-21, the estimates were revised based to create 3% provision. This change will affect only current year. Change in rate of provision of doubtful debt is change in estimate.

CONCLUSION: Change in rate of provision of doubtful debt is **not a change in accounting policy.**

(ii) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(iii) **ANALYSIS:** Till 2019-20, the furniture was depreciated on straight line basis over a period of 5 years. In 2020-21, useful life of furniture has been changed from 5 years to 3 years. It is a change in estimate.

CONCLUSION: Change in useful life is not a change in accounting policy.

(iv) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(v) **ANALYSIS:** Change in cost formula used in measurement of cost of inventories change would result in a more appropriate presentation of the financial statements.

CONCLUSION: Change in Cost formula is a **change in accounting policy.**

17. MAY 22 EXAM

TQ cycles Ltd. is in this manufacturing of bicycles, a labour intensive manufacturing sector. In April 2022, the government enhanced the minimum wages payable to workers with retrospective effect form the Ist January, 2022. Due to this legislative changes, the additional wages for the period from January 2022 to March 2022 amount to ₹ 30 Lakhs. The management asked the Finance manager to charge ₹ 30 Lakhs as period item while finalizing financial statement 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 loss account for the financial year 2021-22.

Discuss with references to applicable Accounting Standard.

SOLUTION

REFERENCE:

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

ANALYSIS:

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1.01.2022 to 31.3.2022 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022-23 as normal expenses. It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. **Such an expense does not qualify as an extraordinary item.**

CONCLUSION:

Finance manager is incorrect in treating increase as extraordinary item. Additional wages liability of ₹30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

18. MTP APRIL 2022 SERIES 2

A company created a provision of ₹ 7,50,000 for staff welfare while preparing the financial statements for the year 2021-22. On 31st March 2022, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to ₹ 10,00,000. The accounts were approved by Board of Directors on 15th April, 2022.

You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2022 in line with the provisions of AS 5?

SOLUTION

REFERENCE

AS 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, defines Prior Period items as 'Income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.'

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

ANALYSIS:

The change in amount of staff welfare provision amounting ₹ 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2021-22.

CONCLUSION:

The effect of the change should be shown in the profit and loss account for the year ending 31st March, 2022.

19. MTP SEP 22 (SERIES 1)

State with reasons, how the following events would be dealt with in the financial statements of Hari Ltd. for the year ended 31st March, 2022 (accounts were approved on 25th July, 2022):

Cashier of Hari Ltd. embezzled cash amounting to ₹ 3,00,000 during March, 2022. However the same comes to the notice of Company management during August, 2022.

SOLUTION

REFERENCE:

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

ANALYSIS:

As the embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. The same will not be adjusted in the financial statements for the year ended 31st March, 2022.

CONCLUSION:

Embezzlement of cash being an **extra-ordinary item** should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2023, in a manner, that its impact on current profit or loss can be perceived.

20. MTP OCT 22 (SERIES 2)

The management of Pluto Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policy or not for the year ended 31st March, 2021. Please advise them in the following situations in accordance with the provisions of Accounting Standard 5:

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

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees would receive a pension of ₹ 25,000 per month. Earlier there was no such scheme of pension in the organization.

(iii) Provision for doubtful Trade Receivables was created @ 2.5% till 31st March, 2020. From 1st April,2020, the rate of provision has been changed to 5%.

(iv) For the year ended 31st March,2021 there was change in the cost formula in measuring the cost of Inventories.

(v) Till the end of the previous year, Computers were depreciated on Straight Line Basis over a period of 5 years. From current year, the useful life of Computers has been changed to 3 years.

SOLUTION

REFERENCE:

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

(i) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions

CONCLUSION: Introduction of formal gratuity scheme will not be treated as change in an accounting policy.

(ii) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(iii) **ANALYSIS:** Pluto limited created 2.5% provision for doubtful debts till 31st March 2020. Subsequently in 2020-21, the company revised the estimates based on the changed circumstances and wants to create 5% provision. This change will affect only current year.

CONCLUSION: Change in rate of provision of doubtful debt is change in estimate and is **not change in accounting policy.**

(iv) **ANALYSIS:** Change in cost formula used in measurement of cost of inventories change would result in a more appropriate presentation of the financial statements.

CONCLUSION: Change in Cost formula is a **change in accounting policy.**

(v) **ANALYSIS:** Till 2019-20, Computer was depreciated on straight line basis over a period of 5 years. In 2020-21, useful life of Computer has been changed from 5 years to 3 years. It is a change in estimate.
CONCLUSION: Change in useful life is **not a change in accounting policy.**

21. EXAM NOV 22

The Account of Shiva Limited has sought your option with relevant reason, whether the following transactions will be treated as change in Account 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) Provisions for doubtful debts was created @ 3% till 31st March, 2020. Form 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-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. Form 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 organizations. Such employees will get pensions of ₹20,000 per month. Earlier there was on such scheme of pension in the organization.

(v) During the years ended 31st March, 2021 there was change in cost formula in measuring in the cost of inventories.

SOLUTION

REFERENCE:

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

(i) **ANALYSIS:** 3% provision for doubtful debts was created till 31st March, 2020. Subsequently in 2020-21, the estimates were revised based to create 4% provision. This change will affect only current year.
CONCLUSION: Change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy.

(ii) **ANALYSIS:** Introduction of a formal retirement gratuity scheme is a transaction which is substantially different from the previous one (Ad hoc payment). It is an adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions

CONCLUSION: Introduction of formal gratuity scheme will **not be treated as change in an accounting policy.**

(iii) **ANALYSIS:** Till 2019-20, the furniture was depreciated on straight line basis over a period of 5 years. In 2020-21, useful life of furniture has been changed from 5 years to 3 years. It is a change in estimate.

CONCLUSION: Change in useful life **is not a change in accounting policy.**

(iv) **ANALYSIS:** As per the reference above, Management deciding to pay pension to those employees who have retired after completing 5 years of service in the organization will not be a change in accounting policy.

Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy.

CONCLUSION: The introduction of new pension scheme is **not a change in accounting policy.**

(v) **ANALYSIS:** Change in cost formula used in measurement of cost of inventories change would result in a more appropriate presentation of the financial statements.

CONCLUSION: Change in Cost formula is a **change in accounting policy.**

AS 7 – CONSTRUCTION CONTRACTS

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI EXAMPLE 1 (THE PERCENTAGE COMPLETION METHOD)				
2	ICAI EXAMPLE 2				
3	ICAI EXAMPLE 3				
4	ICAI EXAMPLE 4				
5	ICAI ILLUSTRATION 1				
6	ICAI ILLUSTRATION 2, IPCC RTP NOV 2017 Q19B				
7	ICAI MOCK TEST PAPER 1 (Q NO 1 (A)), IPCC RTP NOV 2016 Q18B				
8	ICAI CA INTER MAY 2018 (Q NO 1 (A)), QP MAY 2018, MTP MARCH 2022 TEST SERIES 1				
9	QP MAY 19				
10	QP MAY 19				
11	RTP NOV 19				
12	RTP MAY 20 / ICAI PRACTICAL Q 9				
13	RTP NOV 20				
14	RTP MAY 21				
15	RTP MAY 21				
16	QP NOV 20				
17	IPCC RTP MAY 2016 Q19B				
18	RTP MAY 2019 Q 14, IPCC RTP MAY 2019				
19	IPCC RTP Nov 2015 Q19b				
20	IPCC RTP MAY 2017 Q19A				
21	RTP NOV 21				
22	RTP NOV 21				
23	QP JULY 21				
24	MOCK TEST OCT 21 SERIES 1				
25	MOCK TEST OCT 21 SERIES 2				
26	ICAI PRCATICAL QUESTION 13				

27	RTP MAY 22				
28	MAY 2022 EXAM				
29	MTP APRIL 2022 TEST SERIES 2				
30	RTP NOV 22				
31	MTP SEP 22 (SERIES 1)				
32	MTP OCT 22 (SERIES 2)				

Let's Get Started....With Class Work

1. ICAI EXAMPLE 1 (THE PERCENTAGE COMPLETION METHOD)

X Ltd. commenced a construction contract on 01/04/X1. The fixed contract price agreed was ₹ 2,00,000. The company incurred ₹ 81,000 in 20X1-X2 for 45% work and received ₹ 79,000 as progress payment from the customer. The cost incurred in 20X2-X3 was ₹ 89,000 to complete the rest of work. Show the Profit & Loss A/c and Customer A/c for the year 20X1-X2 and 20X2-X3 in the books of X Ltd.

SOLUTION

Percentage of completion = Cost incurred till date/Estimated total cost

Profit & Loss Account

Year		₹ 000	Year		₹ 000
20X1-X2	To Construction Costs (for 45% work)	81	20X1-X2	By Contract Price (45% of Contract Price)	90
	To Net profit (for 45% work)	9			
		90			90
20X2-X3	To Construction costs (for 55% work)	89	20X2-X3	By Contract Price (55% of Contract Price)	110
	To Net Profit (for 55% work)	21			
		110			110

Customer Account

Year		₹ 000	Year		₹ 000
20X1-X2	To Contract Price	90	20X1-X2	By Bank	79
				By Balance c/d	11
		90			90
20X2-X3	To Balance b/d	11	20X2-X3		
	To Contract Price	110		By Bank	121

		121			121

2. ICAI EXAMPLE 2

X Ltd. commenced a construction contract on 01/04/X1. The contract price agreed was reimbursable cost plus 20%. The company incurred ₹ 1,00,000 in 20X1-X2, of which ₹ 90,000 is reimbursable. The further non-reimbursable costs to be incurred to complete the contract are estimated at ₹ 5,000. The other costs to complete the contract could not be estimated reliably.

Show the extract of Profit & Loss A/c in the books of X Ltd.

SOLUTION

Profit & Loss Account

Particulars	₹ 000	Particulars	₹ 000
To Construction Costs	100	By Contract Price	90
To Provision for loss	5	By Net loss	15
	105		105

3. ICAI EXAMPLE 3

Show Profit & Loss A/c (Extract) in books of a contractor in respect of the following data.

Particulars	₹ 000
Contract price (Fixed)	600
Cost incurred to date	390
Estimated cost to complete	**260**

SOLUTION

Particulars	₹ 000
A. Cost incurred to date	390
B. Estimate of cost to completion	260

C. Estimated total cost	650
D. Degree of completion (A/C)	60%
E. Revenue Recognised (60% of 600)	360
Total foreseeable loss (650 – 600)	50
Less: Loss for current year (E – A)	(30)
Expected loss to be recognised immediately	**20**

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Profit & Loss A/c

Particulars	**₹**	**Particulars**	**₹**
To Construction costs	390	By Contract Price	360
To Provision for loss	20	By Net Loss	50
	410		**410**

4. ICAI EXAMPLE 4

XYZ construction Ltd, a construction company undertakes the construction of an industrial complex. It 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 XYZ Ltd, treat construction of each unit as a separate construction contract according to AS 7?

SOLUTION

FACTS:

XYZ Construction Ltd. has separate proposals for each unit followed by each unit being subject to separate negotiation. They are able to identify the costs and revenue for each unit.

REFERENCE:

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.

ANALYSIS:

In light of the facts and reference stated above, the conditions required to treat construction of each asset as separate contract have been satisfied.

CONCLUSION:

XYZ Ltd. is required to treat construction of each unit as a separate construction contract.

5. ICAI ILLUSTRATION 1

A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 20X1.

Particulars	(₹ in lakhs)
Total Contract Price	1,000
Work Certified for the cost incurred	500
Work yet not Certified for the cost incurred	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 issued by your institute.

SOLUTION

(a)	**Amount of foreseeable loss**	**(₹ in lakhs)**
	Total cost of construction (500 + 105 + 495)	1,100
	Less: Total contract price	(1,000)
	Total foreseeable loss to be recognised as expense	**100**

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

(b)	**Contract work-in-progress i.e. cost incurred to date are ₹ 605 lakhs**	**(₹ in lakhs)**
	Work certified	500
	Work not certified	105

		605

Percentage of completion = Cost incurred till date / Estimated total cost

This is 55% (605/1,100 x 100) of total costs of construction.

(c) Proportion of total contract value recognised as revenue: 55% of ₹ 1,000 lakhs = ₹ 550 lakhs

(d) Amount due from / to customers:

Particulars	**Amount (in Lakhs)**
Contract Costs	605
Recognised Profits / (Recognised Loss)	(100)
(A)	505
Progress payments received + Progress payments to be received (400 + 140) (B)	540
Amount due to customers (A) – (B)	**35**

The amount of ₹ 35 lakhs will be shown in the balance sheet as liability.

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

Particulars	**₹ in lakhs**
Contract revenue	550
Contract expenses	605
Recognised profits / (Recognised losses)	(100)
Progress billings ₹ (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

6. ICAI ILLUSTRATION 2, IPCC RTP NOV 2017 Q19B

On 1st December, 20X1, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, 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 recognized in the statement of profit and loss for the year ended 31st March, 20X2 as per provisions of Accounting Standard 7 (Revised)?

SOLUTION

Particulars	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less: Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

The amount of ₹ 12,00,000 is required to be recognised as an expense.

Percentage of completion = Cost incurred till date/Estimated total cost

Contract work in progress = (Rs.64,99,000 x 100) / 97,000 = = 67%

Proportion of total contract value recognised as turnover = 67% of ₹ 85,00,000 = ₹ 56,95,000.

7. ICAI MOCK TEST PAPER 1 (Q NO 1 (A)), IPCC RTP NOV 2016 Q18B

X Ltd. negotiates with Bharat Petroleum Corporation Ltd (BPCL), for construction of "Franchise Retail Petrol Outlet Stations". Based on proposals submitted to different "Zonal offices of BPCL, the final approval for one outlet each in Zone A, Zone B, Zone C, Zone D, is awarded to X Ltd. Agreement (in single document) is entered into with BPCL for ₹ 490 lakhs. The agreement lays down values for each of the four outlets (₹ 88 + 132 + 160 + 110 lakhs) in addition to individual completion time. Examine and Decide whether X Ltd., will treat it as a single contract or four separate contracts.

SOLUTION

FACTS:

The construction agreement of X ltd. with BPCL is a single document for 4 zones. The agreement has values specified for each outlet and individual completion time.

REFERENCE:

As per AS 7 on '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.

ANALYSIS:

In the given case, each outlet is submitted as a separate proposal to different Zonal Office, which can be separately negotiated, and costs and revenues thereof can be separately identified. Therefore, four separate contract accounts have to be recorded and maintained in the books of X Ltd. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS -7.

CONCLUSION:

Each asset will be treated as a **"single contract"** even if there is one document of contract.

8. ICAI CA INTER MAY 2018 (Q NO 1 (A)), QP MAY 2018, MTP MARCH 2022 TEST SERIES 1

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:

Particulars	₹ 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.

SOLUTION

(i)	**Loss for the year ended, 31st March, 2018**	**(₹ in lakhs)**
	Amount of foreseeable loss	

	Total cost of construction (6,250 + 1,250 + 8,750)	16,250
	Less: Total contract price	(12,000)
	Total foreseeable loss to be recognised as expense	**4,250**

According to AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Loss for the year ended, 31st March, 2018 amounting ₹ 4,250 will be recognized.

(ii)	**Contract work-in-progress as on 31.3.18**	**(₹ in lakhs)**
	Contract work-in-progress i.e. cost incurred to date are ₹ 7,500 lakhs:	
	Work certified	6,250
	Work not certified	1,250
		7,500

(iii) **Proportion of total contract value recognised as revenue**

Cost incurred till 31.3.18 is 46.15% (7,500/16,250 x 100) of total costs of construction.

Proportion of total contract value recognised as revenue: 46.15% of ₹ 12,000 lakhs = ₹ 5,538 lakhs

(iv) **Amount due from/to customers at year end**

Particulars	**Amount (in Lakhs)**
Contract Costs	7,500
Recognised Profits / (Recognised Loss)	(4,250)
(A)	3,250
Progress payments received + Progress payments to be received (5,500 + 1,500) (B)	7000
Amount due to customers (A) – (B)	**3,750**

9. QP MAY 19

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 Comment, with reference to AS- 7, whether AP Ltd., should treat it as a single contract or three separate contracts.

SOLUTION

FACTS:

A single construction agreement has been entered between Kay Ltd. and AP Ltd. The agreement has values specified for each unit and individual completion time.

REFERENCE:

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.

ANALYSIS:

In the given case, each unit is submitted as a separate proposal, which can be separately negotiated, and costs and revenues thereof can be separately identified. For each contract, principles of revenue and cost recognition have to be applied separately and net income will be determined for each asset as per AS -7.

CONCLUSION:

Mr. AP Ltd. is required to treat construction of each unit as a separate construction contract

10. QP MAY 19

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?

SOLUTION

Particulars	₹ In Lakhs

Cost of construction incurred till date	32.50
Add: Estimated future cost	15.10
Total estimated cost of construction	47.60

Percentage of completion till date to total estimated cost of construction

= Cost incurred till date/Estimated total cost

= (32.50/47.60)x 100 = 68.28%

Proportion of total contract value recognised as revenue for the year ended 31st March, 2018 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 45 lakh x 68.28% = ₹ 30.73 lakhs.

Particulars	(₹ in lakhs)
Total cost of construction	47.60
Less: Total contract price	(45.00)
Total foreseeable loss to be recognized as expense	2.60

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

11. RTP NOV 19

On 1st December, 2018, "Sampath" Construction Company Limited undertook a contract to construct a building for ₹ 108 lakhs. On 31st March, 2019 the company found that it had already spent ₹ 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹ 36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2019 based on AS 7 "Accounting for Construction Contracts."

SOLUTION

Particulars	₹ In Lakhs
Cost of construction incurred till date	83.99
Add: Estimated future cost	36.01
Total estimated cost of construction	120.00

Less: Total contract price	(108.00)
Total foreseeable loss to be recognized as expense	12.00

According to AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Company for the year ended 31st March, 2019.

12. RTP MAY 20 / ICAI PRACTICAL Q 9

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:

Particulars	(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).

SOLUTION

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

No	Particulars	Year 1	Year 2	Year 3
1	Total contract revenue	9,000	9,000	9,000
2	Cost incurred so far	2,093 (8,050 x 26%)	6,068 (8,200 x 74%)	8,200 (8,200 x 100%)

No	Particulars	Year 1	Year 2	Year 3
3	Estimated total cost	8,200	8,200	8,200
4	% Completion	26%	74%	100%
5	Total revenue to be recognised	2,340 (9,000 x 26%)	6,808 (9,200 x 74%)	9,200 (9,200 x 100%)
6	Contract revenue to be recognised for the respected year	2,340	4,468 (6,808-2,340)	2,392 (9,200-6,808)
7	Cost for the respective year	2,093	3,975 (6,068–2,093)	2,132 (8,200-6068)
8	Profit to be recognised (6-7)	247	493	260

Disclosures –

Working Note:

	Year 1	Year 2	Year 3
Revenue after considering variations Less: Estimated profit for whole contract	9,000 950	9,200 1,000	9,200 1,000
Estimated total cost of the contract (A)	8,050	8,200	8,200
Actual cost incurred upto the reporting date (B)	2,093	6,068 (6,168-100)	8,200 (8,100+100)
Degree of completion (B/A)	26%	74%	100%

13. RTP NOV 20

Uday Constructions undertake to construct a bridge for the Government of Uttar Pradesh. The construction commenced during the financial year ending 31.03.2019 and is likely to be completed by the next financial year. The contract is for a fixed price of ₹ 12 crore with an escalation clause. You are given the following information for the year ended 31.03.2019:

Cost incurred upto 31.03.2019	₹ 4 crore
Further cost estimated to complete the contract	₹ 6 crore

Escalation in cost was by 5%. Hence, the contract price is also increased by 5%.

You are required to ascertain the stage of completion and compute the amount of revenue and profit to be recognized for the year as per AS 7.

SOLUTION

a. Calculation of Cost and Contract price:

Particulars	₹ In Lakhs
Cost of construction of bridge incurred upto 31.3.2019	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction	10.00
Contract Price (12 x 1.05)	12.60

b. Percentage of completion till date to total estimated cost of construction

= Cost incurred till date/Estimated total cost

= (4/10)X100 = 40%

c. Proportion of total contract value recognised as revenue for the year ended 31st March, 2019 per AS 7 (Revised)

= Contract price x percentage of completion

= ₹ 12.60 crore x 40% = ₹ 5.04 crore

d. Profit for the year ended 31st March, 2019 = ₹ 5.04 crore – ₹ 4 crore

= 1.04 crore.

14. RTP MAY 21

Sky Limited belongs to Heavy Engineering Contractors specializing in construction of Flyovers. The company just entered into a contract with a local municipal corporation for building a flyover. No activity has started on this contract.

As per the terms of the contract, Sky Limited will receive an additional ₹ 50 lakhs if the construction of the flyover were to be finished within a period of two years from the commencement of the contract. The accountant of the entity wants to recognize this revenue since in the past the company has been able to meet similar targets very easily. Give your opinion on this treatment.

SOLUTION

FACTS:

Sky Ltd has not started any activity as per the contract. The incentive will be received only if the construction is finished within 2years from the commencement of the contract.

REFERENCE:

According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Incentive payments are included in contract revenue when both the conditions are met:

i. The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

ii. The amount of the incentive payment can be measured reliably.

ANALYSIS:

In the given problem, the contract has not even begun and hence the contractor (Sky Limited) should not recognize any revenue of this contract.

CONCLUSION:

The accountant's contention for recognizing ₹ 50 lakhs as revenue is not correct.

15. RTP MAY 21

ABC Ltd., a construction contractor, undertakes the construction of commercial complex for XYZ Ltd. ABC 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.

Comment, with reference to AS 7, whether ABC Ltd., should treat it as a single contract or three separate contracts.

SOLUTION

FACTS:

A single construction agreement has been entered between XYZ Ltd. and ABC Ltd. The agreement has values specified for each unit and individual completion time.

REFERENCE:

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.

ANALYSIS:

ABC Ltd. has submitted separate proposals for each of the 3 units of commercial complex. The revenue and completion time has been laid down for each unit separately which implies separate negotiation for them.

CONCLUSION:

ABC Ltd. is required to treat construction of each unit as a separate construction contract as the above-mentioned conditions of AS 7 are fulfilled.

16. QP NOV 20

Rajendra undertook a contract ₹ 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-fourth of the work under 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.

SOLUTION

No	Particulars	Year 1	Year 2	Year 3
1	Total contract revenue	20,00,000	20,00,000	20,00,000

No	Particulars	Year 1	Year 2	Year 3
2	Cost incurred so far	8,60,000	13,35,000 (475000+860000)	16,45,000 (1335000+310000)
3	Cost yet to be incurred	10,00,000	4,00,000	0
4	Estimated total cost	18,60,000	17,35,000	16,45,000
5	% Completion	46.24%	76.95%	100%
6	Total revenue to be recognised	9,24,800 (20,00,000x46.24%)	15,39,000 (20,00,000x76.95%)	20,00,000
7	Contract revenue to be recognised for the respected year	9,24,800	6,14,200 (1539000-924800)	4,61,000 (2000000-1539000)

17. IPCC RTP MAY 2016 Q19B

Five Star Construction Limited commenced a construction contract on 1st April, 2014. The fixed contract price agreed was Rs.50,00,000. The company incurred Rs.21,00,000 in 2014-15 for 40% work and received Rs.19,00,000 as progress payment from the customer. The company estimated that a further Rs.31,50,000 would be incurred to complete it. What amount should be charged to revenue for the year 2014-15 as per AS 7? Show the extract of Profit & Loss A/c and Customer A/c for the year 2014-15 in the books of the company. **(RTP May 2016)**

SOLUTION

(a)	**Amount of foreseeable loss**	₹
	Total cost of construction (21,00,000 + 31,50,000)	52,50,0000
	Less: Total contract price	(50,00,000)
	Total foreseeable loss to be recognised as expense	**2,50,0000**

According AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Percentage of completion = 40% (Given)

(a) Proportion of total contract value recognised as revenue: 40% of ₹ 50,00,0000 = ₹ 20,00,000

(b) Calculation for 2014-15 on 40% work:

Particulars	₹
Contract revenue	20,00,000
Contract expenses	21,00,000
Recognised profits / (Recognised losses)	(1,00,000)
Total expected loss recognized as per AS 7	2,50,000
Further provision required in respect of Expected Loss (2,50,000 -1,00,000)	1,50,000

In the Books of Five Star Construction Limited

Profit & Loss A/c (Extract for the year ended 31st March 2015)

Particulars	Amount	Particulars	Amount
To Construction Costs	21,00,000	By Contract Revenue	20,00,000
(for 40% work)			
To Provision for Loss	1,50,000	By Net Loss	2,50,000
	22,50,000		22,50,000

Customer A/c

Particulars	Amount	Particulars	Amount
To Contract Revenue	20,00,000	By Bank	19,00,000
		By Balance c/d	1.00.000
	20,00,000		20,00,000

18. RTP MAY 2019 Q 14, IPCC RTP MAY 2019

GTI Ltd. negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹ 102 lacs, ₹ 150 lacs, ₹ 130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region. Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

SOLUTION

FACTS:

A single construction agreement has been entered between GTI Ltd. and BOCL. The agreement has values specified for each outlets and individual completion time.

REFERENCE:

As per AS 7 'Construction Contracts', when a contract covers 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.

ANALYSIS:

In the given case, each outlet is submitted as a separate proposal to different Zonal Offices, which can be separately negotiated, and costs and revenues thereof can be separately identified.

CONCLUSION:

Each asset will be treated as a "single contract" even if there is one single agreement for contracts. Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.

19. IPCC RTP NOV 2015 Q19B

A contractor entered into a contract for building roads for ₹ 2 crores. After completing 60% of the contract he came to know that the cost of completing the contract would be ₹ 2.40 crores. The accountant transferred ₹ 0.24 crores i.e., 60% of total loss of ₹ 0.40 crores to Profit and Loss account in the current year. You are required to give your opinion in line with AS 7.

SOLUTION

FACTS:

60% of the contract is completed and cost of completion as has been revised to 2.4 crores. Accountant has transferred ₹ 0.24 crores i.e., 60% of total loss of ₹ 0.40 crores to Profit and Loss account.

REFERENCE:

As per AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately irrespective of the stage of completion.

ANALYSIS:

In the given case the revenue that can be recognized for the contract i.e., ₹ 2 crore and the expected expense on the contract is ₹ 2.4 cores. 60% of the contract has been completed.

CONCLUSION:

As per AS 7 whole amount of expected loss i.e., ₹ 0.40 crores should be recognized as an expense immediately irrespective of the stage of completion of the contract. Therefore, the action of accountant of transferring only ₹ 0.24 crores to the profit & loss a/c is wrong. He must transfer whole ₹ 0.40 crore to profit & loss a/c as an expense.

20.IPCC RTP MAY 2017 Q19A

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

SOLUTION

FACTS:

Mr. Mehta has not started any activity as per the contract. The incentive will be received only if the construction is finished within 2 years from the commencement of the contract.

REFERENCE:

According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Incentive payments are included in contract revenue when both the conditions are met:

i. The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
ii. The amount of the incentive payment can be measured reliably.

ANALYSIS:

In the given problem, the contract has not even begun and hence the contractor (Mr. Mehta) should not recognize any revenue of this contract.

CONCLUSION:

Mr. Mehta's contention for recognizing the revenue is not correct.

21. RTP NOV 21

In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably only when certain conditions prescribed under AS 7 are satisfied. You are required to describe these conditions mentioned in the standard.

SOLUTION

In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

(i) total contract revenue can be measured reliably;
(ii) it is probable that the economic benefits associated with the contract will flow to the enterprise;
(iii) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and
(iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

22. RTP NOV 21

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

SOLUTION

FACTS:

Mr. X has not started any activity as per the contract. The incentive will be received only if the construction is finished within 2years from the commencement of the contract.

REFERENCE:

According to AS 7 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Incentive payments are included in contract revenue when both the conditions are met:

i. The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
ii. The amount of the incentive payment can be measured reliably.

ANALYSIS:

In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

CONCLUSION:

Mr. X contention for recognizing additional ₹ 2 crore as revenue is not correct.

23.QP JULY 21

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

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.

SOLUTION

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000x56.25%) = ₹ 47,81,250

Contract costs = ₹ 45,00,000

24. MOCK TEST OCT 21 SERIES I

PRZ & Sons Ltd. are Heavy Engineering contractors specializing in construction of dams. From the records of the company, the following data is available pertaining to year ended 31st March, 2021:

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

Progress payments in pipe line	300

Using the given data and applying the relevant Accounting Standard you are required to:

(i) Compute the amount of profit/loss for the year ended 31st March, 2021.

(ii) Arrive at the contract work in progress as at the end of financial year 2020-21.

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

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

SOLUTION

(i)	**Calculation of profit / loss for the year ended 31st March, 2021**	(₹ in crores)
	Total estimated cost of construction (1,250 + 250 + 1,750)	3,250
	Less: Total contract price	(2,400)
	Total foreseeable loss to be recognized as expense	850

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

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

(iii) **Proportion of total contract value recognised as revenue**

Percentage of completion of contract to total estimated cost of construction

= (1,500 / 3,250)x100 = 46.15%

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

(iv) Amount due from / to customers:

Particulars	**Amount (in Crores)**
Contract Costs	1500
Recognised Profits / (Recognised Loss)	(850)
(A)	650
Progress payments received + Progress payments to be received	1400

(1100 + 300) (B)	
Amount due to customers (A) – (B)	**750**

The amount of ₹ 750 Crores will be shown in the balance sheet as liability.

25. MOCK TEST OCT 21 SERIES 2

A contractor firm obtained a contract for construction of bridge. The following details are available in the records kept for the year ended March 31, 2021:

(₹ in Crore)

Total Contract Price	500
Work Certified	250
Work not Certified	80
Estimated further Cost to Completion	220
Progress Payment Received	200
Payment to be Received	70
You are required to calculate :	

(i) The amount of revenue to be recognized.

(ii)The amount of profit or loss to be recognized.

(iii) The amount due from/ to customers.

Also present relevant disclosures as per AS-7 (Revised).

SOLUTION

Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction

= [(250 + 80) / (250 +80 + 220)]x100 = 60%

Revenue to be recognized till date = 60% of ₹ 500 crore = ₹ 300 crore.

(ii)	**Calculation of profit/ loss for the year ended 31st March, 2021**	**(₹ in crore)**
	Total estimated cost of construction	
	Work certified 250	
	Work not certified 80	
	Estimated further cost to completion 220	550
	Less: Total contract price	(500)

	Total foreseeable loss to be recognized as expense	50

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

(iii) Amount due from / to customers:

Particulars	Amount (in Crores)
Contract Costs (250 + 80)	330
Recognised Profits / (Recognised Loss)	(50)
(A)	280
Progress payments received + Progress payments to be received (200 + 70) (B)	270
Amount due from customers (A) – (B)	**10**

The amount of ₹ 10 Crores will be shown in the balance sheet as an asset

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

	₹ in crores
Contract revenue till 31st March, 2021	300
Contract expenses till 31st March, 2021	330
Recognized losses for the year 31st March, 2021	50
Progress billings ₹ (200+ 70)	270
Progress (billed but not received from contractee)	70
Gross amount due from customers	10

26. ICAI PRCATICAL QUESTION 13

Akar Ltd. Signed on 01/04/X1, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the year ended 31/03/X2.

- Materials used ₹ 71,00,000
- Labour charges paid ₹ 36,00,000
- Hire charges of plant ₹ 10,00,000
- Other contract cost incurred ₹ 15,00,000
- Labour charges of ₹ 2,00,000 are still outstanding on 31.3.X2.
- 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 for the year to be taken to Profit & Loss Account and any provision for foreseeable loss to be recognized as per AS 7.

SOLUTION

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

	Cost of Construction	₹	₹
	Material used		71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.20X2	2,00,000	38,00,000
	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.20X2		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss WN: 1		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

WN:1

Calculation of foreseeable loss	₹
Total cost of construction	1,67,50,000
Less: Total contract price	1,50,00,000
Total foreseeable loss to be recognised as expense	17,50,000

27.RTP MAY 22

B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. 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 that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

SOLUTION

FACTS:

The cost of completion has increased to 53 Crores and contract revenue is 50 crore.

REFERENCE:

As per AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

The amount of loss is determined irrespective of

i) Whether or not work has commenced on the contract;

ii) Stage of completion of contract activity; or

iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.

ANALYSIS:

As the cost of execution of contract is exceeding the revenue, the foreseeable loss of ₹ 3 crores (₹ 53 crores - ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021.

CONCLUSION:

B Ltd should recognise 3crore as an expense in year ended 31st March, 2021

28. MAY 2022 EXAM

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 escalations clause	35,000
Work certified	17,500
Work not certified (incudes ₹ 26,25,000 for materials issue, 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
Escalations 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 the loss to be made, if any, for the year ended 31st March, 2022.

SOLUTION

i. Computation of Contract revenue to be Recognized:

a. Calculation of total estimated cost of construction

Particulars	**(₹ in '000)**	**(₹ in '000)**
Cost of Contract incurred till date		
Work Certified	17,500	
Work not certified (3,815 – 140)	3,675	21,175
Add: Estimated future cost		17,325
Total estimated cost of construction		38,500
Contract Price (35,000 x 1.08)		37,800

b. Stage of completion

Percentage of completion till date to total estimated cost of construction

= [Cost of work completed till date / total estimated cost of the contract] x 100

= [₹ 21,175,000 / ₹ 38,500,000] x 100= 55%

c. Revenue to be recognized for the year ended 31stMarch, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800,000 x 55% = ₹ 20,790,000

ii. Loss to be recognized for the year ended 31stMarch, 2022

Particulars	(₹ in 000)
Cost Incurred till date	21,175
Less: Revenue to be recognized	(20,790)
Total foreseeable loss to be recognized as expense	385

Provision for loss to be made at the end of 31st March, 2022

Particulars	(₹ in 000)
Total estimated cost of the contract	38,500
Less: Total revised contract price	(37,800)
	700
Less: Loss recognized for the year ended 31st March, 2022	(385)
Provision for loss to be made at the end of 31st March, 2022	315

29. MTP APRIL 2022 TEST SERIES 2

Bricks Ltd. signed on 01/04/21, a construction contract for ₹ 1,50,00,000. Following particulars are extracted in respect of contract, for the period ending 31/03/22:

- 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 31.3.22.
- It is estimated that by spending further ₹ 33,50,000 (including material unused ₹ 4,00,000), 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.

SOLUTION

Statement showing the amount of profit/loss to be taken to Profit and Loss Account and additional provision for the foreseeable loss as per AS 7

	Cost of Construction	₹	₹
	Material Issued	75,00,000	
Less:	Unused Material at the end of period	4,00,000	71,00,000
	Labour Charges paid	36,00,000	
Add:	Outstanding on 31.03.2022	2,00,000	38,00,000

	Hire Charges of Plant		10,00,000
	Other Contract cost incurred		15,00,000
	Cost incurred upto 31.03.2022		1,34,00,000
Add:	Estimated future cost		33,50,000
	Total Estimated cost of construction		1,67,50,000
	Degree of completion (1,34,00,000/1,67,50,000 x 100)		80%
	Revenue recognized (80% of 1,50,00,000)		1,20,00,000
	Total foreseeable loss (1,67,50,000 - 1,50,00,000)		17,50,000
Less:	Loss for the current year (1,34,00,000 - 1,20,00,000)		14,00,000
	Loss to be provided for		3,50,000

WN:1

Calculation of foreseeable loss	₹
Total cost of construction	1,67,50,000
Less: Total contract price	1,50,00,000
Total foreseeable loss to be recognised as expense	17,50,000

30. RTP NOV 22

On 1st December, 2020, "Sampath" Construction Limited undertook a contract to construct a building for ₹ 108 lakhs. On 31st March, 2021 the company found that it had already spent ₹ 83.99 lakhs on the construction. A prudent estimate of additional cost for completion was ₹ 36.01 lakhs.

You are required to compute the amount of provision for foreseeable loss, which must be made in the Final Accounts for the year ended 31st March, 2021 based on AS 7 "Accounting for Construction Contracts."

SOLUTION

Calculation of foreseeable loss for the year ended 31st March, 2021

(as per AS 7 "Construction Contracts")

(₹ in lakhs)	
Cost incurred till 31st March, 2021	83.99
Prudent estimate of additional cost for completion	36.01

Total cost of construction	120.00
Less: Contract price	(108.00)
Foreseeable loss	12.00

According to AS 7 (Revised 2002) "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately. Therefore, amount of ₹12 lakhs is required to be provided for in the books of Sampath Construction Ltd. for the year ended 31st March, 2021.

31. MTP SEP 22 (SERIES 1)

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 shown in 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).

SOLUTION

a. Calculation of foreseeable loss:

Particulars	₹
Cost incurred till 31st March, 2020	129,98,000
Prudent estimate of additional cost for completion	64,02,000
Total cost of construction	194,00,000
Less: Contract price	(170,00,000)
Total foreseeable loss	24,00,000

As per AS 7 Construction Contracts, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Hence the foreseeable loss of ₹ 24,00,000 should be recognized as an expense immediately in the year ended 31st March 2020.

b. Percentage of completion = Cost incurred till date/Estimated total cost

= 129,98,000/194,00,000 X 100

= 67%

c. Contract revenue to be recognized = 67% of ₹ 170,00,000 = ₹ 113,90,000.

32.MTP OCT 22 (SERIES 2)

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

1. Contract Price - ₹ 85 lakhs
2. Materials issued - ₹ 21 Lakhs out of which Materials costing ₹ 4 Lakhs is still lying unused.at the end of the period.
3. Labour Expenses for workers engaged at site - ₹ 16 Lakhs (out of which ₹ 1 Lakh is still unpaid)
4. Specific Contract Costs = ₹ 5 Lakhs
5. Sub-Contract Costs for work executed - ₹ 7 Lakhs, Advances paid to Suh-Contractors - ₹ 4 Lakhs
6. 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.

SOLUTION

a. Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	21-4	17
Add: Labour cost incurred on the contract (including outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

b. Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000

= 56.25%

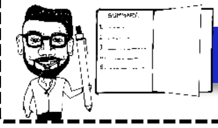
Contract Revenue and Cost to be recognized as per AS-7:

Particulars	₹
Contract revenue to be recognized (₹ 85,00,000x56.25%)	47,81,250
Contract costs	45,00,000

AS 9 – REVENUE RECOGNITION

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION 1				
2	ICAI ILLUSTRATION 2				
3	ICAI ILLUSTRATION 3				
4	ICAI ILLUSTRATION NO 4				
5	MOCK TEST 2 Q NO 1 (A)				
6	RTP MAY 2018 Q NO 15(B)				
7	RTP NOV 19				
8	RTP MAY 20 / ICAI PRACTICAL QUESTION 10				
9	RTP MAY 21				
10	QP MAY 19				
11	RTP MAY 2019 Q15, IPCC RTP MAY 2019				
12	(RTP NOV 2014) (NOV. 2008 – FINAL NEW COURSE)				
13	(RTP IPCC (GR-1) NOV, 2009)				
14	(RTP MAY, 2011 (NEW)				
15	(RTP MAY 2013)				
16	MAY 2015				
17	IPCC RTP NOV 2014 Q19 B				
18	IPCC RTP May 2016 Q20a / IPCC RTP NOV 17				
19	IPCC RTP Nov 2016 Q19a				
20	IPCC RTP May 2017 / ICAI Practical Q 1				
21	QP NOV 19				
22	RTP NOV 21				
23	RTP NOV 21				
24	QP JULY 21				
25	MOCK TEST OCT. 21 SERIES 1				
26	MOCK TEST OCT. 21 SERIES 1 / RTP NOV 20				
27	QP DEC 21				
28	RTP MAY 22				
29	RTP May 22				
30	MTP MARCH 2022 TEST SERIES 1				

31	RTP Nov 22				
32	MTP Oct 22 (Series 2)				
33	EXAM NOV 22				



Let's Get Started….With Class Work

1. ICAI ILLUSTRATION 1

The Board of Directors decided on 31.3.20X2 to increase the sale price of certain items retrospectively from 1st January, 20X2. In view of this price revision with effect from 1st January 20X2, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 20X1-20X2. Advise.

SOLUTION

FACTS:

Retrospective increase of Sales price has been made resulting in increase in sales value by ₹ 15 lakhs

REFERENCE:

As per AS 9, Revenue from sales or service transactions should be recognised when the requirements as to performance are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

ANALYSIS:

Price revision was effected during the current accounting period 20X1-20X2. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 20X2 to 31st March, 20X2. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized.

CONCLUSION:

The additional revenue arising out of the said **price revision may be recognized in 20X1-20X2.**

2. ICAI ILLUSTRATION 2

Y Ltd., used certain resources of X Ltd. In return X Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respective from Y Ltd. during the year 20X1-X2. You are required to state whether and on what basis these revenues can be recognized by X Ltd.

SOLUTION

REFERENCE:

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

ANALYSIS:

These revenues are recognized on the following bases:

i. **Interest:** On a time proportion basis taking into account the amount outstanding and the rate applicable.
ii. **Royalties:** On an accrual basis in accordance with the terms of the relevant agreement.

CONCLUSION:

X Ltd. should recognize interest revenue of ₹ 10 Lakhs and royalty revenue of ₹ 15 Lakhs.

3. ICAI ILLUSTRATION 3

A claim lodged with the Railways in March, 20X1 for loss of goods of ₹ 2,00,000 had been passed for payment in March, 20X3 for ₹ 1,50,000. No entry was passed in the books of the company, when the claim was lodged. Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 20X3.

SOLUTION

FACTS:

Claim filed by P Co. Ltd. for loss of goods has been passed for payment for ₹ 1,50,000 in March 20X3.

REFERENCE:

AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

AS 5 states that 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.

ANALYSIS:

In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,50,000 were collected against a claim of ₹ 2,00,000. Hence, the transaction cannot be taken as a Prior Period Item. Further in the light of AS 5, it will not be treated as extraordinary item.

CONCLUSION:

The nature and amount of this item should be disclosed separately.

4. ICAI ILLUSTRATION NO 4

In the year 20X1-X2, XYZ supplied goods on Consignment basis to ABC – a retail outlet worth ₹10,00,000. As per the terms, ABC will only pay XYZ for the goods which are sold by them to the third party. Rest of the goods can be returned back to XYZ and ABC will not have any further liability for these goods.

During the year 20X1-X2, ABC has sold goods worth ₹ 5,50,000 only and rest of the goods are still lying in its store which may get sold by next year. Advise XYZ, how much revenue it can recognize in its books for period 20X1-X2.

SOLUTION

FACTS:

XYZ supplied goods on Consignment basis to ABC worth ₹10,00,000, of which goods worth ₹5,50,000 has been sold during the year 20X1-X2.

REFERENCE:

As per AS 9, for consignment risk and rewards are not transferred to the customer on just delivery of the goods and no revenue should be recognized until the goods are sold to a third party.

ANALYSIS:

As per the reference and facts above, the goods worth ₹5,50,000 have been sold and ₹4,50,000 worth of goods are still with ABC for sale on behalf of XYZ. For the goods worth ₹4,50,000, ABC have no liability and can be returned back to XYZ as per the terms.

CONCLUSION:

XYZ can recognize revenue of ₹ 5,50,000.

5. MOCK TEST 2 Q NO 1 (A)

Ruby 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 @ 10% p.a. from the agent. The company has not realized interest from the agent in the past. For the year ended 31st March, 2017 interest due from agent (because of delay in payment) amounts to ₹5 lakhs. The accountant of Ruby Ltd. booked Rs. 5 lakhs as interest income in the year ended 31st March, 2017.

Examine and discuss the contention of the accountant with reference to AS 9 "Revenue Recognition".

SOLUTION

FACTS:

As per the terms of sales, Interest of Rs. 5Lakh is receivable from an agent due to delay in payment. Ruby Ltd. has not realized interest from the agent in the past.

REFERENCE:

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 involved. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

ANALYSIS:

In this case, the company never realized interest for the delayed payments made by the agent. Hence, based on the past experience, the realization of interest for the delayed payments by the agent is very much uncertain. The interest should be recognized only if the ultimate collection is certain.

CONCLUSION:

1. The interest income of Rs. 5 lakhs should not be recognized in the books for the year ended 31st March, 2017. The contention of accountant is incorrect.
2. However, if the agents have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 5 lakhs as interest amount.

6. RTP MAY 2018 Q NO 15(B)

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

Date	Activity	Cost 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 calculate how much would be net profit for year ending 31.3.16 on this product as per AS 9.

SOLUTION

REFERENCE:

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) the seller of goods has **transferred to the buyer** the property in the goods for a price or all **significant risks and rewards** of ownership have been **transferred to** the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership and

(ii) **no significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS:

The conditions required for recognition of revenue are satisfied only on 15.3.2016 when sales are agreed upon at a price and goods are allocated for delivery purpose through invoice.

CONCLUSION:

The amount of net profit ₹ 1,50,000 (3,50,000 – 2,00,000) should be recognized in the books for the year ending 31st March, 2016.

7. RTP NOV 19

The Board of Directors decided on 31.3.2019 to increase the sale price of certain items retrospectively from 1st January, 2019. In view of this price revision with effect from 1st January 2019, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 2019 to 31st March, 2019. Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2018-2019. Advise.

SOLUTION

FACTS:

Retrospective increase of Sales price has been made resulting in increase in sales value by ₹ 15 lakhs

REFERENCE:

As per AS 9, Revenue from sales or service transactions should be recognised when the requirements as to performance are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

ANALYSIS:

Price revision was effected during the current accounting period 2018-2019. As a result, the company stands to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 2018 to 31st March, 2019. If the company is able to assess the ultimate collection with reasonable certainty, then additional revenue arising out of the said price revision may be recognized.

CONCLUSION:

The additional revenue arising out of the said **price revision may be recognized in 2018-2019.**

8. RTP MAY 20 / ICAI PRACTICAL QUESTION 10

The following information of Meghna Ltd. is provided:

i. Goods of ₹ 60,000 were sold on 20-3-20X2 but at the request of the buyer these were delivered on 10-4-20X2.

ii. On 15-1-20X2 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-20X2.

iii. ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-20X1. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-20X2 and no approval or disapproval received for the remaining goods till 31-3-20X2.

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 Meghna Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS 9.

SOLUTION

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

i. The seller **of goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards of** ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

ii. **No significant uncertainty** exists regarding the amount of the **consideration** that will be derived from the sale of the goods.

However, the above is subject to trade discount and volume rebates received in the course of carrying on business which shall be deducted in ascertaining revenue since they represent a reduction of cost.

ANALYSIS (i):

The sale is complete but delivery has been postponed at buyer's request. Hence both the conditions for recognition of revenue are satisfied.

CONCLUSION:

The entity should **recognize the entire sale of ₹ 60,000** for the year ended 31st March, 20X2.

ANALYSIS (ii):

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. As the **risk** and rewards are not transferred, it cannot be recognized.

CONCLUSION:

20% goods lying unsold with consignee should be treated as closing inventory and **sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000).**

ANALYSIS (iii):

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

CONCLUSION:

Revenue should be **recognized** for the total sales amounting ₹ **1,20,000** as the time period for rejecting the goods had expired.

ANALYSIS (iv):

The amount of trade discounts is not receivable from the customer. The Trade discount given should be deducted in determining revenue.

CONCLUSION:

₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. **Thus, revenue should be ₹ 7,41,000.**

9. RTP MAY 21

Tonk Tanners is engaged in manufacturing of leather shoes. They provide you the following information for the year ended 31st March,2020:

(i) On 31st December, 2019 shoes worth ₹ 3,20,000 were sent to Mohan Shoes for sale on consignment basis of which 25% shoes were unsold and lying with Mohan Shoes as on 31st March, 2020.

(ii) On 10th January, 2020, Tonk Tanner supplied shoes worth ₹ 4,50,000 to Shani Shoes and concurrently agrees to re-purchase the same goods on 11th April. 2020.

(iii) On 21st March, 2020 shoes worth ₹ 1,60,000 were sold to Shoe Shine but due to refurbishing of their showroom being underway, on their request, shoes were delivered on 12th April, 2020.

You are required to advise the accountant of Tonk Tanners, when amount is to be recognised as revenue in 2019 -20 in above cases in the context of AS 9.

SOLUTION

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

i. The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

ii. **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS (i):

In case goods are sent for consignment sale, revenue is recognized when significant risks of ownership have passed from seller to the buyer. In the given case, Mohan Shoes is the consignee i.e., an agent of Tonk Tanners and not the buyer. Therefore, the risk and reward is considered to vest with Tonk Tanners only till the time the sale is made to the third party.

CONCLUSION:

In the year **2019- 2020, the sale will be recognized** for the amount of goods sold by Mohan Shoes to the third party i.e. for **₹ 3,20,000 x 75% = ₹ 2,40,000.**

ANALYSIS (ii):

Sale and re-purchase of same goods are classified as transactions that are in substance a financing agreement, for which the resulting cash inflow is not revenue and should not be recognised as revenue in the year 2019-2020.

CONCLUSION:

Sale of **₹ 4,50,000** to Shani Shoes should **not be recognized as revenue.**

ANALYSIS (iii):

On 21st March, 2020, the sale is complete but delivery has been postponed at buyer's request. Hence both the conditions for recognition of revenue are satisfied.

CONCLUSION:

Revenue shall be recognized in the **year 2019-2020** irrespective of the fact that the delivery is delayed on the request of Shoe Shine.

10. QP MAY 19

Given below is the following information 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.

SOLUTION

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

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

ANALYSIS (i):

The sale is complete but delivery has been postponed at buyer's request. Hence both the conditions for recognition of revenue are satisfied.

CONCLUSION:

B.S. Ltd. should **recognize** the entire sale of ₹ **50,000** for the year ended 31st March, 2018.

ANALYSIS (ii):

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. As the risk and rewards are not transferred, it cannot be recognized.

CONCLUSION:

20% goods lying unsold with consignee should be treated as closing inventory and **sales** should be **recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).**

ANALYSIS (iii):

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

CONCLUSION:

Revenue should be recognized for the total sales amounting **₹ 1,00,000** as the time period for rejecting the goods had expired.

Total revenue amounting ₹ 2,50,000 (50,000 + 1,00,000+ 1,00,000) will be recognized for the year ended 31st March, 2018 in the books of B.S. Ltd.

11. RTP MAY 2019 Q15, IPCC RTP MAY 2019

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 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.

SOLUTION

FACTS:

Heena Ltd. requested to Raj Ltd. not to dispatch goods worth ₹ 15,00,000 ready for dispatch but the payment for the goods and sales agreement have been made.

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

i. The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards of ownership have been transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

ii. **No significant uncertainty exists regarding** the amount of the consideration that will be derived from the sale of the goods.

ANALYSIS:

In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request.

CONCLUSION:

Raj Ltd. should **recognize the entire sale of ₹ 30,00,000 (₹ 5,00,000 x 6)** and no part of the same is to be treated as Advance Received against Sales.

12. (RTP NOV 2014) (NOV. 2008 – FINAL NEW COURSE)

SCL Ltd. sells agriculture products to dealers. One of the condition of sale is that interest is payable at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2005-2006 the company wants to recognise the entire interest receivable. Do you agree.

SOLUTION

FACTS:

SCL Ltd. Has interest recoverable on delayed payments from dealers. Percentage of interest recovery is only 10% on such overdue outstanding.

REFERENCE:

As per AS 9 on Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognize revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by installments.

ANALYSIS:

SCL Ltd. cannot recognize the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstanding is also an estimate and is not certain.

CONCLUSION:

SCL Ltd., is advised to recognize interest receivable only on **receipt basis.**

13. (RTP IPCC (GR-1) NOV, 2009)

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 31.3.2008, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs.9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per AS 9.

SOLUTION

REFERENCE:

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, e.g. for escalation of price, export incentives, interest etc. 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.

ANALYSIS:

In this case, the company never realized interest for the delayed payments made by the dealer. Hence, based on the past experience, the realization of interest for the delayed payments by the dealer is very much uncertain.

CONCLUSION:

The interest income of Rs. 9 lakhs should not be recognized in the books for the year ended 31st March, 2008. The **contention of accountant is incorrect.** However, if the dealers have agreed to pay the amount of interest and there is an element of certainty associated with these receipts, the accountant is correct regarding booking of Rs. 9 lakhs as interest amount.

14. (RTP MAY, 2011 (NEW)

On 25th January, 2010. Planet Advertising Limited obtained advertisement rights for World Cup Hockey Tournament to be held in March/April, 2010 for Rs.520 lakhs.

They furnish the following information:

1) The company obtained the advertisements for 70% of available time for Rs.700 lakhs by 31st January, 2010.
2) For the balance time they got bookings in February, 2010 for Rs.240 lakhs.
3) All the advertisers paid the full amount at the time of booking the advertisements.
4) 40% of the advertisements appeared before the public in March, 2010 and balance 60% appeared in the month of April, 2010.

You are required to calculate the amount of profit/loss to be recognized in the financial year 2009-10 as per AS 9.

SOLUTION

REFERENCE:

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Further, appendix to AS 9 states that revenue from advertising should be recognized when the service is completed. The service as regards advertisement is deemed to be completed when the related advertisement appears before the public.

ANALYSIS:

In the given problem, 40% of the advertisement appeared before the public in March, 2010 and balance 60% in April, 2010.

Total profit will be computed as follows:

Particulars	**Rs. in lakhs**
Advertisement for 70% of available time obtained by 31st January, 2010	700
Advertisement for 30% of available time obtained by February, 2010	240
Total	940
Less: Cost of advertisement rights	(520)
Profit	**420**
Profit to be recognized in March, 2010 i.e., F Y 2009-10 (Rs.420 lakhs x 40%)	168

Profit to be recognized in April, 2010 i.e., F Y 2010-11 (Rs.420 lakhs x 60%)	252

The profit amounting Rs.420 lakhs should be apportioned in the ratio of 40:60 for the months of March and April, 2010.

15. (RTP MAY 2013)

M Ltd. manufactures machinery used in Steel Plants. It quotes prices in various tenders issued by Steel Plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only. Comment on the treatment done by M Ltd.

SOLUTION

REFERENCE:

According to AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership and

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

ANALYSIS:

In the present case, the goods, as well as the risks and rewards of ownership have been transferred to the steel plants. The invoice raised by M Ltd. is for the full price. M Ltd. receives 90% as 10% is kept as 'Retention Money'. Thus, M Ltd. should recognise revenue at the full invoice price, i.e., 100% of the sale price.

Depending on the past experience of recovering the balance 10% from the steel plants, M Ltd. can make a provision for sales income which is not likely to be realised.

CONCLUSION:

The practice adopted by M Ltd. is **not in consonance with AS 9.**

16. MAY 2015

A company sells the goods with right to return. The following pattern has been observed:

Timeframe of return from date of purchase	% of cumulative sales
Within 10 days	5%
Between 11 days and 20 days	7 %
Between 21 days and 30 days	8%
Between 31 days and 45 days	9 %

Company has made sale of Rs.30 lacs in the month of February 2015 and of Rs.36 lacs in the month of March, 2015. The total sales for the financial year have been Rs.450 lacs and the cost of sales was Rs.360 lacs.

Determine the amount of provision to be made and revenue to be recognised in accordance with AS 9. A year may be considered of 360 days.

SOLUTION

REFERENCE:

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Revenue in respect of sale of goods is recognised fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provisions for returns based on previous experiences.

ANALYSIS:

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company. Revenue in respect of sale of goods is recognized fully at the time of sale itself assuming that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods.

Sales during	Sales value (Rs. in lacs)	Sales value (cumulative) (Rs. in lacs)	Likely returns (%)	Likely returns (Rs. in lacs)	Provision @ 20% (Rs. in lacs)
Last 10 days of March	36/3 or 12	12	5%	0.600	0.120
Previous 10 days of March	36/3 or 12	24	7%	1.680	0.336
Previous 10 days of March	36/3 or 12	36	8%	2.880	0.576
Last 15 days of February	30/2 or 15	51	9%	4.590	0.918
Total				9.75	1.950

Therefore, sale of Rs.30,00,000 and 36,00,000 made in the month of February and March, 2015 will be recognized at full value.

Working Note:

Calculation of Profit % on sales

Particulars	**Rs. In Lacs**
Sales for the year	450
Less: Cost of sales	(360)
Profit	90
Profit mark up on sales (90/450) x 100 = 20%	

Alternatively, AS 9 provides that Revenue should not be recognized until the goods have formally been accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has been elapsed. Based on this, an alternative view can be taken whereby the revenue shall not be recognized in full. In such a case, the revised sales will be as follows:

Particulars		**Rs. In Lacs**
Revised Sales when estimated sales return is 9.75 lacs	450 - 9.75	440.25
Revised Cost of Sales	440.25 x 80%	352.20
Revised Gross Profit		88.05
Given Gross Profit		90
Reduction in Gross Profit		1.95
Reduction in receivables and sales		9.75
Inventory will stand increased by		7.80

17. IPCC RTP NOV 2014 Q19 B

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

SOLUTION

REFERENCE:

According to AS 9 "Revenue Recognition", Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

ANALYSIS:

Lucky Ltd. had sold goods to Victory Ltd on credit worth for ₹ 250 crores and the sale was completed in all respects. Victory Ltd's decision to sell the same in the domestic market at a discount does not affect the amount recorded as sales by Lucky Ltd. **The price discount of 15%** offered by Lucky Ltd. after request of Victory Ltd. **was not in the nature of a discount** given during the **ordinary course of trade** because otherwise the same would have been given at the time of sale itself. It is the special discount which is being allowed at the request of the buyer. Therefore, it would be appropriate to make a separate provision rather than to adjust the amount of revenue originally recorded.

CONCLUSION:

The discount of 15% provided should be **written off to the profit and loss account** and should not be shown as deduction from the sales figure.

18. IPCC RTP May 2016 Q20a / IPCC RTP NOV 17

X Limited sold goods worth ₹ 13 Lakhs to Mr. Y. Mr. Y asked for a Trade Discount amounting to ₹ 1,06,000 and the same was agreed to by X Limited. Such discount was allowed in the ordinary course of business. The sale was effected and goods were dispatched. On receipt of goods, Mr. Y has found that goods worth ₹ 1,34,000 are defective. Mr. Y returned defective goods to X Limited and made payment amount to ₹ 10,60,000. The Accountant of X Limited booked the sale for ₹ 10,60,000.

Discuss the contention of the Accountant with reference to relevant Accounting Standard.

SOLUTION

REFERENCE:

As per AS 9, "Revenue Recognition" is the inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from the sale of Goods. However, the above is subject to trade discount and volume rebates received in the course of carrying on business which shall be deducted in ascertaining revenue since they represent a reduction of cost.

ANALYSIS:

As per the reference above, X Limited should deduct the trade discount from ₹ 13,00,000 and should recognize gross sale at (₹ 13,00,000 - ₹ 1,06,000) = ₹ 11,94,000. Goods returned worth ₹ 1,34,000 should to be recorded in the form of sales return.

CONCLUSION:

The contention of the accountant to book sale of ₹ 10,60,000 is not correct.

19. IPCC RTP Nov 2016 Q19a

Khetan Ltd. has received two lakh subscriptions during the current year under its new scheme whereby customers are required to pay a sum of ₹ 4,500 for which they will be entitled to receive a magazine for a period of 3 years. Khetan wants to treat the entire amount as revenue for the current year. Comment.

SOLUTION

FACTS:

2 Lakh subscriptions have been received for ₹ 4,500 each against which magazine will be provided by Ketan Ltd for 3 years.

REFERENCE:

As per AS 9 - Revenue Recognition, Revenue received or billed from subscriptions for publications should be deferred and recognised either on a straight line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

ANALYSIS:

The revenue of ₹ 4,500 for 2 Lakh subscriptions should be recognized on a straight line basis over the period of 3 years.

CONCLUSION:

The **accounting treating** adopted by Khetan Ltd. to treat the entire amount as revenue for the current year **is not in accordance with AS 9.**

20.IPCC RTP May 2017 / ICAI Practical Q 1

K Ltd. has sold its building for ₹ 50 lakhs to B Ltd. and has also given the possession to B Ltd. The book value of the building is ₹ 30 lakhs. As on 31st March, 2016, the documentation and legal formalities are pending. The company has not recorded the sale and has shown the amount received as advance. Do you agree with this treatment?

SOLUTION

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. K Ltd. should record the sale and recognize the profit of ₹ 20 lakhs in its profit and loss account. The building should be eliminated from the balance sheet.

21. QP NOV 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.

SOLUTION

As per AS 9, the revenue should be recognized as follows:

1. Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.
2. When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.
3. For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.
4. Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.
5. On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers. Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

22. RTP NOV 21

How will you recognize revenue in the following cases:

1. Installation Fees
2. Advertising and insurance agency commissions
3. Subscriptions for publications.

SOLUTION

As per AS 9, revenue should be recognized as per below provisions:

1. **INSTALLATION FEES:** In cases where installation fees are other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer.
2. **ADVERTISING AND INSURANCE AGENCY COMMISSIONS:**
   1) Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.
   2) Insurance agency commissions should be recognized on the **effective commencement** or **renewal dates of the related policies.**
3. **SUBSCRIPTION FOR PUBLICATIONS:** Revenue received or billed should be **deferred** and recognized either on a **straight-line basis over time** or, where the it**ems delivered vary in value** from period to period, revenue should be based on the s**ales value of the item delivered in relation to the total sales value** of all items covered by the subscription.

23. RTP NOV 21

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

SOLUTION

REFERENCE:

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

ANALYSIS:

In the case of the jewellery business the company is selling for cash and returns are negligible. In Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return.

CONCLUSION:

Revenue related to Jewellery business can be recognized as sales. For Apparels business, **the company should not recognize the revenue to the extent of 25% of its sales.** The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

24. QP JULY 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.

SOLUTION

REFERENCE: As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

According to **AS 9 "Revenue Recognition"**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

a. the seller of goods has **transferred to the buyer the property in the goods** for a price or all **significant risks and rewards of ownership have been transferred** to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership and

b. **no significant uncertainty** exists regarding the **amount of the consideration** that will be derived from the sale of the goods.

ANALYSIS:

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company. Revenue in respect of sale of goods is recognized fully at the time of sale itself assuming that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) ₹ (in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				**22.68**	**4.536**

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for ₹ 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales (80/400) x 100 = 20%	

25. MOCK TEST OCT. 21 SERIES I

Old Era Publication Publishes a popular monthly magazine on 15th of every month. The publication sells the advertising space on terms of 90% payable in advance and the balance 10% payable within 30 days of release of the publication. The space for March 2020 issue of the magazine was sold in the month of February, 2020. The magazine was published as per schedule on 15th of the month. The amount of ₹ 2,70,000 has been received upto 31st

March, 2020 and ₹ 30,000 was received on 10th April, 2020 for advertisement published in the March issue of the publication.

Please advise the accountant the amount of revenue to be recognized in the context of the provisions of AS 9 'Revenue Recognition' during the year ending on 31st March, 2020.

SOLUTION

REFERENCE:

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

ANALYSIS:

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is appeared for public and hence revenue is recognized on that date. In this case, it is 15.03.2020, the date of publication of the magazine.

ACCOUNTING TREATMENT:

₹ 3,00,000 (₹ 2,70,000 + ₹ 30,000) is recognized as income in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. ₹ 30,000 is treated as amount due from advertisers as on 31.03.2020 and ₹ 2,70,000 will be treated as payment received against the sale.

26. MOCK TEST OCT. 21 SERIES 1 / RTP NOV 20

Fashion Limited is engaged in manufacturing of readymade garments. They provide you the following information on 31st March, 2021:

(i) On 15th January, 2021 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, 2021.

(ii) Garments worth ₹ 1,95,000 were sold to Shine boutique on 25th March, 2021 but at the request of Shine Boutique, these were delivered on 15th April, 2021.

(iii) On 1st November, 2020 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, 2020 and no approval or disapproval received for the remaining goods till 31st March, 2021.

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.

SOLUTION

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

i. The seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards of ownership** have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

ii. **No significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS (i):

In case of consignment sale revenue should not be recognized until the goods are sold to a third party. As the risk and rewards are not transferred, it cannot be recognized.

CONCLUSION:

25% goods lying unsold with consignee should be treated as closing inventory and **sales should be recognized for ₹ 3,00,000 (75% of Rs. 4,00,000)** for the year ended on 31.3.21.

ANALYSIS (ii):

The sale is complete but delivery has been postponed at buyer's request. Hence both the conditions for recognition of revenue are satisfied.

CONCLUSION:

Fashion Ltd. should **recognize the entire sale of Rs.1,95,000** for the year ended 31st March, 2021.

ANALYSIS (iii):

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

CONCLUSION:

Revenue should be recognized for the total sales amounting Rs. 2,50,000 as the time period for rejecting the goods had expired.

Total revenue amounting Rs. 7,45,000 (3,00,000+1,95,000+2,50,000) will be recognized for the year ended 31st March, 2021 in the books of Fashion Ltd.

27. QP DEC 21

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 ₹ 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 lakhs 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

SOLUTION

i) As per AS 9 "Revenue Recognition", in case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 5,00,000 as the time period for rejecting the goods had expired.

ii) The sale is complete but delivery has been postponed at buyer's request. The entity should recognize the entire sale of ₹ 2,40,000 for the year ended 31st March.

iii) Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date, such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Hence no revenue to be recognized in the given case.

iv)
   a. Revenue arising from the use by others of enterprise resources yielding interest and royalty should be recognized when **no significant uncertainty as to measurability or collectability exists.** The interest should be r**ecognized on time proportion basis taking** into account the amount outstanding and rate applicable.
   b. The royalty should be recognized on **accrual basis** in accordance with the terms of relevant agreement.

v) 40% goods lying unsold with consignee should be treated as closing inventory and **sales should be recognized for ₹ 2,40,000 (60% of ₹ 4,00,000).** In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

28. RTP MAY 22

An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

SOLUTION

REFERENCE:

AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate.

ANALYSIS:

Monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual.

CONCLUSION:

The contention of the Chief Financial Officer **is not in accordance with AS 9.**

29. RTP May 22

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.

SOLUTION

1) Trade discounts and volume rebates received are **not encompassed within the definition of revenue,** since they represent a reduction of cost. Trade discounts and volume rebates given should be **deducted** in determining revenue.
2) When goods are sold to distributor or others, revenue from such sales can be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.
3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.
4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.

30. MTP MARCH 2022 TEST SERIES I

New Era Publications publishes a monthly magazine on 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 2020 issue was made in February 2020. The magazine was published on its scheduled date. It received 2,40,000 on 10.3.2020 and ₹ 60,000 on 10.4.2020 for the March, 2020 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 31.3.2020. What will be the treatment if the publication is delayed till 2.4.2020?

SOLUTION

REFERENCE:

As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the **completed service contract method** or under the **proportionate completion method** as the service is performed, whichever relates the revenue to the work accomplished.

ANALYSIS:

Income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date.

Case 1: When magazine publication is made on 15.03.2020 - **₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income** in March, 2020. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ₹ 3,00,000 will be recognised in the March, 2020, ₹ 60,000 will be treated as amount due from advertisers as on 31.03.2020 and ₹ 2,40,000 will be treated as payment received against the sale.

Case 2: When Publication is delayed till 02.04.2020 - Revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized in the year ended 31.03. 2020 after the magazine is published on 02.04.2020. The amount received from sale of advertising space on 10.03.2020 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2020.

31. RTP Nov 22

When revenue will be recognized in the following situation:

(i) Where the purchaser makes a series of installment payments to the seller and the seller deliver the goods only when the final payment is received.

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

(iii) Where goods are sold to distributors, dealers or others for resale.

(iv) Commissions on service rendered as agent on insurance business.

SOLUTION

(i) **Revenue from sales** where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received, **should not be recognised until goods are delivered.** However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

(ii) For sale where **seller concurrently agrees to repurchase the same goods at** a later date, such transactions are **in substance a financing agreement.** In such a situation, the resulting cash inflow **should not be recognised as revenue.**

(iii) Revenue from sales of goods to distributors, dealers or others for resale can generally be recognised if significant risks of ownership have passed. However, in some situations the **buyer may in substance be an agent** and in such cases the **sale should be treated as a consignment sale.**

(iv) Commissions on service rendered as agent on insurance business should be recognised as revenue when the service is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

32. MTP Oct 22 (Series 2)

Given below is the following information of B.S. Ltd.

(i) Goods of ₹ 50,000 were sold on 18-03-2021 but at the request of the buyer these were delivered on 15-04-2021.

(ii) On 13-01-2021 goods of ₹ 1,25,000 are sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-03-2021.

(iii) ₹ 1,00,000 worth of goods were sold on approval basis on 01-12-2020. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-01-2021 and no approval or disapproval received for the remaining goods till 31 -03- 2021.

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, 2021 in above cases in the context of AS-9.

SOLUTION

REFERENCE:

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of **goods has transferred to the buyer** the property in the goods for a price or **all significant risks and rewards** of ownership have been **transferred** to the buyer and the seller retains **no effective control** of the goods transferred to a degree usually associated with ownership; and

(ii) **no significant uncertainty exists** regarding the amount of the **consideration** that will be derived from the sale of the goods.

ANALYSIS:

Case (i) The sale is complete but delivery has been postponed at buyer's request. B.S. Ltd. should recognize the entire sale of ₹ 50,000 for the year ended 31st March, 2021.

Case (ii) In case of consignment sale revenue should not be recognized until the goods are sold to a third party. 20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,00,000 (80% of ₹ 1,25,000).

Case (iii) In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, revenue should be recognized for the total sales amounting ₹ 1,00,000 as the time period for rejecting the goods had expired.

CONCLUSION:

Total revenue amounting ₹2,50,000 (50,000 + 1,00,000 + 1,00,000) will be recognized for the year ended 31st March, 2021 in the books of B.S. Ltd.

33. EXAM NOV 22

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 taken title and accepts billing.

(ii) Instalment Sales

(iii) Trade discounts and volume rebates.

(iv) Insurance agency commission for rendering services.

(v) Advertising Commission.

SOLUTION

As per AS 9, revenue should be recognized as per below provisions:

(i) **Delivery is delayed at buyer's request and buyer take 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.

(ii) **Instalment sales**: When the consideration is receivable in instalments, revenue attributable to the sales price should be recognised at the date of sale.

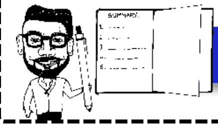
(iii) **Trade discounts and volume rebates:** Discounts and rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

(iv) **Insurance agency commissions**: Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

(v) **Advertising commissions:** Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

AS 17 – SEGMENT REPORTING

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ILLUSTRATION 1				
2	ILLUSTRATION 2 / RTP MAY 2018				
3	ILLUSTRATION 3				
4	ILLUSTRATION 4				
5	ILLUSTRATION 5				
6	RTP NOV 2018				
7	QP MAY 18				
8	RTP NOV 2019 / RTP MAY 2018 / RTP NOV 20 / RTP MAY 21 / MOCK TEST SERIES 2				
9	RTP MAY 2019				
10	QP NOV 2019 (GROUP 1)				
11	RTP MAY 20				
12	QP NOV 20				
13	QP JAN 21				
14	RTP NOV 21				
15	RTP NOV 21				
16	MAY 22 RTP				
17	MAY 22 RTP				
18	MAY 2022 EXAM				
19	RTP NOV 22				



Let's Get Started....With Class Work

I. ILLUSTRATION 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.

SOLUTION

FACTS:

Sports Ltd. has 6 segments and Chief accountant is of the opinion to report only Segment M and N.

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

a. 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
b. 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
c. Its segment assets are 10% or more of the total assets of all segments.
d. 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

As per the criteria specified above, the below segments are reportable:
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.

CONCLUSION:

All the segments are covered in at least one of the above criteria and all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant is wrong.

2. ILLUSTRATION 2 / RTP MAY 2018

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

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

ANALYSIS:

The enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently.

CONCLUSION:

In the given case, inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

3. ILLUSTRATION 3

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.

SOLUTION

REFERENCE:

According to AS 17 "Segment Reporting", segment assets do not include income tax assets.

ANALYSIS:

Calculation of revised total assets: (in Crores)

Particulars	Segment X	Segment Y	Segment Z	Total
Value of Assets	2.00	3.00	5.00	10.00
Deferred Tax Asset	0.50	0.40	0.30	1.20
Revised value of Assets	1.50	2.60	4.70	8.80

All the three segments hold more than 10% of the total assets, all segments are reportable segments.

4. ILLUSTRATION 4

Prepare a segmental report for publication in Diversifiers Ltd. from the following details of the company's three divisions and the head office:

Particulars	₹ ('000)
Forging Shop Division	
Sales to Bright Bar Division	4,575
Other Domestic Sales	90
Export Sales	6,135
	10,800
Bright Bar Division	
Sales to Fitting Division	45
Export Sales to Rwanda	300
	345
Fitting Division	
Export Sales to Maldives	270

Particulars	Head Office ₹ ('000)	Forging Shop Division ₹	Bright Bar Division ₹	Fitting Division

		('000)	('000)	₹ ('000)
Pre-tax operating result		240	30	(12)
Head office cost reallocated		72	36	36
Interest costs		6	8	2
Fixed assets	75	300	60	180
Net current assets	72	180	60	135
Long-term liabilities	57	30	15	180

SOLUTION:

Diversifiers Ltd.
Segmental Report

(₹ '000)

Particulars	Divisions			Inter Segment Eliminations	Consolidated Total
	Forging Shop	Bright Bar	Fitting		
Segment Revenue					
Sales:					
Domestic	90	-	-	-	90
Export	6135	300	270	-	6705
External Sales	6225	300	270	-	6795
Inter-Segment Sales	4575	45	-	4620	-
Total Revenue	10,800	345	270	4620	6795
Segment result (Given)	240	30	(12)		258
Head Office Expenses					(144)
Operating Profit					114
Interest Expense					(16)
Profit Before Tax					98

Information in Relation					
to Assets and Liabilities:					
Fixed Assets	300	60	180	—	540
Net Current Assets	180	60	135	—	375
Segment Assets	480	120	315	—	915
Unallocated Corporate Assets					147
(75 + 72)					
Total Assets					1,062
Segment Liabilities	30	15	180	—	225
Unallocated Corporate Liabilities					57
Total Liabilities					282

Sales Revenue by Geographical Market

	Home Sales	Export Sales (By Forging Shop Division)	Export to Rwanda	Export to Maldives	(₹ '000) Consolidated Total
External Sales	90	6,135	300	270	6,795

5. ILLUSTRATION 5

Microtech Ltd. produces batteries for scooters, cars, trucks, and specialised batteries for invertors and UPS. How many segments should it have and why?

SOLUTION

REFERENCE:

As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments.

ANALYSIS:

In case of Microtech Ltd., the basic product is the batteries, but the risks and returns of the batteries for automobiles (scooters, cars and trucks) and batteries for invertors and UPS are affected by different set of factors. In case of automobile batteries, the risks and returns are affected by the Government policy, road conditions, quality of automobiles, etc. whereas in case of batteries for invertors and UPS, the risks and returns are affected by power condition, standard of living, etc.

CONCLUSION:

Microtech Ltd. has two business segments viz-'Automobile batteries' and 'batteries for Invertors and UPS'.

6. RTP NOV 2018

Calculate the segment results of a manufacturing organization from the following information:

Segments	A	B	C	Total
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)				77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	

SOLUTION

Calculation of segment result

Segments	A ₹	B ₹	C ₹	Total ₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Total segment revenue as per AS 17 (A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

7. QP MAY 18

M/s Nathan Limited has three segments namely P, Q and R. The assets of the company are ₹ 15 crores. Segment P has 4 crores, Segment Q has 6 crores and Segment R has 5 crores. Deferred tax assets included in the assets of each segment are P - ₹ 1 crore, Q - ₹ 0.90 crores and R - ₹ 0.80 crores. The accountant contends all these three segments are reportable segments. Comment.

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

a. 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
b. 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
c. Its segment assets are 10% or more of the total assets of all segments.
d. 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

The revised total assets are 12.3 crores [₹ 15 – (₹ 1 + 0.9 + 0.8)].

Details of Segment wise assets

Segment P holds total assets of ₹ 3 crores (₹ 4 crores – ₹ 1 crores); Segment Q holds ₹ 5.1 crores (₹ 6 crores – 0.9 crores);

Segment R holds ₹ 4.2 crores (₹ 5 crores – ₹ 0.8 crores).

Thus, all the three segments hold more than 10% of the total assets, all segments are reportable segments.

CONCLUSION:

The contention of the accountant that all three segments are reportable segments is correct.

8. RTP NOV 2019 / RTP MAY 2018 / RTP NOV 20 / RTP MAY 21 / MOCK TEST SERIES 2

A Company has an inter-segment transfer pricing policy of charging at cost less 5%. The market prices are generally 20% above cost.

You are required to examine whether the policy adopted by the company is correct or not?

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

ANALYSIS:

The enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently.

CONCLUSION:

In the given case, inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

9. RTP MAY 2019

PK Ltd. has identified business segment as its primary reporting format. It has identified India, USA and UK as three geographical segments. It sells its products in the Indian market, which constitutes 70 percent of the Company's sales. 25 percent is sold in USA and the balance is sold in UK. Is PK Ltd. as part of its geographical secondary segment information, required to disclose segment revenue from export sales, where such sales are not significant?

SOLUTION

REFERENCE:

As per AS 17 if primary format of an enterprise for reporting segment information is business segments, it should also report segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10% or more of enterprise revenue.

ANALYSIS:

For the purposes of disclosing secondary segment information, PK Ltd. is not required to disclose segment revenue from export sales to UK, since that segment does not meet the 10 percent or more of enterprise revenue threshold. However, other secondary segment information as per AS 17 should be disclosed in respect of this segment if the thresholds prescribed in the AS 17 are met.

10. QP NOV 2019 (GROUP 1)

Mac Ltd. gives the following data regarding to its six segments:

(₹ in lakhs)

Particulars	A	B	C	D	E	F	Total
Segment assets	80	160	60	40	40	20	400
Segment results	100	(380)	20	20	(20)	60	(200)
Segment revenue	600	1,240	160	120	160	120	2,400

The accountant contends that segments 'A' and 'B' alone are reportable segments. Is he justified in his view? Discuss in the context of AS-17 'Segment Reporting'.

SOLUTION

FACTS:

Mac Ltd. has 6 segments & Chief accountant is of the opinion to report only Segment A and B.

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

a. 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

b. 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

c. Its segment assets are 10% or more of the total assets of all segments.

d. 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

On the basis of turnover criteria segments A and B are reportable segments.

On the basis of the result criteria, segments A, B and F are reportable segments (since their results in absolute amount is 10% or more of ₹ 400 lakhs).

On the basis of asset criteria, all segments except F are reportable segments

CONCLUSION:

As all the segments are covered in at least one of the above criteria all segments have to be reported upon in accordance with AS 17. Hence, the opinion of accountant is wrong.

11. RTP MAY 20

The Chief Accountant of Cotton Garments Limited gives the following data regarding its five segments: (₹ in Crore)

Particulars	A	B	C	D	E	Total
Segment Assets Segment	40	15	10	10	5	80
Results Segment Revenue	(95)	5	5	(5)	15	(75)
	310	40	30	40	30	450

The Chief 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'.

SOLUTION

FACTS:

Cotton Garments Ltd. has 5 segments & Chief accountant is of the opinion to report only Segment A.

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

1) The combined result of all segments in profit; or

2) The combined result of all segments in loss, whichever is greater in absolute amount; or

3) Its segment assets are 10% or more of the total assets of all segments.

Further, 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

a. On the basis of revenue from sales criteria, segment A is a reportable segment.
b. On the basis of the result criteria, segments A & E are reportable segments (since their results in absolute amount is 10% or more of ₹ 100 crore).
c. On the basis of asset criteria, all segments except E are reportable segments.

CONCLUSION:

Since all the segments are covered in atleast one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'A' is reportable is wrong.

12. QP NOV 20

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	1,000
Segment Result	45	-70	80	-10	45
Segment Assets	39	51	48	12	150

You are requested to identify the reportable segments in accordance with the criteria laid down in AS 17.

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

i. Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

ii. Its segment result whether profit or loss is 10% or more of:

1) The combined result of all segments in profit; or
2) The combined result of all segments in loss, whichever is greater in absolute amount; or
3) Its segment assets are 10% or more of the total assets of all segments.

Further, 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

As per the criteria specified above, the below segments are reportable:

On the basis of revenue criteria → segments A, B, C and D - all are reportable segments.

On the basis of the result criteria → segments A, B and C are reportable segments (since their results in absolute amount is 10% or more of 125 Lakhs).

On the basis of asset criteria → all segments except D are reportable segments.

CONCLUSION:

All the segments are covered in at least one of the above criteria and all segments have to be reported upon in accordance with AS 17.

13. QP JAN 21

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'.

SOLUTION

FACTS:

AMF Ltd. has 5 segments & Chief accountant is of the opinion to report only Segment P.

REFERENCE:

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or

(ii) Its segment result whether profit or loss is 10% or more of:

1) The combined result of all segments in profit; or
2) The combined result of all segments in loss, whichever is greater in absolute amount; or
3) Its segment assets are 10% or more of the total assets of all segments.

Further, 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 at least 75% of total enterprise revenue is included in reportable segments.

ANALYSIS:

As per the criteria specified above, the below segments are reportable:

On the basis of revenue from sales criteria → segment P is a reportable segment.

On the basis of the result criteria → segments P & T 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 T are reportable segments.

CONCLUSION:

All the segments are covered in at least one of the above criteria and all segments have to be reported upon in accordance with AS 17. Hence, the opinion of chief accountant that only segment 'P' is reportable is wrong.

14. RTP NOV 21

Company A is engaged in the manufacture of chemicals. The company manufactures five types of chemicals that have different applications. Can this company include more than one type of chemical in a single business segment? Comment.

SOLUTION

REFERENCE:

As per AS 17, "A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products of services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products of services

(b) the nature of the productions processes

(c) the type of class of customers for the products or services

(d) the methods used to distribute the products or provide the services and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

A single business segment does not include products and services with significantly differing risks and returns. Products and services included in a single business segment may be dissimilar with respect to one or several factors listed above but are expected to be similar with respect to majority of the factors.

ANALYSIS:

In the present case, the Company should consider whether the chemicals with different applications, have similar risks end returns. For this purpose, the company should ascertain whether one or more types of chemicals are related keeping in view the relevant factors including those given in the definition of business segment.

CONCLUSION:

Chemicals having different applications can be included in a single business segment if majority of the relevant factors including those listed above are similar. This would ensure that the chemicals having significantly different risks and returns are not included in a single business segment.

15. RTP NOV 21

Is an enterprise required to disclose changes in the basis of allocation of revenue and expenses to segments? Explain.

SOLUTION

REFERENCE:

As per AS 17, Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable.

ANALYSIS:

As per the reference above, a change in the basis of allocation of revenue and expenses to segments is a change in the accounting policy adopted for segment reporting.

CONCLUSION:

If the change has a material financial effect on the segment information, a description of the nature of the change, and the financial effect of the change, if it is reasonably determinable, should be disclosed.

16. MAY 22 RTP

Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban. Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.

SOLUTION

REFERENCE:

AS 17 explains that, "a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country".

AS 17 further explains that, "In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise."

ANALYSIS:

To identity geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

While the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying 'urban and 'rural' as separate geographical segment.

Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported.

17. MAY 22 RTP

A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 20% above cost. You are required to examine whether the policy adopted by the company is correct or not?

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

ANALYSIS:

The enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently.

CONCLUSION:

In the given case, inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

18. MAY 2022 EXAM

XYZ Ltd. has 5 business segments. Profit/ Loss of each of the segments for the years ended 31st March, 2022 has been provided below. You are required to identify form 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)

SOLUTION

As per AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

Its segment results whether profit or loss is 10% or more of:

- The combined result of all segments in profit; i.e. ₹ 250 Lakhs or
- The combined result of all segments in loss; i.e. ₹ 300 Lakhs

Whichever is greater in absolute amount i.e. ₹ 300 Lakhs.

Operating Segment	Absolute amount of Profit or Loss (₹ In lakhs)	Reportable Segment (Yes / No)
A	225	Yes
B	25	No
C	175	Yes
D	20	No
E	105	Yes

On the basis of the profitability test (result criteria), segments A, C and E are reportable segments since their results in absolute amount is 10% or more of ₹ 300 lakhs i.e., 30 lakhs.

19. RTP NOV 22

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

SOLUTION

REFERENCE:

As per AS 17 'Segment Reporting', inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

ANALYSIS:

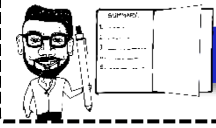
The enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently.

CONCLUSION:

In the given case, inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

AS 18 – RELATED PARTY DISCLOSURES

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION 1				
2	ICAI ILLUSTRATION 2				
3	ICAI Q PAPER NOV 2018				
4	RTP MAY 2013				
5	RTP NOV 2012				
6	RTP MAY 2018				
7	RTP MAY 2015				
8	ICAI PRACTICAL Q 6				
9	RTP May 2019 / RTP NOV 19				
10	RTP Nov 2018				
11	QP MAY 19				
12	RTP MAY 20				
13	RTP NOV 20				
14	RTP MAY 21				
15	RTP NOV 21				
16	RTP NOV 21				
17	QP JULY 21				
18	ICAI PRACTICAL Q 7				
19	ICAI PRACTICAL QUESTION 12				
20	MAY 22 RTP				
21	MAY 22 RTP				
22	MTP MARCH 2022 TEST SERIES 1				
23	MTP MARCH 2022 TEST SERIES 1				
24	RTP NOV 22				
25	MTP SEP 22 (SERIES 1)				



Let's Get Started....With Class Work

1. ICAI ILLUSTRATION 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.

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions

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).

ANALYSIS:

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

2. ICAI ILLUSTRATION 2

Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd. during financial year ended 31-3-20X1. 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?

SOLUTION

FACTS:

Managing Director of Narmada Ltd. own 100% of Ganga Ltd. Narmada Ltd. sold goods for ₹ 90 lakhs to Ganga Ltd.

REFERENCE:

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.

ANALYSIS:

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.

CONCLUSION:

The contention of Chief Accountant of Narmada Ltd is incorrect.

3. ICAI Q PAPER NOV 2018

Following transactions are disclosed as on 31st March, 2018

(i) Mr. Sumit, a relative of Managing Director, received remuneration of Rs.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 Rs.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 transaction.

SOLUTION

REFERENCE:

According to AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. The transactions only for the period in which related party relationships exist need to be reported.

(i) **ANALYSIS:** Mr. Sumit is a relative of key management personnel. He has he received remuneration for his services in the company from 1st April,2017 to 30th June, 2017 and this period comes under the reporting period.

CONCLUSION: Mr. Sumit should be identified as related party as at the closing date.

(ii) **ANALYSIS:** Transactions of the entire year need not be disclosed as related party transactions and transactions for the period (after 1st July) in which related party relationship did not exist need not be reported. Transactions of the entity with its associate company for the first quarter ending 30.06.2017 only are required to be disclosed as related party transactions.

CONCLUSION: Transaction of sale of goods with the associate company for **first quarter ending 30th June, 2017 for ₹ 50 Lakhs only are required to be disclosed** as related party transaction on 31.3.18.

4. RTP MAY 2013

XYZ Ltd. is a 100% subsidiary of ABC Ltd. Which of the following are related party transactions for the purposes of consolidated financial statements?

a. Salary paid to employees of XYZ Ltd.

b. Loans given to employees of ABC Ltd.

c. Intercompany sales between holding and subsidiary companies.

d. Loan given to managing director ABC Ltd.

e. Transfer of Asset by ABC Ltd. to its subsidiary.

SOLUTION

REFERENCE:

According to AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Further it states that 'No disclosure is required in consolidated financial statements in respect of intra-group transactions.'

a. **ANALYSIS:** Employees do not have a significant influence or control over XYZ Ltd.
CONCLUSION: Salary paid to employees is not a related party transaction for consolidation of Financial Statement.

b. **ANALYSIS:** Employees do not have a significant influence or control over ABC Ltd.
CONCLUSION: **Loan given to employees is not a related party transaction** for consolidation of Financial Statement.

c. **ANALYSIS:** Intercompany sales between holding and subsidiary companies are related party transactions. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.
CONCLUSION: **Intercompany sales between holding & subsidiary companies are not related party transaction** for Consolidated Financial Statement.

d. **ANALYSIS:** As per AS 18, Managing director is a related party for ABC Ltd.
CONCLUSION: **Loan given to managing director of ABC Ltd. is related party transaction** for the purpose of consolidated financial transactions.

e. **ANALYSIS:** Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.
CONCLUSION: **Transfer of Asset by ABC Ltd. to its subsidiary is not a related party transaction** for Consolidation of financial statements.

5. RTP NOV 2012

X Ltd. sold to Y Ltd. goods having a sales value of Rs. 25 lakhs during the financial year ended 31.03.2001. Mr. A, the Managing Director and Chief Executive of X Ltd. owns nearly 100% of the capital of Y Ltd. The sales were made to Y Ltd. at the normal selling price of X Ltd. The chief accountant of X 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 of AS-18.

SOLUTION

FACTS:

Managing Director and Chief Executive of X Ltd. owns nearly 100% of Y Ltd. X Ltd. sold goods for ₹ 25 lakhs to Y Ltd. at normal selling price.

REFERENCE:

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.

ANALYSIS:

In the given case, **X Ltd. and Y Ltd are related parties and hence disclosure of transaction between them is required** irrespective of whether the transaction was done at normal selling price.

CONCLUSION:

As per AS –18 all transaction with the related party needs to be reported whether or not they are at arm's length price. The view of the accountant is not current.

6. RTP MAY 2018

Is remuneration paid to Key Management Personnel or Non-Executive Directors or Board of Directors, a related party transaction?

SOLUTION:

As per Accounting Standard Interpretation (ASI) 23, **Key Management Personnel are related parties under AS –18.** Hence, remuneration paid to Key Management Personnel will be a related party transaction requiring disclosure under AS 18.

Non-Executive Directors or the board of directors **are not related parties** as per ASI 21. So, remuneration paid to them will not be considered a related party transaction.

7. RTP MAY 2015

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

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

SOLUTION:

REFERENCE:

AS 18 defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influences over the other party in making financial and/or operating decisions. Control is defined as ownership directly or indirectly of more than-half of the voting power of an enterprise. Significant Influence is defined as participation in the financial and / or operating policy decisions of an enterprise but not control of those policies.

ANALYSIS:

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

In the present case, control of P Ltd. in R Ltd. directly and through Q Ltd., does not go beyond 26%. However, significant influence may be exercised as an investing party (P Ltd.) holds, directly or indirectly through intermediaries 20% of more of the voting power of the R Ltd.

As R Ltd. is a listed company and regularly supplies goods to P Ltd.

CONCLUSION:

As per the above analysis, Related party disclosure is required.

8. ICAI PRACTICAL Q 6

Mr. Raj a relative of key management personnel received remuneration of ₹ 2,50,000 for his services in the company for the period from 1.4.20X1 to 30.6.20X1. On 1.7.20X1, he left the service.

Should the relative be identified as at the closing date i.e., on 31.3.20X2 for the purposes of AS 18?

SOLUTION:

REFERENCE:

According to AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Relative of Key management personnel is also considered to be a related party.

ANALYSIS:

Relative of key management personnel is covered under related party disclosure. Mr. Raj is a relative of Key management personnel and have received remuneration.

CONCLUSION:

Mr. Raj, a relative of key management personnel should be identified as related party for disclosure in the financial statements for the year ended 31.3.20X2.

as he received remuneration for his services in the company from 1.4.20X1 to 30.6.20X1 and this period comes under the reporting period.

9. RTP May 2019 / RTP NOV 19

SP hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?

SOLUTION

REFERENCE:

According to AS 18 - Related Party Disclosures, related parties include individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or signific ant influence over the enterprise, and relatives of any such individual.

ANALYSIS:

In the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

CONCLUSION:

Mr. A will not be considered as a related party of SP Hotels Limited.

10. RTP Nov 2018

Sun Ltd. sold goods for ₹ 50 lakhs to Moon Ltd. during financial year ended 31st March 2017 at normal selling price followed by Sun Ltd. The Managing Director of Sun Ltd. holds 75% shares of Moon Ltd. The Chief accountant of Sun 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. You are required to examine and advise whether the contention of the Chief Accountant is correct?

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. 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.

ANALYSIS:

Sun Ltd. and Moon Ltd are related parties *and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.*

CONCLUSION:

The contention of **Chief Accountant of Sun Ltd is wrong.**

11. QP MAY 19

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.

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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) are considered to be 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.

(i) **ANALYSIS:**

a) Reporting entity- Maya Ltd.

- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd.(subsidiary) is a related party

b) Reporting entity- Sheetal Ltd.

- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

c) Reporting entity- Fair Ltd.

- Maya Ltd. (holding company) is a related party

- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/ investing party) is a related party

d) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

(ii) **ANALYSIS:** Mr. Subhash Kumar is Key management personnel as he has the authority for planning, directing and controlling the activities of A Ltd. He also holds substantial interest in B Ltd. as he holds 72% capital of B Ltd. As per the definition of related party relationship, enterprises over which Subhash is able to exercise significant influence are also related parties.

CONCLUSION:

Mr. Subhash is related party for both A Ltd. and B Ltd. A Ltd. and B Ltd. will also be construed as related to each other.

12. RTP MAY 20

Arohi Ltd. sold goods for ₹ 90 lakhs to Anya Ltd. during financial year ended 31-3 2019.The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi 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? Comment in accordance with AS 18.

SOLUTION

REFERENCE:

As per AS 18 'Related Party Disclosures', Enterprises over which the 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 that have a member of key management in common with the reporting enterprise.

ANALYSIS:

Arohi Ltd. and Anya Ltd. are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

CONCLUSION:

The contention of Chief Accountant of Arohi Ltd. is wrong.

13. RTP NOV 20

On the basis of provisions of AS 18 'Related Party Disclosures':

(i) Identify the related parties in the following cases: X Limited holds 60% shares of Y Limited. Y Limited holds 55% shares of W Limited Z Limited holds 35% shares of W Limited

(ii) Himalaya Limited sold goods for ₹ 40 Lakhs to Aravalli Limited during financial year ended on March 31, 2019. The Managing Director of Himalaya Limited owns 80% shares of Aravalli Limited. The sales were made to Aravalli Limited at normal selling prices followed by Himalaya Limited. The chief accountant of Himalaya Limited 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 AS 18. You are required to comment on this.

SOLUTION:

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

(i) X Ltd., Y Ltd. & W Ltd. are related to each other. Z Ltd. & W Ltd. are related to each other by virtue of associate relationship. However, neither X Ltd. nor Y Ltd. is related to Z Ltd. and vice versa since neither control nor significant influence exists between them.

(ii) **ANALYSIS:** Himalaya Ltd. and Aravalli Ltd are related parties since key management personnel of Himalaya Ltd. i.e., its managing director holds 80% in Aravalli Ltd. and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

CONCLUSION:

The contention of Chief Accountant of Himalaya Ltd that these sales require no disclosure under related party transactions, is wrong.

14. RTP MAY 21

R Ltd. has 60% voting right in S Ltd. S Ltd. has 15% voting right in T Ltd. R Ltd. directly enjoys voting right of 10% in T Ltd. T Ltd. is a listed company and regularly supplies goods to R Ltd. The management of T Ltd. has not disclosed its relationship with R Ltd. You are required to assess the situation from the view point of AS 18 on Related Party Disclosures.

SOLUTION:

REFERENCE:

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

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

ANALYSIS:

R Ltd. has direct economic interest in **T Ltd. to the extent of 10%,** and **through S Ltd.** in which it is the majority shareholders, **it has further control of 9% in T Ltd. (60% of S Ltd.'s 15%).** These two taken together **(10% + 9%)** make the total **control of 19%.**

Control of R Ltd. in T Ltd. directly and through S Ltd., is only 19%. Significant influence may also not be exercised as an investing party (R Ltd.) holds, directly or indirectly through intermediaries only 19% of the voting power of the T Ltd.

CONCLUSION:

R Ltd. and T Ltd. are not related parties. Hence related party disclosure is not required.

15. RTP NOV 21

Omega Bank Limited holds 25 per cent of the voting power of B Limited. Omega Bank Limited also provides finance by way of a loan to B Limited at market rates of interest, on account of which, Omega Bank Limited would have the power to nominate one person to the board of directors of B Limited. Any major transactions proposed to be entered into by B Limited would need the consent of Omega Bank Limited. Would Omega Bank Limited be considered as related party for B Ltd. (Reporting Enterprise)?

SOLUTION:

REFERENCE:

As per AS 18 "associates and joint ventures of the reporting enterprise and the investing party of venture in respect of which the reporting enterprise is an associate or a joint venturer" are related party relationship. An associate has been defined as "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of the party". Significant influence has been defined to be "participation in the financial and /or operating policy decisions of an enterprise, but not control of those policies". Further, it is given in the standard that significant influence may be gained by share ownership, agreement or statute. As regards share ownership, there is a presumption that ownership of 20% or more of the voting power enables the enterprise to exercise significant influence, unless it could be clearly demonstrated otherwise.

ANALYSIS:

Omega Bank Limited exercises significant influence over B Limited by virtue of ownership of 25% of the voting power. Omega Bank Limited is also a provider of finance for B Limited (as it has provided a loan to B Limited), and as per the standard, a provider of finance is deemed not to be a related party during its normal dealings with the enterprise by virtue only of those dealing. However, in this case, the exemption would not be available to Omega Bank Limited as the exercise of significant influence of Omega Bank Limited over B Limited has been demonstrated on account of ownership of more than 20 per cent of voting power. Accordingly, Omega Bank Limited would be construed to be a related party in the financial statements of B Limited and consequently, the latter would be required to disclose the transactions with Omega Bank Limited in its financial statements.

CONCLUSION:

Omega Bank Limited would be a related party of B Limited.

16. RTP NOV 21

A Limited has two Associates, B Limited and C Limited, and owns 25 per cent of the voting power of B Limited and 30 per cent of the voting power of C Limited. Would B Limited be considered a related party for the purpose of financial statements of C Limited?

SOLUTION:

REFERENCE:

AS 18 states that "Enterprise that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are related parties. Further, it is given that "associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venturer" are also related parties.

ANALYSIS:

B Limited and C Limited are 'associates' of A Limited. **Associates cannot be regarded as a related parties only by virtue of the relationship.** As B Limited is not an associate of C Limited, nor is it being controlled, directly or indirectly, by C Limited or is not so controlling C Limited, it is not a related party of C Limited.

CONCLUSION:

B Limited cannot be considered as a related party of C Limited for the purpose of financial statements.

17. QP JULY 21

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.

SOLUTION:

i. **REFERENCE:** As per AS 18 Related Party Disclosures, "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 are related parties".

ANALYSIS: In the absence of share ownership, Mr. Happy would not be considered to exercise significant influence on Khushi Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. Happy does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

CONCLUSION: **Mr. Happy will not be considered as a related party of Khushi Limited.**

ii. **REFERENCE:** As per AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

ANALYSIS: Relative of key management personnel is covered under related party disclosure. Shri Bhanu is a relative of Key management personnel and have received remuneration for his services in the company for the period from 1st April 2020 to 30th June 2020.

CONCLUSION: **Shri Bhanu should be identified as related party** for disclosure in the financial statements for the year ended 31.3.2021.

18. ICAI PRACTICAL Q 7

X Ltd. sold goods to its associate Company during the 1st quarter ending 30.6.20X1. After that, the related party relationship ceased to exist. However, goods were supplied as were supplied like any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

SOLUTION:

REFERENCE:

According to AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. The transactions only for the period in which related party relationships exist need to be reported.

ANALYSIS:

Even though X Limited sold goods continuously throughout the year, the related party relationship ceased to exist after 30.06.20X1. The transactions for the period in which related party relationship did not exist need not be reported.

CONCLUSION:

Transactions of company with its associate company for the first quarter ending 30.06.20X1 only are required to be disclosed as related party transactions.

19. ICAI PRACTICAL QUESTION 12

Arohi Ltd. sold goods for ₹ 90 lakhs to Anya Ltd. during financial year ended 31-3-20X1. The Managing Director of Arohi Ltd. own 100% of Anya Ltd. The sales were made to Anya Ltd. at normal selling prices followed by Arohi Ltd. The Chief accountant of Arohi 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? Comment in accordance with AS 18.

SOLUTION:

REFERENCE:

As per AS 18 'Related Party Disclosures', Enterprises over which the 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 that have a member of key management in common with the reporting enterprise.

ANALYSIS:

As the Managing Director of Arohi Ltd. own 100% of Anya Ltd, Arohi Ltd. and Anya Ltd. are related parties. Hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

CONCLUSION:

The contention of Chief Accountant of Arohi Ltd. is wrong.

20.MAY 22 RTP

In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?

SOLUTION

REFERENCE:

As per AS 18 "Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise" are considered to be related party relationships.

The conditions which define the existence of control:

- *Ownership, directly or indirectly, of more than one-half of the voting power of an enterprise*
- *Control of the composition of the board power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise.*
- *Substantial interest in voting power and the power to direct, by statue or agreement, the financial and/or operating policies of the enterprise.*

Significant influence is defined as 'Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.'

*Further, AS 18 states that **"A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence" would not be deemed to be related parties.***

ANALYSIS:

In the given case, the conditions which define the existence of control are not satisfied. Although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied, the company cannot be said to be related to the supplier.

CONCLUSION:

The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties.

21. MAY 22 RTP

Define "Key management personnel" in the context of AS 18.

SOLUTION

In context of AS 18, "Key management personnel" are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director, whole time director, manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

22. MTP MARCH 2022 TEST SERIES I

Mr. Arnav a relative of key management personnel received remuneration of ₹ 3,00,000 for his services in the company for the period April 1, 2019 to June 30, 2019. On July 1, 2019 he left the job.

Should Mr. Arnav be identified as Related Party at the closing date i.e. March 31, 2020 for the purposes of AS 18?

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. It includes key management personnel and relatives of such personnel.

ANALYSIS:

Relative of key management personnel is covered under related party disclosure. Mr. Arnav is a relative of Key management personnel and have received remuneration.

CONCLUSION:

Mr. Arnav should be identified as related party as at the closing date i.e. on 31.3.2020.
as he received remuneration for his services in the company from1st April,2019 to 30th June, 2019 and this period comes under the reporting period.

23. MTP MARCH 2022 TEST SERIES I

A limited company sold goods to its associate company for the 1st quarter ending June 30, 2020. After that, the related party relationship ceased to exist. However, goods were supplied continuously even after June 30, 2020 as was supplied to another ordinary customer. Does this require disclosure as related party transaction for the entire financial year?

SOLUTION

REFERENCE:

According to AS 18 - Related Party Disclosures, parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. The transactions only for the period in which related party relationships exist need to be reported.

ANALYSIS:

Even though A Limited supplied goods continuously throughout the year, the related party relationship ceased to exist after 30th June 2020. The transactions for the period in which related party relationship did not exist need not be reported.

CONCLUSION:

Transactions of company with its associate company for the first quarter ending 30.06.2020 only are required to be disclosed as related party transactions.

24. RTP NOV 22

SP Hotels Limited enters into an agreement with Mr. A for running its hotel for a fixed return payable to the later every year. The contract involves the day-to-day management of the hotel, while all financial and operating policy decisions are taken by the Board of Directors of the company. Mr. A does not own any voting power in SP Hotels Limited. Would he be considered as a related party of SP Hotels Limited?

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

ANALYSIS:

In the given case, in the absence of share ownership, Mr. A would not be considered to exercise significant influence on SP Hotels Limited, even though there is an agreement giving him the power to manage the company. Further, the fact that Mr. A does not have the ability to direct or instruct the board of directors does not qualify him as a key management personnel.

CONCLUSION:

Mr. A will not be considered as a related party of SP Hotels Limited.

25. MTP SEP 22 (SERIES 1)

Identify the related parties in the following cases as per AS-18: 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.

SOLUTION

REFERENCE:

As per AS 18, parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

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) are considered to be related parties.

ANALYSIS:

(i) Reporting entity- Maya Ltd.

- Sheetal Ltd. (subsidiary) is a related party
- Fair Ltd.(subsidiary) is a related party

(ii) Reporting entity- Sheetal Ltd.

- Maya Ltd. (holding company) is a related party
- Fair Ltd. (subsidiary) is a related party

(iii) Reporting entity- Fair Ltd.

- Maya Ltd. (holding company) is a related party
- Sheetal Ltd. (holding company) is a related party
- Care Ltd. (investor/ investing party) is a related party

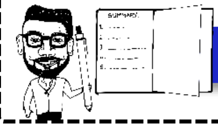
(v) Reporting entity- Care Ltd.

- Fair Ltd. (associate) is a related party

AS 19 – ACCOUNTING FOR LEASES

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI EXAMPLE 1, 2, 3, 4				
2	ICAI ILLUSTRATION NO 1				
3	ICAI ILLUSTRATION NO 2				
4	ICAI Example on Page No 1.88				
5	ICAI Example on Page No 1.90				
6	ICAI Illustration No 3, Mock Test Paper 1				
7	QP MAY 19, MTP OCT 22 SERIES 2				
8	RTP MAY 20				
9	RTP NOV 20				
10	RTP MAY 21				
11	QP NOV 19				
12	QP JAN 21				
13	MOCK TEST PAPER 2 (Q NO 1 D), IPCC RTP NOV 2018 Q19A				
14	QP MAY 2018				
15	Q P MAY 2018 OLD SYLLABUS GROUP 2				
16	(RTP NOV 2015) (NOV 2004) (NOV 2012(5 MARKS))				
17	(Suggested Nov,2011)(5 Marks)				
18	(RTP Nov, 2012)				
19	(RTP MAY 2013)				
20	(MAY 2013, 5 MARKS)				
21	(RTP MAY 2015)				
22	RTP MAY 2019 Q17, IPCC RTP MAY 2019 Q19A				
23	RTP NOV 2018 Q16 B				
24	IPCC RTP NOV 2014 Q19B				
25	IPCC RTP MAY 2015 Q17B				
26	IPCC RTP NOV 2015 Q19B				
27	IPCC RTP NOV 2016				

28	MOCK TEST OCT 21 SERIES I				
29	MOCK TEST OCT 21 SERIES I				
30	QP DEC 21 (SIIMILAR TO Q 33)				
31	ICAI PRACTICAL Q 4				
32	ICAI PRACTICAL QUESTION 16				
33	MAY 22 RTP				
34	MAY 22 RTP				
35	MAY 2022 EXAM				
36	RTP MAY 2018, RTP NOV 22				
37	MTP SEP 22 SERIES I				



Let's Get Started....With Class Work

1. ICAI EXAMPLE 1, 2, 3, 4

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

1. Interest rate implicit on lease
2. Present value of minimum lease payment. Write down entry at the inception of lease to record the asset taken on finance lease in books of lessee.
3. Assuming zero residual value, allocate finance charge over lease period. Pass accounting entries in year 1 to recognise the finance charge in books of lessee
4. suppose unguaranteed residual value is not determinable and lessee's incremental borrowing rate is 10%, calculate
   - Present value of minimum lease payment. Write down entry at the inception of lease to record the asset taken on finance lease in books of lessee.
   - Assuming zero residual value, allocate finance charge over lease period. Pass accounting entries in year 1 to recognise the finance charge in books of lessee

SOLUTION

1. Interest rate implicit on lease is a discounting rate at which present value of minimum lease payments and unguaranteed residual value is ₹ 2 lakhs.

PV of minimum lease payments and unguaranteed residual value at guessed rate 10%

Year	MLP + UGR ₹	DF (10%)	PV ₹
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150

5	50,000	0.621	31,050
5	25,000	0.621	15,525
5	15,000	0.621	9,315
Total	**2,90,000**		**2,14,340**

PV of minimum lease payments and unguaranteed residual value at guessed rate 14%

Year	MLP + UGR ₹	DF (14%)	PV ₹
1	50,000	0.877	43,850
2	50,000	0.769	38,450
3	50,000	0.675	33,750
4	50,000	0.592	29,600
5	50,000	0.519	25,950
5	25,000	0.519	12,975
5	15,000	0.519	7,785
Total	**2,90,000**		**1,92,360**

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease = $10\% + \frac{14\%-10\%}{2,14,340-1,92,360} \times (2,14,340 - 2,00,000) =$

$\mathbf{12.6\%}$

2. Present value of minimum lease payment is computed below:

Year	MLP ₹	DF (12.6%)	PV ₹
1	50,000	0.890	44,500
2	50,000	0.790	39,500
3	50,000	0.700	35,000
4	50,000	0.622	31,100
5	50,000	0.552	27,600
5	25,000	0.552	13,800
Total	**2,75,000**		**1,91,500**

Present value of minimum lease payment = ₹ 1,91,500

Fair value of leased asset = ₹ 2,00,000

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

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

Particulars	₹	₹
Asset A/c Dr.	1,91,500	
To Lessor A/c		1,91,500
(Being recognition of finance lease as asset and liability)		

3. Allocation of finance charge over lease period is shown below:

Year	Amount o/s @ beginning	Interest @ 12.6%	Gross Amount	Lease Payment	Amount o/s @ end
0	1,91,500	--	1,91,500	--	1,91,500
1	1,91,500	24,129	2,15,629	50,000	1,65,629
2	1,65,629	20,869	1,86,498	50,000	1,36,498
3	1,36,498	17,199	1,53,697	50,000	1,03,697
4	1,03,697	13,066	1,16763	50,000	66,7632
5	66,7632	8,237*	75,000	75,000	-
		83,500		2,75,000	

The difference between this figure and finance charge [66,763×12.6%=8412] is due to approximation in computation.

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

Particulars	₹	₹
Finance Charge A/c Dr.	24,129	
To Lessor		24,129
(Being finance charge due for the year)		
Lessor Dr.	50,000	
To Bank A/c		50,000
(Being payment of lease rent for the year)		
P & L A/c Dr.	24,129	
To Finance Charge A/c		24,129
(Being recognition of finance charge as expense for the year)		

4. Since interest rate implicit on lease is discounting rate at which present value of minimum lease payment and present value of unguaranteed residual value equals the

fair value, interest rate implicit on lease cannot be determined unless unguaranteed residual value is known. If interest rate implicit on lease is not determinable, the present value of minimum lease payments should be determined using lessee's incremental borrowing rate.

Present value of minimum lease payment using lessee's incremental borrowing rate 10% is computed below:

Year	MLP ₹	DF (10%)	PV ₹
1	50,000	0.909	45,450
2	50,000	0.826	41,300
3	50,000	0.751	37,550
4	50,000	0.683	34,150
5	50,000	0.621	31,050
5	25,000	0.621	15,525
Total	**2,75,000**		**2,05,025**

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 i.e. ₹ 2,00,000
- Present value of minimum lease payments from the standpoint of the Lessee i.e. ₹ 2,05,025

The accounting entry at the inception of lease to record the asset taken on finance lease in books of lessee is suggested below:

Particulars	₹	₹
AssetA/c Dr.	2,00,000	
To Lessor		2,00,000
(Being recognition of finance lease as asset and liability)		

Since the liability is recognised at fair value ₹ 2 lakh (total principal), we need to ascertain a discounting rate at which present value minimum lease payments equals ₹ 2 lakh. The discounting rate can then be used for allocation of finance charge over lease period.

PV of minimum lease payments at guessed rate 12%

Year	Minimum Lease Payments ₹	DF (12%)	PV ₹
1	50,000	0.893	44,650
2	50,000	0.797	39,850
3	50,000	0.712	35,600

4	50,000	0.636	31,800
5	50,000	0.567	28,350
5	25,000	0.567	14,175
Total			1,94,425

Required discounting rate $= 10\% + \frac{12\%-10\%}{2,05,025-1,94,425} \times (2,05,025 - 1,94,425) = 12.6\%$

Allocation of finance charge over lease period is shown below:

Year	Amount o/s @ beginning	Finance Charge	Gross Amount	Lease Payment	Amount o/s @ end
0	2,00,000	--	2,00,000	--	2,00,000
1	2,00,000	21,900	2,21,900	50,000	1,71,900
2	1,71,900	18,823	1,90,723	50,000	1,40,723
3	1,40,723	15,409	1,56,132	50,000	1,06,132
4	1,06,132	11,621	1,17,753	50,000	67,753
5	67,753	7,247*	75,000	75,000	0
		75,000		2,75,000	

*The difference between this figure & finance charge [67,753×10.95% = 7418] is due to approximation in computation.

Accounting entries in year 1 to recognise the finance charge in books of lessee are suggested below:

Particulars		₹	₹
Finance Charge A/c	Dr.	21,900	
To Lessor			21,900
(Being finance charge due for the year)			
Lessor	Dr.	50,000	
To Bank A/c			50,000
(Being payment of lease rent for the year)			
P & L A/c	Dr.	21,900	
To Finance Charge			21,900
(Being recognition of finance charge as expense for the year)			

2. ICAI ILLUSTRATION NO 1

S. Square Private Limited has taken machinery on 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. And disclose impact of this on Balance sheet and profit & Loss Account at the end of 1 year.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS: Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @ 15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000 [6,25,000 + 1,25,000]	0.5718	4,28,850
Total	26,25,000		18,55,850

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

3. ICAI ILLUSTRATION NO 2

Prakash Limited leased a machine to Badal Limited on the following terms:

		(₹ In lakhs)
(i)	Fair value of the machine	48.00
(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 1^{st} year to 5^{th} year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively. Ascertain Unearned Finance Income.

SOLUTION

REFERENCE: As per AS 19 - Leases, **unearned finance income** is the difference between (a) the **gross investment** in the lease and (b) the **present value of minimum lease payments** under a finance lease from the standpoint of the **lessor**; and any **unguaranteed residual value** accruing to the lessor, at the interest rate implicit in the lease.

Where:

Gross investment in the lease is the aggregate of

(i) minimum lease payments from the stand point of the lessor and

(ii) any unguaranteed residual value accruing to the lessor.

Formula of GIL = Minimum lease payments + Unguaranteed residual value

= [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

ANALYSIS:

(a) Calculation of Gross Investment of Lease:

Particulars	Amount	Amount
Minimum Lease Payments		41,60,000
Total Lease rent [(₹ 8,00,000 x 5 years)	40,00,000	
Guaranteed Residual Value (GRV)	1,60,000	
Add: Unguaranteed residual value (URV)		1,40,000
Gross Investment		**43,00,000**

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

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	1,60,000 (GRV)	0.4972	79,552
	41,60,000		27,61,312 (i)
	1,40,000 (URV)	0.4972	69,608 (ii)
	43,00,000	(i)+ (ii)	28,30,920(b)

Unearned Finance Income (a) - (b) = ₹ 43,00,000 – ₹ 28,30,920= ₹ 14,69,080.

4. ICAI Example on Page No 1.88

Outputs from a machine taken on a 3 year operating lease are estimated as 10,000 units in year 1, 20,000 units in year 2 and 50,000 units in year 3. The agreed annual lease payments are ₹ 25,000, ₹ 45,000 and ₹ 50,000 respectively.

How will you recognise the lease payment in the statement of profit and loss account.

SOLUTION

REFERENCE: As per AS 19, operating lease should be recognized as an expense in the statement of Profit and Loss on Straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

ANALYSIS: The total lease payment **₹ 1,20,000** should be recognised **in proportion of output as ₹ 15,000 in year 1, ₹ 30,000 in year 2 and ₹ 75,000 in year 3.**

The difference between lease rent due and lease rent recognised can be **debited / credited to Lease Equalisation A/c.**

The accounting entries for year 1 in books of lessee are suggested below:

Particulars		₹	₹
Lease Rent A/c	Dr.	25,000	
To Lessor			25,000
(Being lease rent for the year due)			
Lessor	Dr.	25,000	
To Bank A/c			25,000
(Being payment of lease rent for the year)			
Lease Equalisation A/c	Dr.	10,000	
P & L A/c	Dr.	15,000	
To Lease Rent A/c			25,000
(Being recognition of lease rent as expense for the year)			

Since total lease rent due and recognised must be same, the **Lease Equalisation A/c** will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or Current Liabilities" depending on the nature of balance.

5. ICAI Example on Page No 1.90

Outputs from a machine of economic life of 6 years are estimated as 10,000 units in year 1, 20,000 units in year 2 and 30,000 units in year 3, 40,000 units in year 4, 20,000 units in year 5 and 5,000 units in year 6. The machine was given on 3-year operating lease by a dealer of the machine for equal annual lease rentals to yield 20% profit margin on cost ₹ 5,00,000. How will you recognise the lease rent in books.

SOLUTION

REFERENCE: As per AS 19, operating lease should be recognized as an expense in the statement of Profit and Loss on Straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

ANALYSIS: As per the above reference, Straight-line depreciation in proportion of output is considered appropriate.

$$\text{Total lease rent} = 120\%\ of\ Rs.5\ Lakhs \times \frac{Output\ During\ lease\ period}{Total\ Output}$$

$$6\ Lakhs \times \frac{60{,}000\ Units}{1{,}25{,}000\ Units} = Rs.2.88\ Lakhs$$

Annual lease rent = ₹ 2,88,000 / 3 = ₹ 96,000

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of **10 : 20 : 30**. Hence income recognised in years **1, 2** and **3** are **₹ 48,000, ₹ 96,000 and ₹ 1,44,000** respectively.

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 5 lakh should be allocated over useful life 6 years in proportion of output, i.e. in proportion of **10 : 20 : 30 : 40 : 20 : 5.**

Depreciation for year 1 = ₹ 5,00,000 X 10/125 = ₹ 40,000.

The accounting entries for year 1 in books of lessor are suggested below:

Particulars		₹	₹
Machine given on Operating Lease	Dr.	5,00,000	
To Bank / Cash A/c			5,00,000
(Being machine given on operating lease brought into books)			
Lessee	Dr.	96,000	
To Lease Rent			96,000
(Being lease rent for the year due)			
Bank	Dr.	96,000	
To Lessee			96,000
(Being receipt of lease rent for the year)			
Lease Rent	Dr.	96,000	
To P & L A/c			48,000
To Lease Equalisation A/c			48,000
(Being recognition of lease rent as income for the year)			
Depreciation	Dr.	40,000	
To Machine given on Operating Lease			40,000
(Being depreciation for the year)			
P & L A/c	Dr.	40,000	
To Depreciation			40,000
(Being depreciation for the year transferred to P & L A/c)			

Since total lease rent due and recognised must be same, the Lease Equalisation A/c will close in the terminal year. Till then, the balance of Lease Equalisation A/c can be shown in the balance sheet under "Current Assets" or Current Liabilities" depending on the nature of balance.

6. ICAI Illustration No 3, Mock Test Paper I

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.

SOLUTION

Following will be the treatment in the situations given in the question as per AS 19:

(a) When sales price of ₹ 50 lakhs is equal to fair value, A Ltd. should **immediately recognise** the **profit of ₹10 lakhs (i.e. 50 – 40)** in its books.

(b) When fair value is ₹ 60 lakhs then also **profit of ₹10 lakhs** should be **immediately recognised** by A Ltd.

(c) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of **₹ 2 lakhs (40 – 38)** to be **immediately recognised** by A Ltd. in its books provided loss is not compensated by future lease payment.

(d) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, **profit of ₹ 10 lakhs** is to be **deferred and amortised** over the lease period.

(e) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, **profit of ₹ 6 lakhs (46 - 40)** to be **immediately recognised** in its books and **balance profit of ₹4 lakhs (50-46)** is to be **amortised/deferred over lease period.**

(f) When fair value is ₹ 35 lakhs & sales price is ₹39 lakhs, then the **loss of ₹ 5 lakhs (40-35)** to be **immediately recognised** by A Ltd. in its books and **profit of ₹ 4 lakhs (39-35)** should be **amortised/deferred over lease period**

7. QP MAY 19, MTP OCT 22 SERIES 2

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.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS: Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @ 10%)	Present value ₹
1	3,50,000	0.909	3,18,150
2	3,50,000	0.826	2,89,100
3	3,50,000	0.751	2,62,850
4	4,20,000*	0.683	2,86,860
Total	14,70,000	-	11,56,960

CONCLUSION: Present value of minimum lease payments ₹ **11,56,960** is more than fair value at the inception of lease **i.e. ₹ 11,50,000**, therefore, the **lease liability and machinery should be recognized in the books at ₹ 11,50,000 as per AS 19.**

Note: Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 70,000= 4,20,000.

8. RTP MAY 20

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 salvage value of the machine will be only ₹35,000 only. It was not practicable for the lessee to determine the interest rate implicit in the lease, However the incremental borrowing rate of ABC Ltd. is determined at 16.4%. PV factors at 16.4% for year 1, year 2, year 3 and year 4 are 0.8591, 0.7381, 0.6341 and 0.5447 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

SOLUTION:

REFERENCE: As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

ANALYSIS: Value of machinery: In the given case, fair value of the machinery is ₹ 10,00,000 which is more than net present value of minimum lease payments of ₹ 9,98,835 (Refer working Note). Hence, the machine and the corresponding liability will be recorded at value of ₹ 9,98,835 in the books of ABC Ltd.

Calculation of finance charges for each year

Year	Amount o/s @ beginning	Finance Charges	Gross Amount	Lease Payment	Amount o/s @ end
1st Year Beginning	-	-	-	-	9,98,835
End of 1st Year	9,98,835	1,63,809	11,62,644	3,50,000	8,12,644
End of 2nd Year	8,12,644	1,33,274	9,45,918	3,50,000	5,95,918

End of 3rd Year	5,95,918	97,731	6,93,649	3,50,000	3,43,649
End of 4th Year	3,43,649	56,358	4,00,007	4,00,000*	7**
		4,51,172			

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor 3,50,000 x (0.8591+ 0.7381+ 0.6341+ 0.5447) Present value of guaranteed residual value 50,000 x (0.5447)	₹ 9,71,600 ₹ 27,235
	₹ 9,98,835

* Includes guaranteed residual value of ₹ 50,000 (considered to be paid).

** It should be nil, difference of Rs. 7 due to approximations.

9. RTP NOV 20

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

(i) If Present value (PV) of Minimum lease payment (MLP) = "X"; Fair value of the asset is "Y" and X=Y.

(ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

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

SOLUTION

REFERENCE:

As per AS 19 "Leases", a lease will be classified as finance lease if

- At the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset.
- In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.
- The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made.

ANALYSIS (i):

As per the above reference, cases will be classified as follows:

As Present value (PV) of Minimum lease payment (MLP) = Fair value of the asset, the definition of finance lease is satisfied.

CONCLUSION:

The lease will be classified as a **finance lease.**

ANALYSIS (ii):

Economic life of asset (7years) is substantially covered by the lease term (6.5years).

CONCLUSION:

The lease will be classified as a **finance lease.**

ANALYSIS (iii):

As the asset is of special nature and has been procured only for use of the lessee, it has no other usage even if it's economic life is more than lease period.

CONCLUSION:

The lease will be classified as a **finance lease.**

b) Viral Ltd. sold machinery having WDV of ₹ 40 lakhs to Saral Ltd. for ₹ 50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases–

(i) Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.

(ii) Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.

(iii) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

SOLUTION

Following will be the treatment in the situations given in the question as per AS 19:

(i) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then **loss of ₹ 2 lakhs (40 – 38)** to be **immediately recognized** by Viral Ltd. in its books provided loss is not compensated by future lease payment.

(ii) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, **profit of ₹ 10 lakhs** is to be **deferred and amortized** over the lease period.

(iii) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, **profit of ₹ 6 lakhs (46 less 40)** to be **immediately recognized** in its books and **balance profit of ₹ 4 lakhs (50-**

46) is to be **amortized/deferred over lease period.**

10. RTP MAY 21

Sooraj Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 3 years. It enters into an agreement with Star Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Sooraj Limited is not sure about the treatment of these lease rentals and seeks your advice. (use annuity factor at @ 15% for 3 years as 3.36)

SOLUTION

REFERENCE: As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment· amounts to at least substantially all of the fair value of leased asset.

ANALYSIS: In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as:

Annuity Factor (Year 1 to Year 3)	3.36
Present Value of minimum lease payments (₹3 lakhs each year x 3.36 Annuity Factor)	₹ 10.08 lakhs

Thus present value of minimum lease payments is ₹10.08 lakhs and the fair value of the machine is ₹ 30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for three years.

CONCLUSION: In light of above analysis, the lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

11. QP NOV 19

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.

SOLUTION:

REFERENCE:

As per AS 19 "Leases", a lease will be classified as finance lease if:

- At the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset.
- In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.
- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable.
- The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made.

As per the above reference, cases will be classified as follows:

ANALYSIS (i):

A substantial portion of the life of the asset (10years) is covered by the lease term (9years).

CONCLUSION:

The lease will be classified as **Finance lease.**

ANALYSIS (ii):

If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, it will be classified as a **Finance Lease.**

CONCLUSION:

The lease will be classified as **Finance lease.**

ANALYSIS (iii):

As lease payments are recognized as expense in the profit and loss account of lessee to have better matching between cost and revenue, it does not specify any condition for **finance lease.**

CONCLUSION:

The lease will be classified as **Operating lease.**

ANALYSIS (iv):

As Present value (PV) of Minimum lease payment (MLP) = Fair value of the asset, the definition of finance lease is satisfied.

CONCLUSION:

The lease will be classified as a **finance lease.**

ANALYSIS (v):

As the asset is of special nature and has been procured only for use of the lessee, it has no other usage even if it's economic life is more than lease period.

CONCLUSION:

The lease will be classified as a **finance lease.**

12. QP JAN 21

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.

SOLUTION

Following will be the treatment in the given cases as per AS 19:

(i) When sale price of ₹ 400 lakhs is equal to fair value, X Ltd. should **immediately recognise the profit of ₹100 lakhs (i.e. 400 – 300) in its books.**

(ii) When fair value is ₹ 450 lakhs then also **profit of ₹100 lakhs** should be **immediately recognised** by X Ltd.

(iii) When fair value of leased machinery is ₹ 350 lakhs & sales price is ₹ 250 lakhs, then **loss of ₹ 50 lakhs** (300 – 250) to be **immediately recognised** by X Ltd. in its books provided loss is not compensated by future lease payment.

(iv) When fair value is ₹ 300 lakhs & sales price is ₹ 400 lakhs then, **profit of ₹ 100 lakhs** is to be **deferred and amortised** over the lease period.

(v) When fair value is ₹ 250 lakhs & sales price is ₹ 290 lakhs, then the **loss of ₹ 50 lakhs (300-250)** to be **immediately recognised** by X Ltd. in its books and **profit of ₹ 40 lakhs (290-250) should be amortised/deferred over lease period.**

13. MOCK TEST PAPER 2 (Q NO 1 D), IPCC RTP NOV 2018 Q19A

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 yea₹ 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 residential 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.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS:

Value Of Machinery: In the given case, fair value of the machinery is **₹ 10, 00,000** and the net present value of minimum lease payments is **₹ 10, 07,020 (refer working note).** As the present value of the machine is more than the fair value of the machine, the machine and the corresponding **liability will be recorded at value of ₹10,00,000.**

Since Fair Value of Leased Asset is less than the present value of minimum lease payment we need to re-compute the Implicit Rate of Interest for computing Finance Charges.

Year	Minimum Lease Payment	DF @ 18 %	PV
1	3,50,000.00	0.85	2,96,625.00
2	3,50,000.00	0.72	2,51,370.00
3	3,50,000.00	0.61	2,13,010.00
4	4,00,000.00	0.52	2,06,320.00
	14,50,000.00		**9,67,325.00**

Re-computation of Implicit Rate of Interest

Computation of PV of minimum lease payments at guessed rate 18%

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease = $16\% + \frac{7020}{39695} \times (18-16) =$ **16.35%**

Calculation Of Finance Charges For Each Year

Year	Amount o/s @ beginning	Finance Charges @ 16.35%	Gross Amount	Lease Payment	Amount o/s @ End
0					10,00,000
1	10,00,000	1,63,500	11,63,500	3,50,000	8,13,500
2	8,13,500	1,33,007	9,46,507	3,50,000	5,96,507
3	5,96,507	97,529	6,94,036	3,50,000	3,44,036
4	3,44,036	55,964*	4,00,000	4,00,000	0

*The difference between this figure and finance charge [5,96,507×16.35%=56,249.88] is due to approximation in computation.

Working Note:

Present value of minimum lease payments

Year	Minimum Lease Payment	PVAF 16 %	PV
1	3,50,000.00	0.86	3,01,735.00
2	3,50,000.00	0.74	2,60,120.00
3	3,50,000.00	0.64	2,24,245.00
4	4,00,000.00	0.55	2,20,920.00
	14,50,000.00		**10,07,020.00**

14. QP MAY 2018

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.

SOLUTION

Following will be the treatment in the given cases as per AS 19:

i) When sale price of ₹ 24 lakhs is equal to fair value, A Ltd. should **immediately recognise the profit of ₹ 4 lakhs (i.e., 24 - 20) in its books.**

ii) When fair value is ₹ 20 lakhs & sale price is ₹ 24 lakhs then **profit of ₹ 4 lakhs** is to be **deferred and amortised** over the lease period.

iii) When fair value is ₹ 22 lakhs & sale price is ₹ 25 lakhs, **profit of ₹ 2 lakhs (22 -20)** to be **immediately recognised** in its books and **balance profit of ₹ 3 lakhs (25-22)** is to be **amortised/deferred** over lease period.

iv) When fair value of leased machinery is ₹ 25 lakhs & sale price is ₹ 18 lakhs, then **loss of ₹ 2 lakhs (20 - 18)** to be **immediately recognised** by A Ltd. in its books provided loss is not compensated by future lease payment.

v) When fair value is ₹ 18 lakhs & sale price is ₹ 19 lakhs, then the **loss of ₹ 2 lakhs (20-18) to be immediately recognised** by A Ltd. in its books and **profit of ₹ 1 lakhs (19-18) should be amortised/deferred** over lease period.

15. Q PAPER MAY 2018 OLD SYLLABUS GROUP 2

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 Ram 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.

SOLUTION

According to AS 19, following will be the treatment in the given situations as per AS 19:

(i) When sales price of ₹ 150 lakhs is equal to fair value, Ram Ltd. should **immediately recognize** the **profit of ₹25 lakhs (i.e. 150 – 125)** lakhs in its books.

(ii) When fair value of leased machine is ₹ 125 lakhs & sales price is ₹ 112.50 lakhs, then **loss of ₹ 12.5 lakhs (125 – 112.50) lakhs** to be immediately recognized by Ram Ltd. in its books provided loss is not compensated by future lease payments.

(iii) When fair value is ₹ 137.5 lakhs & sales price is ₹ 155 lakhs, **profit of ₹ 12.5 lakhs (137.5- 125) lakhs** to be **immediately recognized** by Ram Ltd. in its books and **balance profit of ₹ 17.5 lakhs (155-137.50) lakhs** is to be **amortised/deferred** over lease period.

(iv) When fair value is ₹ 112.5 lakhs & sales price is ₹ 120 lakhs, then the **loss of ₹ 12.5 lakhs (125-112.5) lakhs** to be **immediately recognized** by Ram Ltd. in its books and **profit of ₹ 7.5 lakhs (120-112.5) lakhs** should be **amortised/deferred over lease period**.

16. (RTP NOV 2015) (NOV 2004) (NOV 2012(5 MARKS))

A Ltd. Leased a machinery to B Ltd. On the following terms:

(₹ in Lakhs)

Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

SOLUTION

Computation of Unearned Finance Income

As per AS 19 on Leases, **unearned finance income** is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Unearned finance income (UFI) = GIL – (PV of MLP + PV of UGR)

Where:

a. **Gross investment** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross investment in Lease (GIL)

= Minimum Lease Payments (MLP) + Unguaranteed Residual value (UGR)

Particulars	Amount	Amount
Minimum Lease Payments		26,00,000
Total Lease rent [(₹ 5,00,000 x 5 years)	25,00,000	
Guaranteed Residual Value (GRV)	1,00,000	
Add: Unguaranteed residual value (URV)		1,00,000
Gross Investment		**27,00,000**

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

Year	MLP inclusive of URV ₹	Internal rate of Return (Discount factor 15%)	Present Value ₹
1	5,00,000	.8696	4,34,800
2	5,00,000	.7561	3,78,050
3	5,00,000	.6575	3,28,750
4	5,00,000	.5718	2,85,900
5	5,00,000	.4972	2,48,600
5	1,00,000	.4972	49,720

Total	26,00,000		17,25,280

=PV of MLP + PV of UGR

=17,25,280 + (1,00,000*0.4972)

=17,25,280+49,720

=17,75,540

Unearned finance income (UFI)

= GIL – (PV of MLP + PV of UGR)

=27,00,000 – 17,75,540

=9,24,460

REFERENCE: As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

As the fair value of ₹ **20,00,000** is more than the present value amounting

₹ **17,25,820,** the machinery has been recorded at ₹ **17,25,820** in the books of B Ltd. (the lessee) at the inception of the lease.

Journal Entries in the books of B Ltd.

Particulars		Dr	Cr
At the inception of lease			
Machinery account	Dr.	17,25,820*	
To A Ltd.'s account			17,25,820*
(Being lease of machinery recorded at present value of MLP)			
At the end of the first year of lease			
Finance charges account (Refer Working Note)	Dr.	2,58,873	
To A Ltd.'s account			2,58,873
(Being the finance charges for first year due)			
A Ltd.'s account	Dr.	5,00,000	
To Bank account			5,00,000

(Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)		
Depreciation account Dr. To Machinery account (Being the depreciation provided @ 10% p.a. on straight line method)	1,72,582	 1,72,582
Profit and loss account Dr To Depreciation account To Finance charges account (Being the depreciation and finance charges transferred to profit and loss account)	4,31,455	 1,72582 2,58,873

Working Note:

Table showing apportionment of lease payments by B Ltd. between the finance charges and the reduction of outstanding liability.

Year	Amount o/s @ beginning	Finance Charge	Gross Amount	Lease Payment	Amount o/s @ end
1	17,25,820	2,58,873	19,84,693	5,00,000	14,84,693
2	14,84,693	2,22,704	17,07,397	5,00,000	12,07,397
3	12,07,397	1,81,110	13,88,507	5,00,000	8,88,507
4	8,88,507	1,33,276	10,21,783	5,00,000	5,21,783
5	5,21,783	78,217	6,00,050	6,00,000	-
		8,74,230		**25,00,000**	

The difference between this figure and finance charge [5,21,783×15%=78,267] is due to approximation in computation

17. (Suggested Nov,2011)(5 Marks)

The following balances are extracted from the books of Ram Ltd. a real estate company on 31st March, 2011:

	Dr. (₹ in 000)	Cr. (₹ in '000)
Lease hold premises	42	
Equipment, fixtures and fittings at cost on 1.4.2010	264	
Deprecation on equipment's, fixtures and fittings on 1.4.2010		164

The following additional information's are also provided.

1. Depreciation on equipment, fittings and fixtures is provided @ 15% on written down value.
2. On 1st October 2010, the company moved to a new premises. The premise is on a 12 year lease and the lease premium paid amounted to ₹₹ 42,000. The company used sub-contract labour of ₹ 40,000 and materials at cost of ₹38,000 in the refurbishment of the premises. These are to be considered as part of the cost of lease hold premises

You are required to prepare the 'Notes to accounts' including significant accounting policies forming part of the financial statements, for disclosure of above facts and information provided.

SOLUTION

Since the implicit rate of interest is not mention in the question it is assumed that value of lease premium paid along with the refurbishment cost is the fair value of the leased asset. Accordingly, question has been solved assuming the lease as finance lease.

Notes on Accounts for the year ended 31st March, 2011:

The cost of lease hold premises includes the cost of refurbishment to the extent of ₹ 78,000 (Materials ₹ 38,000 + Labour ₹40,000).

Working Notes:

(a)	Fixed Assets:	(₹ in 000)	
	Equipment, fixture & fittings	264	
	* Lease hold premises (42+40+38)	120	
		384	
(b)	Depreciation		
	Equipment, fixtures * fittings as on 1.4.2010	164	
	For the year 2010-11	15	179
	* Cost of leasehold premises written off		
	[(42+40+38) x 1/12 x ½]		5
			184

Significant Accounting Policies

1. Depreciation has been charged on equipment, fixtures & fittings on the basis of written down value method year after year. Equipment fixtures & fittings are shown at cost in

the balance sheet & depreciation accumulated, thereon is shown on the liability side of the balance sheet.

2. According to AS-19 leases, the lease has been classified as finance lease assuming that lessor has transferred substantially all the risks and rewards incident to ownership to Ram Ltd. At the inception of lease, asset under finance lease is capitalized in the books of the lessee with the corresponding liability wherein lease payments are recognized as an expense in the profit and loss account on a systematic basis (i.e straight line) over the lease term. The person (lessor/lessee) presenting the leased asset in his balance sheet should also consider the additional requirements of AS 6 and AS 10.

18. (RTP Nov, 2012)

An equipment is leased for 3 years and its useful life is 5 years Both the cost and the fair value of the equipment are ₹ 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

(i) State with reason whether the lease constitutes finance lease.

(ii) Calculate unearned finance income.

SOLUTION

REFERENCE: As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.

(i) Present value of residual value = ₹40,000 x 0.7513 = ₹ 30,052

Present value of lease payments = ₹ 3,00,000 – ₹30,052 = ₹ 2,69,948.

The present value of lease payments being 89.98% $\left(\frac{2,69,948}{3,00,000} \ x \ \rightleftarrows 100\right)$ of the fair value, i.e. being a substantial portion thereof, the **lease constitutes a finance lease.**

(ii) Calculation of unearned finance income

Particulars	₹
Gross investment in the lease [(₹1,08,552* x 3) + ₹40,000]	3,65,656
Less: Cost ofd the equipment	3,00,000
Unearned finance income	**65,656**

Note: - In the above solution, annual lease payment has been determined on the basis that the present value of lease payments plus residual value is equal to the fair value (cost) of the asset.

* Annual lease payments = $\frac{Rs.2,69,948}{2,4868}$ = ₹1,08,552 (approx.)

19. (RTP MAY 2013)

Annual lease rent = ₹40,000 at the end of each year

Lease period = 5 years

Guaranteed residual value = ₹14,000

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

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively. Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

SOLUTION

As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

Present value of minimum lease payments **1,49,888** is less than fair value at the inception of lease i.e. **1,50,000** therefore, the **lease liability and machinery should be recognized in the books at 1,49,888 as per AS 19.**

In books of Lessee

Journal Entry

Particulars	Dr.	Cr.

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

Working Note:

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

20. (MAY 2013, 5 MARKS)

On 1st January, 2011 Santa Ltd sold equipment for ₹6,14,460. The carrying amount of the equipment on the date was ₹1,00,000. The sale was part of the package under which Banta Ltd. leased the asset to Santa Ltd. for 10 year term. The economic life of the asset is estimated at 10 years. The Minimum Lease Rents payable by the Lessee has been fixed at ₹1,00,000 payable annually beginning 31st December, 2011. The incremental borrowing Interest Rate of Santa Ltd is estimated at 10% p.a. Calculate the net effect on the Profit and Loss in the books of Santa Ltd.

SOLUTION

A. In the books of the Lessee:

1. It is assumed that the asset is depreciated on SLM Basis. Since the lease period covers the balance useful life of the asset, it is a **Finance Lease.**
2. PV of MLP = 6.1446 × 1,00,000 = **₹6,14,460.**
3. The Asset is sold at PV of MLP (₹ 6,14,460). Hence the same is capitalized in Lessor's Books.
4. Depreciation to be charged for the next 10 years = 6,14,460 ÷ 10 = ₹ 61,446 p.a.

5. Profit on Sale & Lease Back = Revised Book Value – Old Book Value = ₹ 6,14,460 – ₹ 1,00,000 = ₹ 5,14,460

This Profit will be credited to P&L A/c in the next 10 years, in proportion to the depreciation charge. In this case, **₹51,446 p.a.** will be credited to the P & L A/c over the next 10 year (Since Depreciation is constant on SLM basis)

1. Interest Charge to be debited in P&L A/c is determined as under –

Year	Opening Balance	Interest at 10% on Opening Balance	Lease Payment	Balance Principal Repaid	Closing Balance
1	6,14,460	61,446	1,00,000	38,554	5,75,906
2	5,75,906	57,591	1,00,000	42,409	5,33,497
3	5,33,497	53,350	1,00,000	46,650	4,86,847
4	4,86,847	48,685	1,00,000	51,315	4,35,532
5	4,35,532	43,553	1,00,000	56,447	3,79,085
6	3,79,085	37,909	1,00,000	62,091	3,16,994
7	3,16,994	31,699	1,00,000	68,301	2,48,693
8	2,48,693	24,869	1,00,000	75,131	1,73,562
9	1,73,562	17,356	1,00,000	82,644	90,918
10	90,918	9,082	1,00,000	90,918	-

Note: In the 10th year, the Balance Principal to be repaid is taken as 90,918 and the balancing figure is treated as towards Interest.

21. (RTP MAY 2015)

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.

SOLUTION

REFERENCE: As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.

(i) Determination of nature of lease

Fair value of asset = ₹7,00,000

Unguaranteed residual value = ₹70,000

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

= ₹47,810

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

= ₹6,52,190

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

= (₹6 ,52,190/₹7,00,000)x100

= 93.17%

Conclusion: As percentage of present value of lease payment to fair value of the asset is substantial and it also covers the life of the asset, the lease constitutes a **finance lease.**

(ii) Calculation of Unearned Finance Income

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

= ₹2,05,803 (approx.)

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

= (₹2,05,803 x 4) + ₹70,000

= ₹8,23,212 + ₹70,000

= ₹8,93 ,212

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

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

= ₹1,93,212.

22. RTP MAY 2019 Q17, IPCC RTP MAY 2019 Q19A

Aksat International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is ₹ 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

SOLUTION

REFERENCE: As per AS 19 'leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.

ANALYSIS: Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year

= ₹ 50,000 x 0.7513

= ₹ 37,565

Present value of lease payments = ₹ 5,00,000 – ₹ 37,565

= ₹ 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (₹ 4,62,435/ ₹ 5,00,000) x 100 = 92.487%.

Conclusion: As lease payments substantially covers the major portion of the fair value, the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/ 2.4868 =₹ 1,85,956 (approx.)

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

= (₹ 1,85,956 × 3) + ₹ 50,000

= ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

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

= ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868

23.RTP NOV 2018 Q16 B

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 ₹ 40,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential 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.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease
b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS:

Value of machinery - Fair value of the machinery is **₹ 10, 00,000** and the net present value of minimum lease payments is **₹ 10,01,497 (Refer working Note)**. As the present value of the machine is more than the fair value of the machine, the machine and the corresponding **liability will be recorded at fair value of ₹ 10,00,000 as per AS 19.**

Since Fair Value of Leased Asset is less than the present value of minimum lease payment we need to re-compute the Implicit Rate of Interest for computing Finance Charges.

Re-computation of Implicit Rate of Interest

Computation of PV of minimum lease payments at guessed rate 18%

Year	Minimum Lease Payment	DF @ 18 %	PV
1	3,50,000.00	0.8475	2,96,625.00

2	3,50,000.00	0.7182	2,51,370.00
3	3,50,000.00	0.6086	2,13,010.00
4	3,90,000.00	0.5158	2,01,162.00
	14,40,000.00		**9,62,167.00**

Interest rate implicit on lease is computed below by interpolation:

Interest rate implicit on lease = 16% + 1497/37833 x (18-16) = **16.079%**

Calculation of finance charges for each year

Year	Amount o/s @ beginning	Finance Charges @ 16.079%	Gross Amount	Lease Payment	Amount o/s @ End
0					10,00,000
1	10,00,000	1,60,790	11,60,790	3,50,000	8,10,790
2	8,10,790	1,30,367	9,41,157	3,50,000	5,91,157
3	5,91,157	95,052	6,86,209	3,50,000	3,36,209
4	3,36,209	53,791	3,90,268	3,90,000	0

*The difference between this figure and finance charge [3,36,209×16.079%=54,059] is due to approximation in computation.

Working Note:

Present value of minimum lease payments

Year	Minimum Lease Payment ₹	Internal rate of return	Present value ₹
1	3,50,000	0.8621	3,017,35
2	3,50,000	0.7432	2,60,120
3	3,50,000	0.6407	2,24,245
4	3,90,000*	0.5523	2,15,397
Total	**14,40,000**		**10,01,497**

*Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 3,50,000 + 40,000 = 3,90,000.

24. IPCC RTP NOV 2014 Q19B

Jet Carriers Ltd. has initiated a lease for four years in respect of a vehicle costing ₹ 20,00,000 with expected useful life of 5 years. The asset would revert to the company under the lease agreement. The other information available in respect of lease agreement is:

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹ 2,50,000.

(2) The implicit rate of interest is 10%.

(3) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hand of Jet Carriers Ltd.

(1) The annual lease payment.

(2) The unearned finance income.

(3) The segregation of finance income.

Note: (a) PV Residual value for 4 years @ 10% is 0.683.

(b) P V Factor for 4 years @ 10% is 3.16987.

SOLUTION

(1) Calculation of annual lease payment

Particulars	₹
Cost of the equipment	20,00,000
Unguaranteed residual value	2,50,000
PV residual value for 4 years @ 10% (2,50,000 x 0.683)	1,70,750
Fair value to be recovered from lease payment (₹ 20,00,000-1,70,750)	18,29,250
PV Factor for 4 years @ 10%	3.16987
Annual lease payment (₹18,29,250/PV Factor for 4 years @ 10%	**577074**
i.e. 3.16987	

(2) Unearned Finance Income

Unearned finance income (UFI) = GIL – (PV of MLP + PV of UGR)

Gross investment in Lease (GIL)

= Minimum Lease Payments (MLP) + Unguaranteed Residual value (UGR)

Total lease payments (₹ 5,77,074 x 4)	23,08,296
Add: Unguaranteed Residual value	2,50,000
Gross investments	25,58,296
Less: Present value of investments (₹ 18,29,250 +1,70,750)	20,00,000

Unearned Finance Income	5,58,296

(3) Segregation of Finance Income

Year	Amount o/s @ beginning	Finance Charge @ 10 %	Gross Amount	Lease Payment	Amount o/s @ end
0	-	-	-	-	20,00,000
1	20,00,000	2,00,000	22,00,000	5,77,074	16,22,926
2	16,22,926	1,62,293	17,85,219	5,77,074	12,08,145
3	12,08,145	1,20,814	13,28,959	5,77,074	7,51,885
4	7,51,885	75,189	8,27,074	8,27,074	-
	Total	5,58,296		25,58,296	

25. IPCC RTP MAY 2015 Q17B

X Ltd. has leased equipment over its useful life that costs ₹ 7,46,55,100 for a three year lease period. After the lease term the asset would revert to the Lessor. You are informed that:

(i) The estimated unguaranteed residual value would be ₹ 1 lakh only.

(ii) The annual lease payments have been structured in such a way that the sum of their present values together with that of the residual value of the asset will equal the cost thereof.

(iii) Implicit interest rate is 10%.

You are required to ascertain the annual lease payment and the unearned finance income. Annual lease payments are made at the end of each accounting year. P.V. factor @ 10% for years 1 to 3 are 0.909, 0.826 and 0.751 respectively.

SOLUTION

Calculation of Annual Lease Payment

Particulars	₹
Cost of the equipment	7,46,55,100
Unguaranteed Residual Value	1,00,000

PV of unguaranteed residual value for 3 years @ 10%	75,100
(₹ 1,00,000 x 0.751)	
Fair value to be recovered from Lease Payment	
(₹ 7,46,55,100 – ₹ 75,100)	7,45,80,000
PV Factor for 3 years @ 10%	2.486
Annual Lease Payment	
(₹ 7,45,80,000 / PV Factor for 3 years @ 10% i.e. 2.486)	**3,00,00,000**

(ii)Unearned Finance Income

Unearned finance income (UFI) = GIL – (PV of MLP + PV of UGR)

Where,

Gross investment in Lease (GIL)

= Minimum Lease Payments (MLP) + Unguaranteed Residual value (UGR)

Total lease payments [₹ 3,00,00,000 x 3]	9,00,00,000
Add: Unguaranteed Residual value	1,00,000
Gross Investments	9,01,00,000
Less: Present value of Investments	
(₹ 7,45,80,000+ ₹ 75,100)	(7,46,55,100)
Unearned Finance Income	1,54,44,900

26.IPCC RTP NOV 2015 Q19B

L Private Limited has taken machinery on lease from P 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 AS19.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS: Present value of minimum lease payments will be calculated as follows:

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

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

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

27.IPCC RTP NOV 2016

Annual lease rent = ₹ 80,000 at the end of each year Lease period

= 5 years Guaranteed residual value = ₹ 28,000

Fair value at the inception (beginning) of lease = ₹ 3,00,000

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

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

SOLUTION

As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease

b. The present value of the minimum lease payments from the standpoint of the lessee.

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

Present value of minimum lease payments **2,99,776** is less than fair value at the inception of lease i.e. **3,00,000** therefore, **the lease liability and machinery should be recognized in the books at 2,99,776 as per AS 19.**

Journal entry in the books of Lessee

	₹	₹
Asset A/c Dr.	2,99,776	
To Lessor		2,99,776
(Being recognition of finance lease as an asset and a liability)		

Working Note:

Year	Lease Payments ₹	Discounting Factor (12.6%)	Present Value ₹
1	80,000	0.89	71,200
2	80,000	0.79	63,200
3	80,000	0.70	56,000
4	80,000	0.622	49,760
5	80,000	0.552	44,160
5	28,000 (GRV)	0.552	15,456
Total	**4,28,000**		**2,99,776**

28. MOCK TEST OCT 21 SERIES I

Monu Ltd. sold machinery having WDV of ₹ 400 lakhs to Sonu Ltd. for ₹ 500 lakhs and the same machinery was leased back by Sonu Ltd. to Monu Ltd. The lease back was in nature of operating lease.

Explain the accounting treatment as per AS 19 in the following cases:

(i) Sale price of ₹ 500 lakhs is equal to fair value.

(ii) Fair value is ₹ 450 lakhs and sale price is ₹ 380 lakhs.

(iii) Fair value is ₹ 400 lakhs and sale price is ₹ 500 lakhs.

(iv) Fair value is ₹ 460 lakhs and sale price is ₹ 500 lakhs

SOLUTION

Following will be the treatment in the given cases as per AS 19:

(i) When sales price of ₹ 500 lakhs is equal to fair value, Monu Ltd. should **immediately recognise the profit of ₹ 100 lakhs (i.e. 500 – 400) in its books.**

(ii) When fair value of leased machinery is ₹ 450 lakhs & sales price is ₹ 380 lakhs, then **loss of ₹ 20 lakhs (400 – 380)** to be **immediately recognised** by Monu Ltd. in its books provided loss is not compensated by future lease payment.

(iii) When fair value is ₹ 400 lakhs & sales price is ₹ 500 lakhs then, **profit of ₹ 100 lakhs** is to be **deferred and amortised** over the lease period.

(iv) When fair value is ₹ 460 lakhs & sales price is ₹ 500 lakhs, **profit of ₹ 60 lakhs (460-400)** to be **immediately recognised** in its books and balance **profit of ₹ 40 lakhs (500-460)** is to be **amortised/deferred** over lease period.

29. MOCK TEST OCT 21 SERIES I

S. Square Private Limited has taken machinery on 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.

You are required to calculate the value of the lease liability as per AS-19 and also disclose impact of this on Balance sheet and Profit & loss account at the end of year 1.

SOLUTION

REFERENCE: As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease
b. The present value of the minimum lease payments from the standpoint of the lessee.

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

Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment	Implicit interest rate (Discount rate @ 15%)	Present value ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

*Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e. 6,25,000 + 1,25,000 = 7,50,000

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

30. QP DEC 21 (SIIMILAR TO Q 33)

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 recognised in each operating year and

iii. Depreciation for 3 years of lease

SOLUTION

(i) Annual lease rent

Total lease rent

= 130% of ₹ 2,25,000 x Output during lease period/ Total output

= 130% of ₹ 2,25,000 x (60,000 +75,000+ 90,000)/(60,000 + 75,000 + 90,000 + 1,20,000 + 1,05,000)

= 2,92,500 x 2,25,000 units/4,50,000 units = ₹ 1,46,250

Annual lease rent = ₹ 1,46,250 / 3 = ₹ 48,750

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognized as income in proportion of output during lease period, i.e. in the proportion of 60,000 : 75,000 : 90,000 or 4:5:6

Hence income recognized in years 1, 2 and 3 will be as:

Year 1 ₹ 39,000,

Year 2 ₹ 48,750 and

Year 3 ₹ 58,500.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 2,25,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 60 :75: 90 : 120 : 105 .

Depreciation for year 1 is ₹ 30,000, year 2 = 37,500 and year 3 = 45,000.

31. ICAI PRACTICAL Q 4

Classify the following into either operating or finance lease:

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

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

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

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

SOLUTION

REFERENCE:

As per AS 19 "Leases", a lease will be classified as finance lease if

- At the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset.
- In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.
- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value.
- The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made.

ANALYSIS (i):

As per the above reference, cases will be classified as follows:

As per AS 19, If it becomes certain at the inception of lease itself that the option will be exercised by the lessee, then it is a **Finance Lease.**

CONCLUSION:

The lease will be classified as a **finance lease**

ANALYSIS (ii):

Economic life of asset (7years) is substantially covered by the lease term (6years).

CONCLUSION:

The lease will be classified as a **finance lease.**

ANALYSIS (iii):

As the asset is of special nature and has been procured only for use of the lessee, it has no other usage even if it's economic life is more than lease period.

CONCLUSION:

The lease will be classified as a **finance lease.**

ANALYSIS (iv):

As Present value (PV) of Minimum lease payment (MLP) = Fair value of the asset, the definition of **finance lease** is satisfied.

CONCLUSION:

The lease will be classified as a **finance lease.**

32.ICAI PRACTICAL QUESTION 16

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 output 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.

SOLUTION

(i) Annual lease rent

Total lease rent

= 130% of ₹ 1,50,000 x (Output during lease period / Total output)

= 130% of ₹ 1,50,000 x (40,000 +50,000+ 60,000)/(40,000 + 50,000 + 60,000 + 80,000 + 70,000)

= 1,95,000 x 1,50,000 units/3,00,000 units = ₹ 97,500

Annual lease rent = ₹ 97,500 / 3 = ₹ 32,500

(ii) Lease rent Income to be recognized in each operating year

Total lease rent should be recognised as income in proportion of output during lease period, i.e. in the proportion of 40 : 50 : 60.

Hence income recognised in years 1, 2 and 3 will be as:

Year 1 ₹ 26,000,

Year 2 ₹ 32,500 and

Year 3 ₹ 39,000.

(iii) Depreciation for three years of lease

Since depreciation in proportion of output is considered appropriate, the depreciable amount ₹ 1,50,000 should be allocated over useful life 5 years in proportion of output, i.e. in proportion of 40 : 50 : 60 : 80 : 70 .

Depreciation for **year 1 is ₹ 20,000, year 2 = 25,000 and year 3 = 30,000.**

33.MAY 22 RTP

Classify the following into either operating or finance lease:

i) If Present value (PV) of Minimum lease payment (MLP) = "X"; Fair value of the asset is "Y" and X=Y.

ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;

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

SOLUTION

REFERENCE:

As per AS 19 "Leases", a lease will be classified as finance lease if

- At the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset.
- In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred.

The leased asset is of a specialized nature such that only the lessee can use it without major modifications being made.

ANALYSIS (i):

As per the above reference, cases will be classified as follows:

As Present value (PV) of Minimum lease payment (MLP) = Fair value of the asset, the definition of finance lease is satisfied.

CONCLUSION:

The lease will be classified as a finance lease.

ANALYSIS (ii):

Economic life of asset (7years) is substantially covered by the lease term (6.5years).

CONCLUSION:

The lease will be classified as a finance lease.

ANALYSIS (iii):

As the asset is of special nature and has been procured only for use of the lessee, it has no other usage even if it's economic life is more than lease period.

CONCLUSION:

The lease will be classified as a finance lease.

34.MAY 22 RTP

Viral Ltd. sold machinery having WDV of ₹ 40 lakhs to Saral Ltd. for ₹ 50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –

(i) Fair value is ₹ 45 lakhs and sale price is ₹ 39 lakhs.

(ii) Fair value is ₹ 40 lakhs and sale price is ₹ 49 lakhs.

(iii) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

SOLUTION

Following will be the treatment in the situations given in the question as per AS 19:

i) When fair value of leased machinery is ₹ 45 lakhs & sale price is ₹ 39 lakhs, then **loss of ₹ 1 lakh (40 – 39)** to be **immediately recognized** by Viral Ltd. in its books provided loss is not compensated by future lease payment.

ii) When fair value is ₹ 40 lakhs & sale price is ₹ 49 lakhs then, **profit of ₹ 9 lakhs** is to be **deferred and amortized** over the lease period.

iii) When fair value is ₹ 46 lakhs & sale price is ₹ 50 lakhs, **profit of ₹ 6 lakhs (46-40)** to be **immediately recognized** in its books and balance **profit of ₹4 lakhs (50-46)** is to be **amortized/deferred** over lease period.

35.MAY 2022 EXAM

What are the disclosures requirements for operating leases by the lessee as per AS-19?

SOLUTION

As per AS 19, lessees are required to make following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Note: The Level II and Level III non-corporate entities (and SMCs) need not make disclosures required by (a), (b) and (e) above

36.RTP NOV 22 (SAME ASQ 14)

WIN Ltd. has entered into a three year lease arrangement with Tanya sports club in respect of Fitness Equipment's costing ₹ 16,99,999.50. The annual lease payments to be made at the end of each year are structured in such a way that the sum of the Present Values of the lease payments and that of the residual value together equal the cost of the equipments leased out. The unguaranteed residual value of the equipment at the expiry of the lease is estimated to be ₹ 1,33,500. The assets would revert to the lessor at the end of the lease. Given that the implicit rate of interest is 10%. You are required to compute the amount of the annual lease payment and the unearned finance income. Discounting Factor at 10% for years 1, 2 and 3 are 0.909, 0.826 and 0.751 respectively.

SOLUTION

REFERENCE:

As per AS 19 - Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease. Where:

Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

ANALYSIS:

(i) Computation of annual lease payment to the lessor

	₹
Cost of equipment	16,99,999.50
Unguaranteed residual value	1,33,500.00
Present value of residual value after third year @ 10% (1,33,500 × 0.751)	1,00,258.50
Fair value to be recovered from lease payments (16,99,999.5– 1,00,258.5)	15,99,741.00
Present value of annuity for three years is 2.486	
Annual lease payment = 15,99,741/ 2.486	6,43,500.00

(ii) Computation of Unearned Finance Income

	₹
Total lease payments (6,43,500 x 3)	19,30,500
Add: Unguaranteed residual value	1,33,500
Gross investment in the lease	20,64,000.00
Less: Present value of investment (lease payments and residual value) (1,00,258.5+ 15,99,741)	(16,99,999.50)
Unearned finance income	**3,64,000.50**

37. MTP SEP 22 SERIES I

Sun Limited leased a machine to Moon Limited on the following terms:

Particulars	(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.

SOLUTION

REFERENCE:

As per AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount lower of:

a. The fair value of the leased asset at the inception of the finance lease
b. The present value of the minimum lease payments from the standpoint of the lessee.

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

ANALYSIS:

Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment ₹	Internal rate of return (Discount rate @ 15%)	Present value ₹
1	16,00,000	0.8696	13,91,360
2	16,00,000	0.7561	12,09,760
3	16,00,000	0.6575	10,52,000
4	19,00,000* [16,00,000 + 3,00,000]	0.5718	10,86,420
Total	**67,00,000**		**47,39,540**

*Minimum Lease Payment of 4th year includes guaranteed residual value amounting i.e 16,00,000 + 3,00,000 =19,00,000.

Present value of minimum lease payments i.e., ₹ **47,39,540** is less than fair value at the inception of lease i.e., ₹ **50,00,000**, therefore, the value of lease is ₹ 47,39,540 and **lease liability should be recognized in the books at ₹ 47,39,540 as per AS 19**.

Calculation of Unearned Finance Income

REFERENCE:

As per AS 19 on Leases, **unearned finance income** is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

i.e. Unearned finance income (UFI) = GIL – (PV of MLP + PV of UGR)

Where:

Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

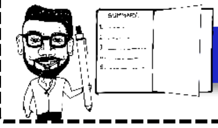
ANALYSIS:

Particulars	Amount	Amount
Minimum Lease Payments		67,00,000
Total Lease rent [(₹ 16,00,000 x 4 years)	64,00,000	
Guaranteed Residual Value (GRV)	3,00,000	
Add: Unguaranteed residual value (URV)		1,50,000
Gross Investment (a)		68,50,000
Present value of minimum lease payment from Lessor's view point		
Lease liability	47,39,540	
present value of (URV) unguaranteed residual value (₹ 1,50,000 x 0.5718)	85,770	
(b)		48,25,310
Unearned Finance Income (a) – (b)		**20,24,690**

AS 20 – EARNING PER SHARE

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION NO 1				
2	ICAI ILLUSTRATION NO 2, RTP MAY 2017				
3	ICAI ILLUSTRATION NO 3				
4	ICAI ILLUSTRATION NO 4				
5	ICAI ILLUSTRATION NO 5				
6	ICAI ILLUSTRATION NO 6				
7	RTP MAY 2018				
8	RTP NOV 18				
9	RTP MAY 19				
10	RTP NOV 19				
11	RTP MAY 20				
12	RTP NOV 20				
13	RTP MAY 21				
14	QP MAY 18 / ICAI PRACTICAL QUESTION 14				
15	QP NOV 18				
16	MOCK TEST PAPER 1, RTP MAY 2016				
17	NOV 2015, NOV 2004				
18	SIMILAR QUESTION MAY 2013 EXAM				
19	SUGGESTED IPCC-II NOV, 2009				
20	RTP IPCC (Gr-II) Nov, 2010				
21	SUGGESTED NOV, 2009 (NEW)				
22	RTP NOV 2015				
23	RTP May 2015				
24	IPCC RTP Nov 2014, IPCC RTP Nov 2017				
25	RTP May 2015				
26	RTP May 2018				
27	QP NOV 19				
28	RTP NOV 21				
29	MOCK TEST OCT 21 SERIES 1				
30	MOCK TEST OCT 21 SERIES 2				
31	QP DEC 21				

32	ICAI PRACTICAL Q 2				
33	MAY 22 RTP				
34	MAY 22 RTP				
35	MAY 2022 EXAM				
36	MTP MARCH 2022 TEST SERIES 1				
37	MTP APRIL 2022 TEST SERIES 2				
38	RTP NOV 22				
39	MTP SEP 22 (SERIES 1)				
40	EXAM NOV 22				



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1. ICAI ILLUSTRATION NO 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.

SOLUTION

Computation of Weighted Average:

(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows:

(1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

2. ICAI ILLUSTRATION NO 2, RTP MAY 2017

Date	Particulars	No. of Share	Face Value	Paid up Value
1st January	Balance at beginning of year	1,800	₹ 10	₹ 10
31st October	Issue of Shares	600	₹ 10	₹ 5

Calculate Weighted Number of Shares.

SOLUTION

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800 x 12/12) + (300 x 2/12) = 1,850 shares.

3. ICAI ILLUSTRATION NO 3

Net profit for the year 20X1	₹ 18,00,000
Net profit for the year 20X2	₹ 60,00,000
No. of equity shares outstanding until 30th September 20X2	20,00,000

Bonus issue 1st October 20X2 was 2 equity shares for each equity share outstanding at 30th September, 20X2

Calculate Basic Earnings Per Share.

SOLUTION

No. of Bonus Issue 20,00,000 x 2 = 40,00,000 shares

Earnings per share (EPS) = $\frac{\textit{Profit for the current year}}{\textit{Weighted average number of shares outstanding}}$

Earnings per share for the year 20X2 = ₹ 60,00,000 / (20,00,000 + 40,00,000) = ₹ 1.00

Adjusted earnings per share for the year 20X1 ₹ 18,00,000 / (20,00,000 + 40,00,000) = ₹ 0.30

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X1, the earliest period reported.

4. ICAI ILLUSTRATION NO 4

Net profit for the year 20X1	₹ 11,00,000
Net profit for the year 20X2	₹ 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 20X2

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 20X2 was ₹ 21.00. Compute Basic Earnings Per Share.

SOLUTION

a. Calculation of Theoretical ex-rights fair value per share

$$\frac{\textit{Fair value of shares immediately prior to exercise of rights} + \textit{Total amount received from exercise of right shares}}{\textit{Number of shares outstanding prior to exercise} + \textit{Number of shares issued in the exercise of right shares}}$$

$$\frac{(21.00\ X\ 5{,}00{,}000\ shares) + (Rs.15.00\ X\ 1{,}00{,}000\ Shares)}{5{,}00{,}000\ Shares + 1{,}00{,}000\ Shares}$$

Theoretical ex-rights fair value per share = ₹ 20.00

b. Computation of adjustment factor

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

$$\frac{Rs.(21.00)}{Rs.(20{,}00)} = 1.05$$

c. Computation of earnings per share:

EPS for the year 20X1 as originally reported: ₹ 11,00,000/5,00,000 shares = ₹ 2.20

EPS for the year 20X1 restated for rights issue: ₹ 11,00,000/(5,00,000 shares x 1.05) = ₹ 2.10

EPS for the year 20X2 including effects of rights issue:

(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12) = 5,87,500 shares

EPS = 15,00,000/5,87,500 = ₹ 2.55

5. ICAI ILLUSTRATION NO 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.

SOLUTION

Net profit for the current year	₹ 1,00,00,000
Interest expense for the current year	₹ 12,00,000
Tax relating to interest expense (30%)	₹ 3,60,000

Adjusted net profit for the current year	₹ 1,08,40,000
No. of equity shares resulting from conversion of debentures	10,00,000 Shares
No. of equity shares used to compute diluted EPS (50,00,000 + 10,00,000)	60,00,000 Shares

Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$

Diluted earnings per share: (1,08,40,000/60,00,000) = ₹ 1.81

6. ICAI ILLUSTRATION 6

Net profit for the year 20X1	₹ 12,00,000
Weighted average number of equity shares outstanding during the year 20X1	5,00,000 shares
Average fair value of one equity share during the year 20X1	₹ 20.00
Weighted average number of shares under option during the year 20X1	1,00,000 shares
Exercise price for shares under option during the year 20X1	₹ 15.00

Compute Basic and Diluted Earnings Per Share.

SOLUTION

Particulars	
Net profit for the year 20X1	₹ 12,00,000
Weighted average no. of shares during year 20X1	5,00,000 Shares
Basic earnings per share= $\frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$	2.40
Number of shares under option	1,00,000 Shares
Number of shares that would have been issued at fair value (100,000 x 15.00)/20.00	(75,000) Shares
No. of equity shares used to compute diluted EPS	5,25,000 Shares
Diluted earnings per share Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$	2.29

=12,00,000 / 5,25,000	

Note: AS per AS 20, The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

7. RTP MAY 2018

The following information relates to 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 (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹ 100 each	1,00,000
Equity Shares to be issued on conversion	1,10,000

The Rate of Income Tax: 30%.

You are required to **calculate** Basic and Diluted Earnings Per Share (EPS).

SOLUTION

Computation of basic earnings per share

$$= \frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$$

= ₹ 75,00,000 / 10,00,000 = ₹ 7.50 per share

Computation of Diluted earnings per share

Adjusted net profit for the current year

Particulars	₹
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of ₹ 8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$

= 80,60,000/ 11,10,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

8. RTP NOV 18

The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

	Net profit for	₹
Year	2015-16	35,00,000
Year	2016-17	45,00,000

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise rights 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.20 16 is ₹ 35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.

(ii) Restated basic earnings per share for the year 2015-16 for right issue.

(iii) Basic earnings per share for the year 2016-17.

SOLUTION

Computation of Basic Earnings per Share

	Particulars	(₹)
(i)	EPS for the year 2015-16 as originally reported $= \frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$ =₹ 35,00,000/ 15,00,000 shares	2.33
(ii)	EPS for the year 2015-16 restated for the right issue	2.16

	₹ 35,00,000/15,00,0000 shares x 1.08	
(iii)	EPS for the year 2016-17 (including effect of right issue) ₹ 45,00,000 / [(15,00,000x1.08 x 4/12) + (20,00,000x8/12)]	2.40

Working Notes:

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

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

= [(₹ 35 x15,00,000) + (₹ 25 x 5,00,000)] / (15,00,000 + 5,00,000) = ₹ 32.5

2. **Computation of adjustment factor**

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

= ₹ 35 /32.50 = 1.08 (approx.)

9. RTP MAY 19

"While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period." Explain this statement in the light of relevant AS. Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax)	₹ 1,00,00,000
No. of Equity shares outstanding	10,00,000
No. of 10% Fully Convertible Debentures of ₹ 100 each (Each Debenture is compulsorily & fully convertible into 10 equity shares issued at the mid of the year)	1,00,000
Debenture interest expense for the current year	₹ 5,00,000
Assume applicable Income Tax rate @ 30%	

SOLUTION

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Adjusted net profit for the current year

Particulars	₹
Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000
Less: Tax relating to interest expense (30% of ₹5,00,000)	(1,50,000)
Adjusted net profit for the current year	1,03,50,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$=\frac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share

= [(10,00,000 x 12) + (10,00,000 x 6)]/12 = 15,00,000 equity shares

Computation of diluted earnings per share $=\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

= ₹ 1,03,50,000 / 15,00,000 shares = ₹ 6.90 per share

10. RTP NOV 19

The following information relates to M/s. XYZ Limited for the year ended 31st March, 2019:

Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10

each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

SOLUTION

Computation of basic earnings per share

$=\frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$

= ₹ 37,50,000 / 5,00,000 = ₹ 7.50 per share

Adjusted net profit for the current year

Particulars	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share = 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

Computation of diluted earnings per share= $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid net of tax on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

11. RTP MAY 20

From the following information, you are required to compute Basic and Diluted Earnings Per Share (EPS) of M/s. XYZ Limited for the year ended 31st March, 2019:

Net Profit for the year after tax: ₹ 75,00,000

Number of Equity Shares of ₹ 10 each outstanding: 10,00,000

1,00,000, 8% Convertible Debentures of ₹ 100 each were issued by the Company at the beginning of the year. 1,10,000 Equity Shares were supposed to be issued on conversion. Consider rate of Income Tax as 30%.

SOLUTION

Computation of basic earnings per share

$$= \frac{Profit\ for\ the\ current\ year}{Weighted\ average\ number\ of\ shares\ outstanding}$$

= ₹ 75,00,000 / 10,00,000 = ₹7.50 per share

Adjusted net profit for the current year

Particulars	₹
Net profit for the current year	75,00,000
Add: Interest expense for the current year	8,00,000
Less: Tax relating to interest expense (30% of ₹ 8,00,000)	(2,40,000)
Adjusted net profit for the current year	80,60,000

Number of equity shares resulting from conversion of debentures

= 1,10,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share = 11,10,000 shares (10,00,000 + 1,10,000)

Diluted earnings per share

Computation of diluted earnings per share

$$= \frac{Adjusted\ net\ profit\ for\ the\ current\ year}{Weighted\ average\ number\ of\ equity\ shares}$$

= ₹ 80,60,000/ 11,10,000

= ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid net of tax on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

12. RTP NOV 20

A-One Limited supplied the following information.

You are required to compute the earnings per share as per AS 20:

Net profit attributable to equity shareholders Year 2017-18: ₹1,00,00,000

Year 2018-19: ₹1,50,00,000

Number of shares outstanding prior to Right Issue 50,00,000 shares

Right Issue: One new share for each four outstanding shares i.e., 12,50,000 shares

Right Issue Price - ₹ 96

Last date of exercising rights - 30-06-2018

Fair value of one equity share immediately prior to exercise of rights on 30-06-2018 was ₹ 101.

SOLUTION

COMPUTATION OF EARNINGS PER SHARE

Particulars	
EPS for the year 2017-18 as originally reported: (₹ 1,00,00,000 / 50,00,000 shares)	2.00
EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000 / (50,00,000 shares x 1.01)*	1.98
EPS for the year 2018-19 including effects of rights issue 1,50,00,000/(50,00,000 x 1.01 x 3/12)+ (62,50,000 x 9/12)	2.52

*Computation of earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note.

WORKING NOTES:

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

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

$$\frac{(\text{`}\ 101 \times 50,00,000 \textit{ shares}) + (\text{`}\ 96 \times 12,50,000 \textit{ shares})}{50,00,000 \textit{ shares} + 12,50,000 \textit{ shares}}$$

= ₹ 62,50,00,000 / 62,50,000 = ₹100

Therefore, theoretical ex-rights fair value per share is = ₹ 100

2. Computation of adjustment factor

$$\frac{\textit{Fair value per share prior to exercise of rights}}{\textit{Theoretical ex} - \textit{rights value per share}} = \frac{(101)}{(100)} = 1.01$$

13. RTP MAY 21

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 another financial instrument

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

SOLUTION

As per AS 20 – Earning per Share, the following dates should be considered for consideration of weights for the purpose of calculation of weighted average number of shares in the given situations:

(i) Date of Cash receivable

(ii) Date of conversion

(iii) Date on which settlement becomes effective

(iv) When the services are rendered

(v) Date when interest ceases to accrue

(vi) Date on which the acquisition is recognised.

14. QP MAY 18 / ICAI PRACTICAL QUESTION 14

As at 1" April. 20X1 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 20X1 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, 20X2 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, 20X2 as per Accounting Standard 20 "Earnings Per Share".

SOLUTION

REFERENCE:

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period.

ANALYSIS:

Basic Earnings per share (EPS)

$$= \frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$$

= 21,96,000 / 4,57,500 Shares (as per working note)

= ₹ 4.80 per share

WORKING NOTE:

Calculation of weighted average number of equity shares

Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share ₹	Weighted average no. of equity shares
1.4.20X1	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.20X1	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.20X1	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

15. QP NOV 18

From the following information given by Sampark Ltd. Calculate Basis EPS and Diluted EPS as per AS20

Particulars	₹
Net profit for the current year	2,50,00,000
No. of Equity Shares Outstanding	50,00,000
No. of 12% convertible debentures of Rs.100 each	50,000
Each debenture is convertible into 8 Equity Shares	
Interest expenses for the current year	6,00,000
Tax saving relating to interest expense (30%)	1,80,000

SOLUTION

Calculation of Basic Earning Per Share

$$\text{Basic EPS} = \frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$$

$$= \frac{2,50,00,000}{50,00,000}$$

Basic EPS per share = ₹5

Calculation of Diluted Earnings Per Share

Adjusted net profit for the current year	**₹**
Net profit for the current year	2,50,00,000
Add: Interest expenses for the current year	6,00,000
Less: Tax saving relating to Tax Expenses	(1,80,000)
	2,54,20,000

No. of equity shares resulting from conversion of debentures: 4,00,000 Shares

Weighted average no. of equity shares used to compute diluted EPS:

(50,00,000 + 4,00,000) = 54,00,000 Equity Shares

$$\textbf{Diluted EPS} = \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$$

= 2,54,20,000 / 54,00,000 = ₹ 4.71 (Approx.)

16. MOCK TEST PAPER 1, RTP MAY 2016

From the following information, you are required to compute the basic and adjusted Earnings per share:

Net profit for 2015-16	11 lakh
Net profit for 2016-17	15 lakh
No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	15 per share
Last date of exercising right option	1-06-2016
Fair value of shares before right issue	21 per share

SOLUTION

Particulars	
EPS for the year 2015-16 as originally reported: (₹ 11,00,000 / 5,00,000shares)	2.20

EPS for the year 2015-16 restated for rights issue: ₹11,00,000 / (5,00,000 shares x 1.05)	2.10
EPS for the year 2016-17 including effects of rights issue 15,00,000/(5,00,000x1.05x2/12) + (6,00,000x10/12)	2.55

WORKING:

Calculation of Theoretical ex-rights fair value per share

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

= (₹ 21.00 x 5,00,000 shares) + (₹15.00 x 1,00,000 shares)/5,00,000 shares + 1,00,000 shares

Theoretical ex-rights fair value per share = ₹ 20.00

Computation of adjustment factor

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

= ₹ 21/20 = 1.05 (approx.)

17. NOV 2015, NOV 2004

Vidya Ltd. Supplied the following information. You are required to compute the basic earning per share:

Accounting year 1.1.2005 – 31.12.2005)

Net Profit: Year 2005: Rs. 20,00,000

Year 2006: Rs. 30,00,000

No. of shares outstanding prior to Right Issue : 10,00,000 shares

Right Issue: One new share for each four outstanding i.e., 2,50,000 shares.

Right Issue Price – Rs. 20 Last

date of exercise rights – 31.3.2006.

Fair rate of one Equity share immediately prior to exercise of rights on 31.3.2006: Rs. 25

SOLUTION

Computation of Basic Earnings Per Share

$$EPS = \frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

Particulars	

EPS for the year 2005 as originally reported: (Rs. 20,00,000 / 10,00,000 shares)	2.00
EPS for the year 2005 restated for rights issue: Rs. 20,00,000 / (10,00,000 shares x 1.04*)	1.92 (Approx.)
EPS for the year 2006 including effects of rights issue $\frac{\text{Rs. } 30{,}00{,}000}{(10{,}00{,}000 \text{ shares} \times 1.04 \times 3/12) + (12{,}50{,}000 \text{ shares} \times 9/12)}$	2.51 (Approx.)

WORKING NOTES:

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

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

$$= \frac{(Rs.25 \ x \ 10{,}00{,}000 \ shares) + (Rs.20 \ x \ 2{,}50{,}000 \ shares)}{10{,}00{,}000 \ shares + 2{,}50{,}000 \ shares}$$

$$= \frac{\text{Rs. } 3{,}00{,}00{,}000}{12{,}50{,}000 \text{ shares}} = \text{Rs. } 24$$

2. Computation of adjustment factor

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

$$= \frac{\text{Rs. } 25}{\text{Rs. } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

18. SIMILAR QUESTION MAY 2013 EXAM

Net profit for the current year Rs.1,00,00,000

No. of equity shares outstanding 50,00,000

Interest expense for the current year Rs.12,00,000

Rate of income tax 30%

No. of 12% debentures of Rs.100 each 1,00,000

Each debentures is convertible into 10 equity shares

Calculate Basic EPS and Diluted EPS.

SOLUTION

Particulars	₹	₹
Net profit for the purpose of Basic EPS		1,00,00,000
Add: Interest Expense	12,00,000	

Less: Tax Saving on Interest expense	3,60,000	8,40,000
Adjusted net profit for the purpose of diluted EPS		1,08,40,000
No. of equity shares used to compute Basic EPS		50,00,000
Add: Dilutive Potential equity shares		10,00,000
No. of equity shares used to compute diluted EPS		60,00,000
Basic EPS = $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = 1,00,00,000/50,00,000		2.00
Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ = 1,08,40,000/60,00,000		1.81

Note: Interest is an expense deductible for tax purposes hence result into tax saving. As against this if it is a case of convertible preference share, the preference dividend will be adjusted in full. It will not result into tax saving because dividend is paid from after tax profit.

19. SUGGESTED IPCC-II NOV, 2009

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 Rs.2,75,000.

SOLUTION

Computation of weighted average number of shares outstanding during the period

Date	1st April, 2008	1st August, 2008	31st March, 2009
No. of Equity Shares	1,500 (Opening)	600 (Additional issue)	500 (Buy back)
Period O/s	12 Months	8 Months	0 Months
Weight (Months)	12/12	8/12	0/12

Weighted Average no. of shares	1,500 (1,500 x 12/12)	400 (600 x 8/12)	0 (500 x 0/12)

Weighted Average Number of Equity Shares outstanding during the period = 1,900 Shares

Basic earnings Per Share =

$$\frac{\textit{Net Profit or loss for the attributable to equity Shareholders}}{\textit{Weighted Average Number of Equity Shares outstanding during the period}}$$

$$= \frac{Rs.2,75,000}{1,900\ shares} = Rs. 144.74$$

20.RTP IPCC (Gr-II) Nov, 2010

Net profit after tax including extraordinary profit/losses for the year ended 31st December, 2009 = Rs.2,00,000

10% cumulative preference shares of Rs.5,00,000.

Number of equity shares = 5,000 shares, Equity shares of Rs.100 each = Rs.5,00,000.

Equity dividend declared @ 18%. Corporate dividend tax 15%.

Calculate EPS assuming that out of 5,000 equity shares, 2,000 equity shares were issued on 1.7.2009.

SOLUTION

REFERENCE:

As per AS 20, Equity Dividend and Corporate Dividend Tax thereon are not to be considered for calculating EPS.

ANALYSIS:

Net profit		Rs.2,00,000
Less: Preference Dividend 5,00,000 x 10%	50,000	
Corporate Dividend tax 15%	7,500	Rs.57,500
Net profit attributable to equity shareholders		Rs.1,42,500

Equity Dividend and Corporate Dividend Tax are not deducted from net profit/loss for the period available for equity Shareholders.

Weighted average number of shares = $3000 \times \frac{12}{12} + 2000 \times \frac{6}{12} = 4{,}000$

Basic earnings Per Share =

$$\frac{\textit{Net Profit or loss for the attributable to equity Shareholders}}{\textit{Weighted Average Number of Equity Shares outstanding during the period}}$$

$= \frac{1,42,500}{4,000} = Rs. 35.625$

21. SUGGESTED NOV, 2009 (NEW) (4 MARKS)

From the following information compute diluted earnings per share.

Net profit for the year 2008	Rs.12,00,000
Weighted average number of equity shares outstanding during year	5,00,000 shares
2008	Rs.20
Average fair value of one equity share during the year 2008	1,00,000 shares
Weighted average number of share under option during the year 2008	Rs.15
Exercise price per share under option during the year	

SOLUTION

Computation of Basic EPS and Diluted EPS:

Particulars	
Net profit for the year 2008	₹ 12,00,000
Weighted average no. of shares during year 2008	5,00,000 Shares
Basic earnings per share= $\frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$	2.40
Number of shares under option	1,00,000 Shares
Number of shares that would have been issued at fair value (100,000 x 15.00)/20.00	(75,000) Shares
No. of equity shares used to compute diluted EPS	5,25,000 Shares
Diluted earnings per share Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ =12,00,000 / 5,25,000	2.29

Note: AS per AS 20, The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration.

22. RTP NOV 2015

From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2011 to 31-03-2012 and adjusted EPS for the year 01-04-2010 to 31-03-2011.

Net profit for year ended 31-03-2011	Rs.75,50,000
Net profit for year ended 31-03-2012	Rs. 1,00,25,000
No. of equity shares as on 01-04-2011	50,00,250
Bonus issue on 01-01-2012	1 share for every 2 held
No. of 12% Convertible Debentures of Rs. 100 each issued on 01-01-2012	1,00,000
Conversion ratio of Debentures	10 shares per debenture
Tax rate	30 percent

SOLUTION

Calculation of Basic EPS and Adjusted EPS for the year 01-04-2010 to 31-03-2011:

Particulars	
No. of Bonus shares issued as on 1.1.2012	
On existing shares (50,00,250 x ½)	25,00,125 shares
On convertible debentures as per SEBI Guidelines on Bonus Issue (1,00,000 debentures x 10 shares x ½)	5,00,000 shares
Net profit for the purpose of Basic EPS	Rs. 1,00,25,000
No. of equity shares used to compute Basic EPS (50,00,250 + 25,00,125 + 5,00,000)	80,00,375
Basic EPS = $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ $\frac{Rs\ 1,00,25,000}{(50,00,250 + 25,00,125 + 5,00,000)}$	1.25
Adjusted earnings per share for the year 2010-11 $\frac{Rs\ 75,50,000}{(50,00,250\ +\ 25,00,125\ +\ 5,00,000)}$	0.94

Reference: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2010- 11, the earliest period reported.

Particulars	
Net profit for year ended 31-03-2012	Rs. 1,00,25,000
Interest expense for the current year	Rs.12,00,000
Tax relating to interest expense (30%)	Rs.3,60,000
Adjusted net profit for the current year Rs.1,00,25,000 + (12,00,000 – 3,60,000) x 3/12	Rs.1,02,35,000
No. of equity shares resulting from conversion of debentures 1,00,000 x 10 shares	10,00,000 shares
No. of equity used to compute diluted earnings per share = 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 x 3/12)	82,50,375 shares
Diluted earnings per share Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ = 1,02,35,000/82,50,375	Rs.1.24

23. RTP May 2015

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

SOLUTION

As per AS 20, the following dates should be considered for consideration of weights for calculation of weighted average number of shares in the given situations:

(i) Equity Shares issued in exchange of cash - Date of Cash receivable

(ii) Equity Shares issued as a result of conversion of a debt instrument - Date of conversion

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise - Date on which settlement becomes effective

(iv) Equity Shares issued for rendering of services to the enterprise - When the services are rendered

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument - Date when interest ceases to accrue

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash - Date on which the acquisition is recognised.

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

24. IPCC RTP Nov 2014, IPCC RTP Nov 2017

Compute Basic and Adjusted Earnings per share from the following information:

Net Profit for 2012-13	₹ 22 lakhs
Net Profit for 2013-14	₹ 33 lakhs
No. of shares before Rights Issue	110,000
Rights issue Ratio	One for Every Four Held
Rights Issue Price	₹ 180
Date of exercising Rights option	31.7.2013 (fully subscribed on this date)
Fair value of share before Rights Issue	₹ 270

All workings may be rounded off to two decimals.

SOLUTION

Computation of earnings per share

EPS for the year 2012-13 as originally reported

$$= \frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

= ₹ 22,00,000/1,10,000 shares = ₹ 20

EPS for the year 2012-13 restated for rights issue

= ₹ 22,00,000/ (1,10,000 shares x 1.07) = ₹ 18.69

Adjusted No. of Shares = (1,10,000 x 1.07 x 4/12) + (1,37,500 x 8/12) = 1,30,900

EPS for the year 2013-14 including effects of rights issue

= 33,00,000 / 1,30,900 = 25.21

Working Note:

1. Calculation of Theoretical ex-rights fair value per share

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

$$\frac{(270 \times 1{,}10{,}000 \text{ shares}) + (180 \times 27{,}500 \text{ Shares})}{1{,}10{,}000 + 27{,}500 \text{ Shares}} = \frac{3{,}46{,}50{,}000}{1{,}37{,}500}$$

Theoretical ex-rights fair value per share = ₹ 252

2. Calculation of Computation of adjustment factor:

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

$$\frac{(270)}{(252)} = 1.071$$

25. RTP May 2015

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.

SOLUTION

Computation of Basic Earnings per Share

		EPS
(i)	EPS for the year 2012-13 as originally reported $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = 22,00,000 / 10,00,000	2.20
(ii)	EPS for the year 2012-13 restated for the right issue 22,00,000 / (10,00,000 shares x 1.04)	2.12
(iii)	EPS for the year 2013-14 (including effect of right issue) 30,00,000 / [(10,00,000 x 1.04 x 4/12) + (12,00,000 x 8/12)]	2.62

Working Note:

1. **Calculation of Theoretical ex-rights fair value per share**

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

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

Theoretical ex-rights fair value per share = ₹ 30.83

2. **Calculation of Computation of adjustment factor:**

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

$\frac{32}{30.83}$ = 1.04 (Approx.)

26. RTP May 2018

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

SOLUTION

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

27. QP NOV 19

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.

SOLUTION

Particulars	
EPS for the year 2017-18 as originally reported ₹ 50,00,000 / 2,50,000 shares	20
EPS for the year 2017-18 restated for rights issue = ₹ 50,00,000 / (2,50,000 shares x 1.01)	19.80
EPS for the year 2018-19 including effects of rights issue 75,00,000/3,25,625 = [(2,50,000 x 1.01 x 3/12) + (3,50,000 x 9/12)] = 63,125 + 2,62,500 = 3,25,625 shares	23.03

WORKING:

Calculation of Theoretical ex-rights fair value per share

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

= 102 x 2,50,000 Shares +₹ 98 x 1,00,000 shares / 3,50,000 shares

Theoretical ex-rights fair value per share = ₹ 100.86

Computation of adjustment factor

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

= 102/100.86 = 1.01

28.RTP NOV 21

AB Limited is a company engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered with its debenture holders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the reserve constitutes at least half the value of such debentures. As such appropriations are not available for distribution to the equity shareholders, AB Limited has excluded this from the numerator in the computation of Basic EPS. Is this treatment correct as per provisions of AS 20?

SOLUTION

FACTS:

AB Limited has made an appropriation from profits for debentures redemption. AB Limited has excluded this from the numerator in the computation of Basic EPS.

REFERENCE:

AS 20 states that "For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period."

ANALYSIS:

With an emphasis on the phrase attributable to equity shareholders, it may be construed that such amounts appropriated to mandatory reserves, though not available for distribution as dividend, are still attributable to equity shareholders. The appropriation made to such a mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS.

CONCLUSION:

The amounts should be included in the computation of Basic EPS. In view of this, the treatment made by the company is not correct.

29. MOCK TEST OCT 21 SERIES I

On 1st April, 2019 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 2019 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, 2020 was ₹ 21,96,000 after considering dividend ₹ 3,40,000 on preference shares.

You are required to compute Basic EPS for the year ended 31st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

SOLUTION

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

= 21,96,000 / 4,57,500 Shares (as per working note)

= ₹ 4.80 per share

WORKING NOTE:

Calculation of weighted average number of equity shares

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

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			4,57,500

30. MOCK TEST OCT 21 SERIES 2

The following information relates to XYZ Limited for the year ended 31st March, 2021:

Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: ₹ 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	No.
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

SOLUTION

Computation of basic earnings per share

$$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

= ₹ 37,50,000 / 5,00,000 = ₹ 7.50 per share

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

$$\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$$

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid net of tax on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

31. QP DEC 21

"At the time of 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 debentures is convertible into 8 equity shares	
v.	Tax relating to interest expenses	35%

SOLUTION

REFERENCE:

As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Net profit for the current year	₹ 64,12,500
Add: Interest expense for the current year (75,00,000×9%×9/12)	₹ 5,06,250
Less: Tax relating to interest expense (5,06,250 x 35%)	₹ 1,77,188
Adjusted net profit for the current year	₹ 67,41,562
No. of equity shares resulting from conversion of debentures (75,000 × 8)	6,00,000 Shares
No. of equity shares used to compute diluted EPS (15,00,000 X12/12+ 6,00,000X9/12)	19,50,000 Shares
Basic Earning Per Share for the year 2020-21 $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$ = 64,12,500 / 15,00,000	4.275

Diluted earnings per share for year 2020-21 $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ = (67,41,562 / 19,50,000)	3.46

32. ICAI PRACTICAL Q 2

X Ltd. supplied the following information. You are required to compute the basic earnings per share:

(Accounting year 1.1.20X1– 31.12.20X1)		
Net Profit	:	Year 20X1: ₹ 20,00,000
	:	Year 20X2: ₹ 30,00,000
No. of shares outstanding prior to Right Issue	:	10,00,000 shares
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares.
	Right Issue price – ₹ 20	
	Last date of exercise rights–31.3.20X2.	
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.20X2	:	₹ 25

SOLUTION

$$EPS = \frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

Computation of Basic Earnings Per Share

Particulars	
EPS for the year 20X1 as originally reported = (₹ 20,00,000 / 10,00,000 shares)	2.00
EPS for the year 20X1 restated for rights issue = [₹ 20,00,000 / (10,00,000 shares x 1.04*)]	1.92 (Approx.)

EPS for the year 20X2 including effects of rights issue = 30,00,000 / (10,00,000 shares x1.04 x3/12) + (12,50,000 shares x 9/12) = ₹ 30,00,000 / 11,97,500 shares	2.51 (Approx.)

WORKING NOTES:

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

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

= (₹ 25 × 10,00,000 shares) + (₹ 20 × 2,50,000 shares) / 10,00,000 shares + 2,50,000 shares

= ₹ 3,00,00,000 / 12,50,000 shares = 24

2. Computation of adjustment factor

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

= 25 / 24 = 1.04 (approx.)

33. May 22 RTP

Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 percent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.

SOLUTION

FACTS:

AB Limited includes only the vested options for calculating Diluted EPS.

REFERENCE:

As per AS 20, the calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern.

ANALYSIS:

The options that have lapsed during the year should be included for the portion of the period the same were outstanding, pursuant to the requirement of the standard.

CONCLUSION:

The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20.

34. May 22 RTP

X Limited, as at March 31, 2021, has income from continuing ordinary operations of 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

SOLUTION:

REFERENCE:

As per AS 20, potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares. Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

ANALYSIS:

As income from continuing ordinary operations, 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ *240 to ₹ #200.

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

= Rs. (1,20,000) / 1000shares = (120)

$$\text{Diluted E.P.S.} = \frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$$

= (1,20,000) / 1200shares = (100)

* 2,40,000/1000 = ₹ 240

\# 2,40,000/1200 = ₹ 200

35. MAY 2022 EXAM

NAT, a listed entity as on 1st April, 2021 has the following capital structure:

	₹
10,00,000 Equity Shares having face value of ₹ 1 each	10,00,000
10,00,000 8% preferences Shares having face value of ₹ 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 31st 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 years 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 statement statements of NAT for the year ended 31st Match, 2022including the comparative figure in accordance with AS-20 including the comparative figure.

(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?

SOLUTION

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

Calculation of EPS for year ended 31st March 2021:

Particulars	
Earnings for the year ended 31st March, 2021 ₹ 62.30 x 10,00,000 equity shares	₹ 6,23,00,000
Adjusted Earnings per share after taking into consideration bonus issue for 2021 - ₹ 6,23,00,000 / (10,00,000+ 5,00,000)	₹ 41.53

Calculation of EPS for year ended 31st March 2022:

Net profit for the current year	₹ 90,00,000
Less: Preference share dividend (1,00,00,000 x 8%)	₹ 8,00,000
Adjusted net profit for the current year	**₹ 82,00,000**

Total shares outstanding at the beginning	10,00,000 Shares
Bonus issue (10,00,000 x ½)	5,00,000 Shares
Weighted average of the shares issued in January, 2022 (2,00,000 x 3/12)	50,000 Shares
No. of equity shares used to compute diluted EPS	**15,50,000 Shares**
Diluted E.P.S. = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ = 82,00,000 / 15,50,000	5.29

(ii) In case of a bonus issue, 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. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2021, the earliest period reported.

However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time-weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

36. MTP March 2022 Test Series I

On 1st April, 2019 a company had 6,00,000 equity shares of ₹ 10 each (₹ 5 paid up by all shareholders). On 1st September, 2019 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, 2020 was ₹ 21,96,000 after considering dividend on preference shares and dividend distribution tax on such dividend totalling to ₹ 3,40,000.

You are required to compute Basic EPS for the year ended 31 st March, 2020 as per Accounting Standard 20 "Earnings Per Share".

SOLUTION

REFERENCE:

As per AS 20 'Earnings Per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period.

ANALYSIS:

Basic Earnings per share (EPS) =

$$\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

= 21,96,000 / 4,57,500 Shares

= ₹ 4.80 per share

Calculation of weighted average number of equity shares

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
1.4.2020	6,00,000	5	6,00,000 x 5/10 x 5/12 = 1,25,000
1.9.2020	5,40,000	10	5,40,000 x 10/10 x 7/12 = 3,15,000
1.9.2020	60,000	5	60,000 x 5/10 x 7/12 = 17,500
Total weighted average equity shares			**4,57,500**

37. MTP April 2022 Test Series 2

Explain the concept of 'weighted average number of equity shares outstanding during the period'. Also compute, based on AS 20, the weighted average number of equity shares in the following case:

		No. of shares
1st April, 2021	Balance of equity shares	7,20,000
31st August, 2021	Equity shares issued for cash	2,40,000
1st February, 2022	Equity shares bought back	1,20,000
31st March, 2022	Balance of equity shares	8,40,000

SOLUTION

As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares:

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	8,40,000 shares

38. RTP Nov 22

The following information relates to XYZ Limited for the year ended 31 st March, 2022: Net Profit for the year after tax: ₹ 37,50,000

Number of Equity Shares of ₹ 10 each outstanding: 5,00,000

Convertible Debentures Issued by the Company (at the beginning of the year)

Particulars	Nos.
8% Convertible Debentures of ₹ 100 each	50,000
Equity Shares to be issued on conversion	55,000

The Rate of Income Tax: 30%.

You are required to calculate Basic and Diluted Earnings Per Share (EPS).

SOLUTION

Computation of basic earnings per share

$$= \frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

= ₹ 37,50,000 / 5,00,000 = ₹ 7.50 per share

Adjusted net profit for the current year

	₹
Net profit for the current year	37,50,000
Add: Interest expense for the current year	4,00,000
Less: Tax relating to interest expense (30% of ₹ 4,00,000)	(1,20,000)
Adjusted net profit for the current year	40,30,000

Number of equity shares resulting from conversion of debentures

= 55,000 Equity shares (given in the question)

Weighted average number of equity shares used to compute diluted earnings per share

= 5,55,000 shares (5,00,000 + 55,000)

Diluted earnings per share

$= \frac{Adjusted\ net\ profit\ for\ the\ current\ year}{Weighted\ average\ number\ of\ equity\ shares}$

= 40,30,000/ 5,55,000 = ₹ 7.26 per share

Note: Conversion of convertible debentures into Equity Share will be dilutive potential equity shares. Hence, to compute the adjusted profit the interest paid net of tax on such debentures will be added back as the same would not be payable in case these are converted into equity shares.

39. MTP Sep 22 (Series 1)

Net Profit for FY 2020-21	30,00,000
Net Profit for FY 2021-22	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, 2021

Right issue is one new share for each five equity shares outstanding (i.e. 4,00,000 new shares) Fair value of one equity share immediately prior to exercise of rights on 1st June, 2021 was ₹ 26.00.

Compute Basic Earnings Per Share for FY 2020-21, FY 2021-2022 and restated EPS for FY 2020-21.

SOLUTION

Computation of Basic Earnings Per Share (as per AS 20 Earnings Per Share)

Particulars	
EPS for the year 2020-21 as originally reported $\frac{Net\ profit\ of\ the\ year\ attributable\ to\ equity\ shareholders}{Weighted\ average\ number\ of\ equity\ shares\ outstanding\ during\ the\ year}$ = (₹ 30,00,000 / 20,00,000 shares)	1.5
EPS for the year 2020-21 restated for rights issue = [₹ 30,00,000 / (20,00,000 shares X 1.04 (W.N. 2)]	1.44 (approx.)
EPS for the year 2021-22 including effects of rights issue ₹ 50,00,000 = (20,00,000 shares X 1.04 X 2/12) X (24,00,000 shares X 10/12)	2.13 (approx.)

= ₹ 50,00,000/ 23,46,667 shares	

WORKING NOTES:

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

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

$$= \frac{(Rs.26\ x\ 20,00,000\ shares)\ +\ (Rs.20\ x\ 4,00,000\ shares)}{20,00,000\ shares\ +\ 4,00,000\ shares}$$

$$= \frac{Rs.60,00,000}{24,00,000\ Shares} = Rs.25$$

2. Computation of adjustment factor

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

$$= \frac{Rs.26}{Rs.25\ (Refer\ Working\ Note\ 1)} = 1.04(approx)$$

40. EXAM NOV 22

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 share as per AS- 20.

SOLUTION

Particulars	
Net profit for the year 2022	₹ 72,00,000
Weighted average no. of shares during year 2022	30,00,000 Shares
Basic earnings per share= $\frac{Profit\ for\ the\ current\ year}{Weighted\ average\ number\ of\ shares\ outstanding}$	2.40
Number of shares under option	6,00,000 Shares

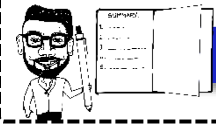
Number of shares that would havebeen issued at fair value (600,000 x 20.00)/25.00	(4,80,000) Shares
No. of equity shares used to compute diluted EPS	31,20,000 Shares
Diluted earnings per share Diluted EPS = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average no of Equity shares}}$ =72,00,000 / 31,20,000	2.30

Note: AS per AS 20, The earnings have not been increased as the total number of shares has been increased only by the number of shares (1,20,000) deemed for the purpose of the computation to have been issued for no consideration.

AS 22 – ACCOUNTING FOR TAXES ON INCOME

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION 1, RTP MAY 2018				
2	ICAI ILLUSTRATION 2				
3	ICAI ILLUSTRATION 3				
4	ICAI ILLUSTRATION 4				
5	RTP NOV 2018				
6	RTP MAY 19				
7	RTP NOV 2019				
8	RTP MAY 20				
9	RTP MAY 21				
10	QP MAY 18 (GROUP 1)				
11	QP MAY 2019 (Group 1), RTP NOV 20				
12	QP NOV 2019 (Group 1)				
13	QP NOV 20				
14	QP JAN 21				
15	QUESTION				
16	QUESTION				
17	QUESTION				
18	SIMILAR QUESTION IN MAY 2011 EXAM				
19	QUESTION				
20	QUESTION				
21	QUESTION				
22	QUESTION				
23	QUESTION				
24	QUESTION				
25	RTP MAY2013, RTP MAY 2014				
26	ICAI PRACTICAL Q 11				
27	(ICAI)				
28	RTP NOV 21				
29	ICAI PRACTICAL Q 8				
30	QP JULY 21				
31	RTP May 22				

32	RTP Nov 22				
33	EXAM NOV 22				



Let's Get Started....With Class Work

1. ICAI ILLUSTRATION 1, RTP MAY 2018

Rama Ltd., has provided the following information:

Particulars	₹
Depreciation as per accounting records	2,00,000
Depreciation as per tax income records	5,00,000
Unamortised preliminary expenses as per tax record	30,000

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

SOLUTION

Table showing calculation of deferred tax asset / liability

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

2. ICAI ILLUSTRATION 2

From the following details of A Ltd. for the year ended 31-03-20x1, 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.

Particulars	₹
Accounting Profit	6,00,000
Book Profit as per MAT	3,50,000
Profit as per Income Tax Act	60,000
Tax rate	20%

MAT rate	7.50%

SOLUTION

Tax as per accounting profit 6,00,000x20% = ₹ 1,20,000

Tax as per Income-tax Profit 60,000x20% = ₹ 12,000

Tax as per MAT 3,50,000x7.50% = ₹ 26,250

Excess of MAT over current tax = 26,250 – 12,000 = 14,250

Tax expense = Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2017

=Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 = ₹ 1,34,250

Particulars		Amt	Amt
Profit and Loss A/c	Dr.	12,000	
To Provision for Income Tax			12,000
(Being provision made for Tax payable)			
Profit and Loss A/c	Dr.	1,08,000	
To Deferred Tax Liability			1,08,000
(Being Deferred Tax liability recorded)			
Profit and Loss A/c (MAT)	Dr.	14,250	
To MAT Credit (Asset)			14,250
(Being excess of current tax paid in form of MAT recorded)			

3. ICAI ILLUSTRATION 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

SOLUTION

Statement of Profit and Loss

Particulars	31.3.20X1	31.3.20X2	31.3.20X3
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current Tax (20,000X40%)			(8,000)
Deferred Tax:			
Tax effect of timing differences originating during the year (2,00,000 × 40%)	80,000		
Tax effect of timing differences reversed/ adjusted during the year (1,00,000 × 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

4. ICAI ILLUSTRATION 4

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 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 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

SOLUTION:

Calculation of Deferred Tax Asset/Liability in Omega Limited.

(Figures in Rs.)

Particulars	2014-15	2015-16	2016-17

Income as per Books	11,00,000	16,00,000	21,00,000
Taxable income as per Income tax	7,00,000	18,00,000	23,00,000
Timing Difference (Balance)	4,00,000	2,00,000	Nil
Current tax @ 35%	3,85,000	5,60,000	7,35,000
Deferred Tax Liability	1,40,000	70,000	Nil

5. RTP NOV 2018

Beta Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference resulting in a tax liability in year 1 and 2 is ₹ 1,000 lakhs and ₹ 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by ₹ 50 lakhs. Assuming tax rate of 40%, you are required to compute to the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

SOLUTION

(₹ in Lakhs)

Year	Originating Timing Difference	Reversing Timing Difference	Timing Difference (Balance)
1	1000	-	1000
2	2000	-	3000
3		50	2950
4		50	2900
5		50	2850
6		50	2800
7		50	2750
8		50	2700
9		50	2650
10		50	2600

REFERENCE:

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

COMPUTATION OF DEFERRED TAX LIABILITY:

Out of ₹ 1,000 lakhs depreciation, timing difference amounting ₹ 400 lakhs (₹ 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for ₹ 600 lakhs (₹ 1,000 lakhs – ₹ 400 lakhs), deferred tax liability will be recognized for ₹ 240 lakhs (40% of ₹ 600 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 2,000 lakhs will reverse only after tax holiday period and hence, will be recognized in full. Deferred tax liability amounting ₹ 800 lakhs (40% of ₹ 2,000 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 1,040 lakhs (240 lakhs + 800 lakhs).

6. RTP MAY 19

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advise to the company.

SOLUTION

REFERENCE:

As per AS 22 - Accounting for Taxes on Income, Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognized in the year in which the timing differences originate.

ANALYSIS:

Company expects that there will be losses both for accounting and tax purposes in near future.

CONCLUSION:

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

7. RTP NOV 2019

The Accountant of Sohna Ltd. provides the following information for the year ended 31-03-2019:

Particulars	₹
Accounting Profit	7,50,000
Book Profit as per MAT	4,37,500
Profit as per Income Tax Act	90,000
Tax rate	20%
MAT rate	7.50%

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.

SOLUTION:

Tax as per accounting profit 7,50,000 x 20% = ₹ 1,50,000

Tax as per Income-tax Profit 90,000 x 20% = ₹ 18,000

Tax as per MAT 4,37,500 x 7.50% = ₹ 32,812.50

Excess of MAT over current tax = 32,812.50 – 18,000 = 14,812.50

Tax expense= Current Tax + Deferred Tax

₹ 1,50,000 = ₹ 18,000+ Deferred tax

Therefore, **Deferred Tax liability** as on 31-03-2019

= ₹ 1,50,000 – ₹ 18,000 = ₹ 1,32,000

Amount of tax to be debited in Profit and Loss account for the year 31 -03-2019

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 18,000 + ₹ 1,32,000 + ₹ 14,812.50 (32,812.50 – 18,000)

= ₹ 1,64,812.50

8. RTP MAY 20

The following particulars are stated in the Balance Sheet of PQR Ltd. as on 31.03.2018:

Particulars	(₹ in lakh)

Deferred Tax Liability (Cr.)	30.00
Deferred Tax Assets (Dr.)	15.00

The following transactions were reported during the year 2018-2019:

	Tax Rate	30%
		(₹ in lakh)
i.	Depreciation as per books	80.00
	Depreciation for tax purposes	70.00
ii.	Items disallowed in 2017-2018 and allowed for tax purposes in 2018-2019.	10.00
iii.	Donations to Private Trust made in 2018-2019.	10.00

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 31.03.2019.

SOLUTION:

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

Analysis	Nature of difference	Effect	Amount (in Lakhs)
i. Difference in Depreciation:			
Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Reversing timing difference	Reversal of DTL	(80-70)X30% = ₹ 3 lakh
ii. Disallowances, as per IT Act, of earlier years			
Tax payable for the earlier year was higher on this account.	Reversing timing difference	Reversal of DTA	₹10 X30% = ₹ 3 lakh
iii. Donation to Private Trusts			
Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not Applicable

9. RTP MAY 21

a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books ₹ 2,80,000

Depreciation for tax purpose ₹ 1,90,000

The above depreciation does not include depreciation on new additions.

(ii) A new machinery purchased on 1.4.18 costing ₹ 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.

(iii) The company has made a profit of ₹ 6,40,000 before depreciation and taxes.

(iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

SOLUTION

Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)

Particulars		₹
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes (A)		3,30,000
Less: Tax expense (B)		
Current tax (W.N.1) (3,30,000 x 40%) Deferred tax (W.N.2)	1,32,000 NIL	(1,32,000)
Profit after tax (A-B)		1,98,000

Working Notes:

1. Computation of taxable income

	Amount (₹)
Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000

Tax on taxable income @ 40%	1,32,000

2. Impact of various items in terms of deferred tax liability / deferred tax asset

Analysis	Nature of difference	Effect	Amount (₹)
i. Difference in depreciation			
Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years	Reversing timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x40% = (36,000)
ii. Depreciation on new Machinery			
Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 – 30,000) x 40% = 36,000
Net Impact			NIL

b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22?

SOLUTION:

1. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts.
2. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period.
3. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
4. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

10. QP MAY 18 (GROUP I)

Rohit Ltd. has provided the following information

Particulars	₹
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 assets/liability should be recognized as transition adjustment when the tax rate is 50%?

SOLUTION

Table showing calculation of deferred tax asset / liability

Particulars	Amount ₹	Timing difference	Deferred tax	Amount @ 50% ₹
Excess depreciation as per tax records (₹ 5,50,000 – ₹ 2,50,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	40,000	Timing	Deferred tax asset	(20,000)
Net deferred tax liability				1,30,000

Net deferred tax liability amounting ₹ 1,30,000 should be recognized as transition adjustment.

11. QP MAY 2019 (Group I), RTP NOV 20

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

SOLUTION:

Matching of taxes against revenue for a period poses special problems arising from the fact that in number of cases, taxable income may be different from the accounting income. The divergence between taxable income may be different from the accounting income arises due to two main reasons:

1. Permanent differences are the differences between taxable income and accounting income which arise in one accounting period and do not reverse subsequently. For example, an income exempt from tax or an expense that is not allowable as a deduction for tax purposes.
2. Timing differences are those differences between taxable income and accounting income which arise in one accounting period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation, Bonus, etc.

12. QP NOV 2019 (Group I)

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.

SOLUTION:

Tax as per accounting profit 9,00,000X30%= ₹ 2,70,000

Tax as per Income-tax Profit 95,000x30% =₹ 28,500

Tax as per MAT 5,25,000 x 7.50%= ₹ 39,375

Excess of MAT over current tax = 39,375 – 28,500 = 10,875

Tax expense= Current Tax +Deferred Tax

₹ 2,70,000 = ₹ 28,500+ Deferred tax

Deferred Tax liability as on 31-03-2019

= ₹ 2,70,000 – ₹ 28,500 = ₹ 2,41,500

Amount of tax to be debited in Profit and Loss account for the year 31-03-2019

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 28,500 + ₹ 2,41,500+ ₹ 10,875 (39,375 – 28,500)

= ₹ 2,80,875

13. QP NOV 20

From the following details of Aditya Limited for accounting year ended on 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.

SOLUTION:

Tax as per accounting profit 15,00,000x20%= ₹ 3,00,000

Tax as per Income-tax Profit 2,50,000x20% =₹ 50,000

Tax as per MAT 7,50,000x7.50%= ₹ 56,250

Excess of MAT over current tax = 56,250 – 50,000 = 6,250

Tax expense= Current Tax +Deferred Tax

₹ 3,00,000 = ₹ 50,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

= ₹ 3,00,000 – ₹ 50,000 = ₹ 2,50,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020 Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 50,000 + ₹ 2,50,000 + ₹ 6,250 (56,250 – 50,000) = ₹ 3,06,250

14. QP JAN 21

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.

SOLUTION:

Impact of various items in terms of AS 22 deferred tax liability/deferred tax asset

1) Difference in Depreciation- Generally, written down value method of depreciation is adopted under income Tax Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years. It is timing difference for which reversal of Deferred tax liability is required.

   Reversal of DTL= ₹ (160 – 140) Lakhs X 30% = ₹6 Lakhs

2) Disallowances, as per IT Act of earlier years- Due to disallowance tax payable for the earlier years was higher on this account. It is responding timing difference which required Reversal of Deferred tax assets.

   Reversal of Deferred tax assets = ₹20 Lakhs X 30% = ₹ 6 Lakhs

3) Donations to private trusts is not an allowable expenditure under IT Act. It is permanent difference. Hence, no reversal of tax is required.

15. QUESTION

ABC Ltd. has shown profit before tax of Rs.5,00,000. However, the taxable income has been calculated as Rs. 4,50,000. The tax rate is 35%. Find out the amount of current tax and deferred tax asset / liability of the company. Would it make any difference of the taxable income is calculated as Rs.6,00,000?

SOLUTION:

Current Tax

CASE	TAXABLE INCOME	TAX RATE	CURRENT TAX
1	4,50,000	35%	
2	6,00,000	35%	

Deferred Tax

Case	Particulars	Financial Balance sheet	Tax Balance Sheet	Permanent difference	Timing difference	Tax rate	DTA	DTL
1	Profit							
2	Profit							

16. QUESTION

XYZ Ltd. charges depreciation at different rates for financial statements and tax purpose. Consequently, the WDV of some of the assets are different for two records as follows:

	Balance Sheet	Tax Record
Plant &Machinery	Rs.5,00,000	Rs.3,00,000
Furniture & Fixture	Rs.1,00,000	Nil

There is a liability for Rs.60,000 which is provided for in accounting record. This is allowable deduction for tax purpose. Find out the amount of Deferred Tax Asset / liability, given that the tax rate is 35%.

SOLUTION:

Calculation of DTA / DTL

S.N	Particulars	Financial Balance sheet	Tax Balance Sheet	Permanent difference	Timing difference	Tax rate	DTA	DTL	Net
1	Plant and Machinery								
2	Furniture & Fixture								

3	Expenditure								
	Total								

17. QUESTION

RST Ltd. has reported a profit before tax of Rs. 200,000 for the current year. Following additional information is provided:

Additional depreciation allowable for tax purpose	Rs. 30,000
Advance rent received: (in respect of next year)	15,000
Interest income from Tax-free Government Bonds	18,000
Tax rate	35%

Find out the current tax and deferred tax asset / liability.

SOLUTION:

Calculation of Current Tax

Particulars	**Rs.**
Profit before Tax	2,00,000
Less: Additional depreciation under tax laws	(30,000)
Interest income from Tax free Govt. Bonds	(18,000)
	152,000
Current Tax @ 35% (1,52,000 x 35%)	53,200
Calculation of Deferred Tax liability	
Timing difference on depreciation (DTL)	30,000
Deferred Tax liability (35% x 30,000)	10,500

18. SIMILAR QUESTION IN MAY 2011 EXAM

The WDV of fixed assets of ABC Ltd. as per accounting records is Rs. 15,00,000 and as per tax records is Rs. 11,00,000. The reason being higher depreciation has been claimed for tax purposes. There is also a deferred revenue expenditure of Rs. 30,000 which is charged to Profit & Loss A/c in earlier years, but is yet to be written off for tax purposes.

Find out the amount of deferred tax asset / liability to be recognized given that:

a. Rate of tax is 35%.

b. This is the first year when AS-22 is applied.

SOLUTION:

Calculation of DTA / DTL

S.N.	Particulars	Financial Balance sheet	Tax Balance Sheet	Permanent difference	Timing difference	Tax rate	DTA	DTL	Net
1	Plant and Machinery								
2	Expenditure								
	Total								

19. QUESTION

The profit before tax of an enterprise is Rs. 3,00,000. However, its taxable income has been calculated as Rs. 50,000. This difference has been identified as timing difference as per AS-22. The rate of income tax is 35%, whereas the rate of MAT is 7.5%. Find out the amount of deferred tax asset / liability.

SOLUTION:

Current Tax

Tax as per accounting profit 35% x 3,00,000 = ₹ 1,05,000

Tax as per Income-tax Profit 35% x 50,000 = ₹ 17,500

Tax as per MAT 3,00,000 x 7.50% = ₹ 22,500

Excess of MAT over current tax = 22,500 – 17,500 = 5,000

Tax expense = Current Tax +Deferred Tax

₹ 1,05,000 = ₹ 17,500+ Deferred tax

Therefore, Deferred Tax liability = ₹ 1,05,000 – ₹ 17,500 = ₹ 87,500

Note: As per the clarification issued by ICAI regarding MAT the following points should be noted.

1. The payment of tax under MAT is the current tax for the period.

2. In a period in which a company pays tax as per MAT (Sec. 115 JB) of Income Tax Act the DTA / DTL in respect of timing difference should be measured using the normal tax rate.

20.QUESTION

PQR Ltd. pays a premium of Rs. 2,50,000 on an insurance policy for one year with effect from Oct. 1. It prepares its final accounts on March 31 next. The entire premium is a deductible expense in the year in which it is paid. Find out the amount of deferred tax asset / liability to be recognized on March 31 given the tax rate of 35%.

SOLUTION:

S.N	Particulars	Books of accounts	Tax record	Permanent difference	Timing difference	Tax rate	DTA	DTL
1	Insurance Premium	1,25,000	2,50,000			35%		

21. QUESTION

XYZ Ltd. shows accounting profit of Rs. 6,00,000 and taxable income of Rs. 8,50,000 for the Year 1. The difference between the two has been caused by a timing difference. This would be allowed as deductible expense during year 2, Year 3 and year 4 to the extent of Rs. 1,00,000, Rs. 1,00,000 and Rs. 50,000. Find out the deferred tax asset / liability for different years given that the tax rate for Year 1 and 2 is 35% and for year 3 and 4 is 30%.

SOLUTION:

Calculation of DTA / DTL

S.no	Particulars	Year			
		1	2	3	4
A	Opening Timing Difference				
B	Originating Timing Difference				
C	Total Timing Difference (A+ B)				

D	Timing Difference Reversed				
E	Timing Difference c/f (C – D)				
F	Tax rate applicable				
G	DTA / DTL to be c/f (E x F)				
H	Deferred tax to be recognized in				

Note: *It is assumed that tax rates for subsequent year has been substantively enacted.*

22.QUESTION

BST Ltd. is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on % of completion method for financial statements. During three years period, it has recognised revenue of Rs.10,00,000, Rs.15,00,000 and Rs.20,00,000 in the Profit and Loss A/c.

However, for income tax purpose, it has adopted the completed contract method under which it has recognized revenues of Rs.6,00,000, Rs.17,00,000 and Rs.22,00,000 over 3 years. Find out the amount of deferred tax asset / liability for different years, given that the tax rate is 35%.

SOLUTION:

Calculation of DTA / DTL

S.no	Particulars	Year		
		1	2	3
A	Opening Timing Difference			
B	Originating Timing Difference (OTD)			
C	Total Timing Difference (A+ B)			
D	Timing Difference Reversed (RTD)			
E	Timing Difference c/f			
F	Tax rate applicable			
G	DTA / DTL to be c/f (E x F)			
H	Deferred tax to be recognized in P&L			

23. QUESTION

PQR Ltd. purchased a machine for Rs.3,00,000 on Year 1. The expected salvage value was nil after life of 3 years. It adopted straight line method of depreciation for accounting purpose whereas the machine was eligible for 100% depreciation in the year of purchase. The profit before depreciation of the company for the years Year 1, Year 2 and Year 3 are Rs.4,00,000 p.a. Find out the deferred tax asset / liability for different years, given that the tax rate is 35% for all the 3 years. Also show the presentation in the Profit and Loss A/c.

SOLUTION:

1. Current Tax (Figures in Rs.)

S.N.		Year 1	Year 2	Year 3
A	Profit before depreciation and tax			
B	Less: Depreciation			
C	Taxable income (A – B)			
D	∴ Current Tax @ 35%			

2. Deferred Tax

S.no	Particulars	Year		
		1	2	3
A	Opening Timing Difference			
B	Originating Timing Difference (OTD)			
C	Total Timing Difference (A+ B)			
D	Timing Difference Reversed (RTD)			
E	Timing Difference c/f (C- D)			
F	Tax rate applicable			
G	DTA / DTL to be c/f			
H	Deferred tax to be recognized in P&L A/c.			

3. Profit and loss statement

	Year 1	Year 2	Year 3
Profit before depreciation and tax			
Less: Depreciation			
PBT			
(-) Tax Expense			
(a) Current Tax (W.N. 1)			
(b) Deferred Tax (W.N. 2)			
Sub -Total			

Profit After Tax			

24. QUESTION

Continue with above Illustration and find out the amount of deferred tax liability if the tax rates for the three years are 35%, 30% and 32% respectively.

SOLUTION:

Deferred Tax (Figures in Rs.)

S.no	Particulars	Year		
		1	2	3
A	Opening Timing Difference			
B	Originating Timing Difference (OTD)			
C	Total Timing Difference (A+ B)			
D	Timing Difference Reversed (RTD)			
E	Timing Difference c/f (C- D)			
F	Tax rate applicable			
G	DTA / DTL to be c/f			
H	Deferred tax to be recognized in P&L A/c.			

ASSUMPTION:

It is assumed that the tax rate for the subsequent year has been either enacted on substantively enacted. Hence the tax rate applicable to the next year is used for calculating the deferred tax.

25. RTP MAY2013, RTP MAY 2014

PQR Ltd. incurs a loss of Rs.2,00,000 in Year 1 and makes profit of Rs.1,00,000 and Rs.1,20,000 in Year 2 and year 3 respectively. The tax rate is 40% and the loss can be carried forward for 5 years under the tax laws. At the end of year 1, it was certain that the company would have sufficient taxable income in future years against which unabsorbed depreciation and carry forward of losses can be set off. Show the reversal of timing difference and the consequent effect on tax liability.

SOLUTION:

Step – 1: Current Tax (Figures in Rs.)

S.N.	Particulars	Year		
		1	2	3
A	Profit / Loss			
B	Less: brought forward loss adjusted			
C	Taxable income			
D	Current tax @ 40%			

Step – 2: Deferred Tax

S.no	Particulars	Year		
		1	2	3
A	Opening Timing Difference			
B	Originating Timing Difference			
C	Total Timing Difference (A+ B)			
D	Timing Difference Reversed (RTD)			
E	Timing Difference c/f (C- D)			
F	Tax rate applicable			
G	DTA / DTL to be c/f (E x F)			
H	Deferred tax to be recognized in			

Step – 3: Profit & Loss Statement

S.No.	Particulars	Year		
		1	2	3
A	Profit / Loss			
B	(-) Tax expense			
	(a) Current Tax (WN – 1)			
	(b) Deferred Tax (WN – 2)			
	Sub –Total			
D	Profit / Loss after tax			

26. ICAI PRACTICAL Q 11

Ultra Ltd. has provided the following information.

Depreciation as per accounting records = ₹ 4,00,000

Depreciation as per tax records =₹ 10,00,000

Unamortised preliminary expenses as per tax record = ₹ 30,000

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%?

SOLUTION

Table showing calculation of deferred tax asset / liability

Particulars	Amount ₹	Timing difference	Deferred tax	Amount @ 50% ₹
Excess depreciation as per tax records (₹10,00,000 – ₹ 4,00,000)	6,00,000	Timing	Deferred tax liability	3,00,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				2,85,000

Tax expense is more than the current tax due to timing difference. Net deferred tax liability amounting ₹ 2,85,000 should be recognized.

27. (ICAI)

XYZ is an export oriented unit and was enjoying tax holiday upto 31.3.2016. No provision for deferred tax liability was made in accounts for the year ended 31.3.2016. While finalising the accounts for the year ended 31.3.2017, the Accountant says that the entire deferred tax liability upto 31.3.2016 and current year deferred tax liability should be routed through Profit and Loss Account as the relevant Accounting Standard has already become mandatory from 1.4.2001. Do you agree?

SOLUTION

FACTS:

XYZ is an export oriented unit and has no provision for deferred tax liability was made in accounts for the year ended 31.3.2016

REFERENCE:

AS 22 on "Accounting for Taxes on Income" relates to the transitional provisions. It says, "On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets."

Further AS 22 lays down, "For the purpose of determining accumulated deferred tax in the period in which this statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences."

ANALYSIS:

In the case of XYZ, even though AS 22 has come into effect from 1.4.2001, the transitional provisions permit adjustment of deferred tax liability/asset upto the previous year to be adjusted from opening reserve. In other words, the deferred taxes not provided for alone can be adjusted against opening reserves.

CONCLUSION:

Provision for deferred tax asset/liability for the current year should be routed through profit and loss account like normal provision.

28.RTP NOV 21

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22.

SOLUTION:

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

(i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

29. ICAI PRACTICAL Q 8

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

SOLUTION:

REFERENCE:

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

ANALYSIS:

1. First Year: Out of ₹ 200 lakhs timing difference due to depreciation, difference amounting ₹ 80 lakhs (₹ 10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised.

For ₹ 120 lakhs (₹ 200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised.

Deferred Liability to be recognised = 120 Lakhs x 40% = ₹ 48 lakhs.

2. In Second year: The entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full.

Deferred tax liability to be recognised = 400 Lakhs x 40% = ₹ 160 lakhs.

Deferred Tax Liability will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be ₹ 208 lakhs (48 lakhs + 160 lakhs).

30. QP JULY 21

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.

(v) 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.

SOLUTION:

Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of	Responding timing difference	Reversal of DTL	28 lakhs x 40% = ₹ 11.20 lakhs

	useful life of the asset in comparison to later years.			
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs x 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs x 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs x 40% =28 lakhs

31. RTP May 22

The following transactions were reported by PQR Ltd. during the year 2020-2021:

i.	Tax Rate	30% (₹ in lakh)
ii.	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	20.00
iii.	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
iv.	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

SOLUTION:

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	Analysis	Nature of difference	Effect	Amount
Disallowances, as per IT Act, of earlier Years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	₹ 20 lakh x 30% = ₹ 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

32. RTP Nov 22

Define following as per AS 22:

1. Accounting income (loss)
2. Taxable income (tax loss)
3. Tax expense (tax saving)

SOLUTION

1. Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income-tax expense or adding income tax saving.

2. Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income-tax payable (recoverable) is determined.

3. Tax expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

33.EXAM NOV 22

The following information is furnished in respect of Mohit Limited for the year ended 31st March, 2022.

(i) Depreciations as per accounting records ₹56,000
Depreciations for income tax records ₹ 38,000

The above depreciations does not include depreciations 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 depreciations is considered appropriate for accounting purpose with a life estimation of 4years.

(iii) The company has made a profit of ₹ 1,28,000 before depreciations and taxes.

(iv) Donations to private trust during the year is ₹ 15,000 (not allowed under tax laws.)

(v) corporate tax is 40%.

Prepare relevant extract of statement of profit and Loss for the year ending 31st March,2022. Also show the effect of the above item on Deferred Tax Liability / Assets as per AS-22.

SOLUTION:

Statement of Profit and Loss for the year ended 31st March, 2022 (Extract)

		₹
Profit before depreciation and taxes		1,28,000
Less: Depreciation for accounting purposes (56,000 + 6,000		(62,000)
Profit before taxes (A)		66,000
Less: Tax expense (B)		
Current tax (W.N.1)	32,400	
Deferred tax (W.N.2)	NIL	(32,400)
Profit after tax (A-B)		33,600

Working Notes:

WN 1: Computation of taxable income

	Amount (₹)
Profit before depreciation and tax	1,28,000
Less: Depreciation for tax purpose (38,000 +24,000)	(62,000)
Add: Donation to Private Trust	15,000
Taxable income	81,000

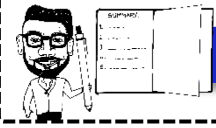
Tax on taxable income @ 40%	32,400

WN 2: Impact of various items in terms of deferred tax liability / deferred tax asset

Analysis	**Nature of difference**	**Effect**	**Amount (₹)**
Difference in depreciation			
Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years	Reversing timing difference	Reversal of DTL	(38,000 - 56,000) x40% = (7,200)
Depreciation on new Machinery			
Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(24,000 – 6,000) x 40% = 7,200
Net Impact			NIL

AS 24 - DISCONTINUING OPERATIONS

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	RTP Nov 2018 Q18				
2	RTP NOV 19 / QP NOV 18				
3	RTP NOV 20				
4	RTP MAY 21				
5	(RTP May 2015) (Suggested Nov, 2009)				
6	RTP NOV 21				
7	QP JULY 21				
8	RTP May 22				
9	RTP May 22				
10	RTP NOV 22				



Let's Get Started....With Class Work

1. RTP Nov 2018 Q18

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

SOLUTION

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

i. Gradual or evolutionary phasing out of a product line or class of service
ii. Discontinuing, even if relatively abruptly, several products within an ongoing line of business
iii. Shifting of some production or marketing activities for a particular line of business from one location to another and
iv. Closing of a facility to achieve productivity improvements or other cost savings.

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

2. RTP NOV 19 / QP NOV 18

i. What are the disclosure and presentation requirements of AS 24 for discontinuing operations?
ii. Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

SOLUTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3. RTP NOV 20

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief.

SOLUTION

As per AS 24 - Discontinuing Operations, a discontinuing operation is a component of an enterprise:

a. **That the enterprise, pursuant to a single plan, is:**
   (i) **Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or**
   (ii) **Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or**
   (iii) **Terminating through abandonment and**

b. **That represents a separate major line of business or geographical area of operations.**

c. **That can be distinguished operationally and for financial reporting purposes.**

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

- A **description** of the discontinuing operation(s);
- The **business or geographical segment(s)** in which it is reported as per AS 17;
- The **date and nature** of the initial disclosure event.
- The **date or period** in which the discontinuance is expected to be completed if known or determinable,
- The **carrying amounts**, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- The **amounts of revenue and expenses** in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- The **amount of pre-tax profit or loss from ordinary activities** attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto;
- The **amounts of net cash flows attributable to the operating, investing, and financing activities** of the discontinuing operation during the current financial reporting period.

4. RTP MAY 21

Arzoo 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 to the commercial vehicles 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 has planned that 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 plus transfer of employees in a phased manner. These plans have not approved from the Board of Directors and the new factory for manufacture of commercial vehicles has not yet started. You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

SOLUTION

REFERENCE:

As per AS 24 - Discontinuing Operations, mere gradual phasing out is not considered as discontinuing operation.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

1) Gradual or evolutionary phasing out of a product line or class of service
2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business
3) Shifting of some production or marketing activities for a particular line of business from one location to another and
4) Closing of a facility to achieve productivity improvements or other cost savings.

ANALYSIS:

The companies' strategic plan also has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e., commercial vehicle production line in a new factory has not started.

CONCLUSION:

In view of the above, **mere gradual phasing out in itself cannot be considered as discontinuing operation.**

5. (RTP May 2015) (Suggested Nov, 2009 New (4 Marks)

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.

(i) You are required to comment 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?

SOLUTION

REFERENCE:

As per AS 24, a discontinuing operation is a component of an enterprise:

a) that the enterprise, pursuant to a single plan, is:

   (i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

   (ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

   (iii) terminating through abandonment; and

b) that represents a separate major line of business or geographical area of operations; and

c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

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

b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business

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

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

ANALYSIS (i):

The company's strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has not started.

CONCLUSION:

No, it will **not be considered as Discontinued operation as per AS 24.**

ANALYSIS (ii):

The resolution is silent about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing.

CONCLUSION:

AS-24 – **Discontinued operations will not be applicable.**

ANALYSIS (iii):

Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map.

CONCLUSION:

The above action **will attract AS-24 Discontinued Operations compliance.**

6. RTP NOV 21

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

SOLUTION

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:

i. Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or

ii. Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or

iii. Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.

7. QP JULY 21

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?

SOLUTION

REFERENCE:

As per AS 24, a discontinuing operation is a component of an enterprise:

a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

b) that represents a separate major line of business or geographical area of operations; and

c) that can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing out is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operations'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

a) *Gradual or evolutionary phasing out of a product line or class of service;*
b) *Discontinuing, even if relatively abruptly, several products within an ongoing line of business*
c) *Shifting of some production or marketing activities for a particular line of business from one location to another; and*
d) *Closing of a facility to achieve productivity improvements or other cost savings.*

ANALYSIS (i):

The company's strategic plan has no final approval from the board through a resolution and no specific time bound activities like shifting of Assets and employees and above all the new segment commercial vehicle production line and factory has not started.

CONCLUSION:

No, it will ***not be considered as Discontinued operation as per AS 24.***

ANALYSIS (ii):

The resolution is silent about stoppage of the Car segment in definite time period. Though, some assets sales and transfer proposal was passed through a resolution to the new factory, closure road map and new segment starting road map is missing.

CONCLUSION:

AS-24 – ***Discontinued operations will not be applicable.***

ANALYSIS (iii):

Phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and clear road map.

CONCLUSION:

The above action ***will attract AS-24 Discontinued Operations compliance.***

8. RTP May 22

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

SOLUTION

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

a) *a **description** of the discontinuing operation(s);*
b) ***the business or geographical segment(s)** in which it is reported as per AS 17 'Segment Reporting';*
c) *the **date and nature** of the initial disclosure event;*
d) *the **date or period** in which the discontinuance is expected to be completed if known or determinable;*
e) *the **carrying amounts,** as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;*
f) *the **amounts of revenue and expenses** in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;*
g) *the **amount of pre-tax profit or loss from ordinary activities** attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and*
h) *the **amounts of net cash flows attributable to the operating, investing, and financing activities** of the discontinuing operation during the current financial reporting period.*

9. RTP May 22

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

SOLUTION

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

i) *Gradual or evolutionary phasing out of a product line or class of service;*
ii) *Discontinuing, even if relatively abruptly, several products within an ongoing line of business;*
iii) *Shifting of some production or marketing activities for a particular line of business*

from one location to another; and

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

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

10. RTP NOV 22

What are the disclosure requirements in interim financial reports as per AS 24 for discontinuing operations?

SOLUTION

Disclosure in interim financial reports

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:

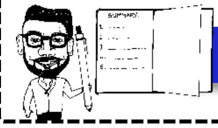
(a) Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and

(b) Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

AS 26 – INTANGIBLE ASSETS

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI Example 1				
2	ICAI EXAMPLE 2				
3	ICAI ILLUSTRATION NO 1				
4	ICAI ILLUSTRATION NO 2				
5	ICAI ILLUSTRATION NO 3				
6	PRACTICAL QUESTION 3				
7	RTP MAY 2018, IPCC RTP MAY 2018) / RTP NOV 19, PRACTICAL QUESTION 5				
8	RTP NOV 2018 Q19, IPCC RTP NOV 2018 20A				
9	MOCK TEST PAPER 2 (Q NO 1 C)				
10	Q PAPER MAY 2018 GROUP 2 OLD Q NO 1 D				
11	QP MAY 2018 Q NO 1 C				
12	RTP MAY 20				
13	RTP NOV 20				
14	RTP MAY 21				
15	QP NOV 19				
16	QP NOV 20				
17	QP JAN 21				
18	RTP MAY 2019, IPCC RTP MAY 2019				
19	QP NOV 20				
20	IPCC RTP NOV 2014				
21	IPCC RTP MAY 2015, IPCC RTP NOV 2017				
22	IPCC RTP NOV 2015				
23	IPCC RTP MAY 2016				
24	IPCC RTP MAY 2017				
25	RTP NOV 21				
26	MOCK TEST OCT 21 SERIES 1 / ICAI PRACTICAL QUESTION 18				
27	QP DEC 21				

28	RTP MAY 2022				
29	RTP MAY 2022				
30	MTP MARCH 2022 TEST SERIES I				
31	MTP APRIL 2022 SERIES 2, QP NOV 18(GROUP 2 OLD]				
32	RTP NOV 22				
33	MTP SEP 22 (SERIES 1)				
34	MTP OCT 22 (SERIES 2)				



Let's Get Started....With Class Work

1. ICAI Example 1

An enterprise is developing a new production process. During the year 20X1, expenditure incurred was Rs. 10 lacs, of which Rs. 9 lacs was incurred before 1 December 20X1 and 1 lac was incurred between 1 December 20X1 and 31 December 20X1. The enterprise is able to demonstrate that, at 1 December 20X1, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 5 lacs.

At the end of 20X1, the production process is recognised as an intangible asset at a cost of Rs. 1 lac (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X1). The Rs. 9 lacs expenditure incurred before 1 December 20X1 is recognised as an expense because the recognition criteria were not met until 1 December 20X1. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During the year 20X2, expenditure incurred is Rs. 20 lacs. At the end of 20X2, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 19 lacs.

At the end of the year 20X2, the cost of the production process is Rs. 21 lacs (Rs. 1 lac expenditure recognised at the end of 20X1 plus Rs. 20 lacs expenditure recognised in 20X2). The enterprise recognises an impairment loss of Rs. 2 lacs to adjust the carrying amount of the process before impairment loss (Rs. 21 lacs) to its recoverable amount (Rs. 19 lacs). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in AS 28, are met.

2. ICAI EXAMPLE 2

A. An enterprise has purchased an exclusive right to generate hydroelectric power for 60 years. The costs of generating hydro-electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least 60 years.

The enterprise amortises the right to generate power over 60 years, unless there is evidence that its useful life is shorter.

B. An enterprise has purchased an exclusive right to operate a toll motorway for 30 years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least 30 years.

The enterprise amortises the right to operate the motorway over 30 years, unless there is evidence that its useful life is shorter.

If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless the legal rights are renewable and renewal is virtually certain.

There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

3. ICAI ILLUSTRATION NO 1

ABC Ltd. developed know-how by incurring expenditure of ₹ 20 lakhs, The know-how was used by the company from 1.4.20X1. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.20X8. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.20X8.

SOLUTION

REFERENCE:

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

ANALYSIS:

Journal Entry

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

4. ICAI ILLUSTRATION NO 2

The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer Product, which was marketed in the accounting year 20X1-20X2, but proved to be a failure. State, how you will deal with the following matters in the accounts of U Ltd. for the year ended 31st March, 20X2.

SOLUTION

FACTS:

The company had spent ₹ 45 lakhs for publicity and research expenses and proved to be a failure.

REFERENCE:

According to AS 26 - Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

ANALYSIS:

In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product.

CONCLUSION:

The **company should charge** the total amount of **₹ 45 lakhs as an expense** in the profit and loss account.

5. ICAI ILLUSTRATION NO 3

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

SOLUTION

FACTS:

Company has incurred expenditure of Rs. 2 crore and had debited it to Profit and Loss Account.

REFERENCE:

According to AS 26 Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset. Further AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

ANALYSIS:

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised.

CONCLUSION:

The accounting treatment by the **company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.**

6. PRACTICAL QUESTION 3

Swift Ltd. acquired a patent at a cost of Rs. 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalised the cost and started amortising the asset at Rs. 10,00,000 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 were expected to be Rs. 36,00,000, Rs. 46,00,000, Rs. 44,00,000, Rs. 40,00,000 and Rs. 34,00,000. Find out the amortisation cost of the patent for each of the years.

SOLUTION

REFERENCE:

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

ANALYSIS:

Swift Limited amortised Rs. 10,00,000 per annum for the first two years i.e., Rs. 20,00,000. The remaining carrying cost can be amortised during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount
I	-	0.125 (10L/80L)	10,00,000 (0.125 x 80L)
II	-	0.125 (10L/80L)	10,00,000 (0.125 x 80L)
III	36,00,000	0.180 (36L/200L)	10,80,000 (0.180 X 60L)
IV	46,00,000	0.230 (46L/200L)	13,80,000 (0.230 X 60L)
V	44,00,000	0.220 (44L/200L)	13,20,000 (0.220 X 60L)
VI	40,00,000	0.200 (40L/200L)	12,00,000 (0.200 X 60L)
VII	34,00,000	0.170 (34L /200L)	10,20,000 (0.170 X 60L)
Total	2,00,00,000		80,00,000

It has been assumed that the company had amortized the patent at Rs. 10,00,000 per annum in the first two years on the basis of economic benefits derived from the product manufactured under the patent.

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 60,00,000 has been amortised in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

7. (RTP MAY 2018, IPCC RTP MAY 2018) / RTP NOV 19, PRACTICAL QUESTION 5

K Ltd. launched a project for producing product X in October, 2016. The Company incurred Rs. 40 lakhs towards Research and Development expenses upto 31st March, 2017. 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.

You are required to **advise** the Company as per the applicable Accounting Standard.

SOLUTION

FACTS:

K Ltd. had incurred ₹ 40 lakhs for research and management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management wants to defer the expenditure write off to future years.

REFERENCE:

According to AS 26 - Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

ANALYSIS:

In the given case, K Ltd. spent ₹ 40 lakhs for research of a new product. It is clear that the product cannot be manufactured and sold in the market for the next 10 years. The expenses amounting Rs.40 lakhs incurred on the research has to be written off in the current year ending 31st March, 2017.

CONCLUSION:

The **contention of the management** to defer the expenditure write off to future years is **incorrect.**

8. RTP NOV 2018 Q19, IPCC RTP NOV 2018 20A

Desire Ltd. acquired a patent at a cost of Rs. 1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. 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 were expected to be Rs. 45,00,000, Rs. 42,00,000, Rs. 40,00,000, Rs. 38,00,000 and Rs. 35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e., from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years (1st year to 7th year).

SOLUTION

REFERENCE:

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

ANALYSIS:

Desire ltd. Amortised Rs. 20,00,000 per annum for the first two years i.e., Rs. 40,00,000. The remaining carrying cost can be amortized cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows.

Year	Net cash flows Rs.	Amortization Ratio	Amortization Amount Rs.
I	-	0.200	20,00,000 (100L / 5yrs)
II	-	0.200	20,00,000 (100L / 5yrs)
III	45,00,000	0.225 (45L/200L)	13,50,000 (0.225 X 60L)
IV	42,00,000	0.21 (42L/200L)	12,60,000 (0.21 X 60L)
V	40,00,000	0.20 (40L/200L)	12,00,000 (0.20 X 60L)
VI	38,00,000	0.19 (38L/200L)	11,40,000 (0.19 X 60L)
VII	35,00,000	0.175 (35L/200L)	10,50,000 (0.175 X 60L)
Total	**2,00,00,000**		**1,00,00,000**

It may be seen from above that from third year onwards, the balance of carrying amount i.e., Rs. 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd.

9. MOCK TEST PAPER 2 (Q NO 1 C)

A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of Rs. 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. 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.

You are required to determine the amortization method in line with AS 26.

SOLUTION

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis -à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operating Cash in flow (Rs.)	Amortize amount (Rs. in lakhs)
1	900	6 (200 x 900/27,400)
2	1,800	12 (200 x 1,800/27,400)
3	2,300	16 (200 x 2,300/27,400)
4	3,200	24 (200 x 3,200/27,400)
5	3,200	24 (200 x 3,200/27,400)
6	3,200	24 (200 x 3,200/27,400)
7	3,200	24 (200 x 3,200/27,400)
8	3,200	24 (200 x 3,200/27,400)
9	3,200	24 (200 x 3,200/27,400)
10	3,200	22 (Bal. figure)
	27,400	200

10. Q PAPER MAY 2018 GROUP 2 OLD Q NO 1 D

A Company acquired a patent right for Rs. 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 (Rs. in Lakhs)	600	600	600	300	300

After 3^{rd} year it was ascertained that the patent would have an estimated balance future life of 3 years and the estimated cash flow after 5^{th} year is expected to be Rs. 150Lakhs. Determine the amortization under Accounting Standard 26

SOLUTION

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flow i.e., (600:600:600:300:300). The unamortized amount of the patent after 3^{rd} year will be Rs. 300 Lakh (1200-900) which will be amortized in the ratio of revised estimated future cash flows (300:300:150) in the fourth, fifth and sixth year.

Year	Estimated future cash flow (Rs. in Lakhs)	Amortization Ratio	Amortized Amount (Rs. in Lakhs)
1	600	25	300 (1200 x 600/2400)
2	600	25	300 (1200 x 600/2400)
3	600	25	300 (1200 x 600/2400)
4	300	40 (Revised)	120 (300 x 300/750)
5	300	40 (Revised)	120 (300 x 300/750)
6	150	20 (Revised)	60 (300 x 150/750)
			1200

11. QP MAY 2018 Q NO 1 C

A Company acquired a patent at a cost of Rs. 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 Rs. 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 Rs. 50 lakhs, Rs. 30 lakhs, Rs. 60 lakhs, Rs. 70 lakhs and Rs. 40 lakhs. Find out the amortization cost of the patent for each of the years.

SOLUTION

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

Company amortized Rs. 16,00,000 per annum for the first two years.

Amortization for the first two years (Rs. 16,00,000 X 2) = Rs. 32,00,000.

Remaining carrying cost after two years =Rs. 1,60,00,000 – Rs. 32,00,000

= Rs. 1,28,00,000

Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost Rs.128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.

The amortization cost of the patents may be computed as follows:

Year	Net cash flows (Rs.)	Amortization Ratio	Amortization Amount (Rs.)
I	-	0.1 (160L/16L)	16,00,000 (Given)
II	-	0.1 (160L/16L)	16,00,000 (Given)
III	50,00,000	0.2 (50L/250L)	25,60,000 (128L X 0.2)
IV	30,00,000	0.12 (30L/250L)	15,36,000 (128L X 0.12)
V	60,00,000	0.24 (60L/250L)	30,72,000 (128L X 0.24)
VI	70,00,000	0.28 (70L/250L)	35,84,000 (128L X 0.28)
VII	40,00,000	0.16 (40L/250L)	20,48,000 (128L X 0.16)
Total	250,00,000		160,00,000

12. RTP MAY 20

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. You are required to determine the amortization pattern under Accounting Standard 26.

SOLUTION

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (600: 600: 600: 300: 300).

The unamortized amount of the patent after third year will be ₹ 300 lakh (1,200-900) which will be amortized in the ratio of revised estimated future e cash flows (300:300:150) in the fourth, fifth and sixth year.

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	600	0.25 (600/2400)	300 (1200 X 0.25)
2	600	0.25 (600/2400)	300 (1200 X 0.25)
3	600	0.25 (600/2400)	300 (1200 X 0.25)
4	300	0.40 (300/750)	120 (0.40 X 300)
5	300	0.40 (300/750)	120 (0.40 X 300)
6	150	0.20 (150/750)	60 (0.20 X 300)

			1,200

13. RTP NOV 20

X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya''. One month before, the company comes to know through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya"'. X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

SOLUTION

FACTS:

X Ltd. 2 trademarks and they have been infringed. X Ltd. has incurred additional legal fees to stop infringement on both trademarks.

REFERENCE:

As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance.

ANALYSIS:

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company.

CONCLUSION:

Legal costs incurred for both trademarks must be recognized as an expense.

14. RTP MAY 21

Naresh Ltd. had the following transactions during the financial year 2019 -2020:

(i) Naresh Ltd. acquired running business of Sunil Ltd. for ₹ 10,80,000 on 15th May, 2019. The fair value of Sunil Ltd.'s net assets was ₹ 5,16,000. Naresh Ltd. is of the view that due to popularity of Sunil Ltd.'s product in the market, its goodwill exists.

(ii) Naresh Ltd. had taken a franchise on July 2019 to operate a restaurant from Sankalp Ltd. for ₹ 1,80,000 and at an annual fee of 10% of net revenues (after deducting expenditure). The franchise expires after 6 years. Net revenues were ₹ 60,000 during the financial year 2019-2020.

(iii) On 20th August, 2019, Naresh Ltd, incurred costs of ₹ 2,40,000 to register the patent for its product. Naresh Ltd. expects the patent's economic life to be 8 years.

Naresh Ltd. follows an accounting policy to amortize all intangibles on straight line basis over the maximum period permitted by accounting standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business to be amortized over 5 years (SLM) as per AS 14.

Prepare a schedule showing the intangible assets section in Naresh Ltd. Balance Sheet at 31st March, 2020.

SOLUTION

Naresh Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31st March 2020

	Note No.	₹
Assets		
(I) Non-current assets		
Intangible assets	1	8,11,200

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	4,51,200	
	Franchise (Refer to Note 2)	1,50,000	
	Patents (Refer to Note 3)	2,10,000	8,11,200

Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	10,80,000
	Less: Fair value of net assets acquired	(5,16,000)
	Goodwill	5,64,000
	Less: Amortisation as per AS 14 ie. over 5 years (as per SLM)	(1,12,800)
	Balance to be shown in the balance sheet	4,51,200
(2)	Franchise	1,80,000
	Less: Amortisation (over 6 years)	(30,000)
	Balance to be shown in the balance sheet	1,50,000
(3)	Patent	2,40,000
	Less: Amortisation (over 8 years as per SLM)	(30,000)
	Balance to be shown in the balance sheet	2,10,000

15. QP NOV 19

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.

SOLUTION

REFERENCE:

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless (a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and (b) expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(i) In the given case, the legal expenses to defend the patent of a product amounting ₹ **23,00,000 should not be capitalized** and be charged to Profit and Loss Statement.

(ii) The company is **required to expense the entire amount of ₹ 7,00,000** in the Profit and Loss account for the year ended 31st March, 2019 because no benefit will arise in the future.

(iii) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company **cannot capitalize the amount of ₹ 25,00,000** and it should be recognized as expense

(iv) Expenditure of **₹ 50,00,000** on advertising and promotional activities **should always be charged to Profit and Loss Statement.** Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

16. QP NOV 20

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 Flows (₹ 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.

SOLUTION:

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150).

The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future e cash flows (150:150:75) in the fourth, fifth and sixth year.

Amortization of cost of patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	0.25 (300/1200)	150 (600 X 0.25)
2	300	0.25 (300/1200)	150 (600 X 0.25)
3	300	0.25 (300/1200)	150 (600 X 0.25)
4	150	0.40 (150/375)	60 (0.40 X 150)
5	150	0.40 (150/375)	60 (0.40 X 150)
6	75	0.20 (75/375)	30 (0.20 X 150)
			600

17. QP JAN 21

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.

SOLUTION

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

Purchase cost of the software	£ 1,50,000
Less: Trade discount @ 2.5%	£ (3,750)
	£1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	146,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	160,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	168,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	170,91,875

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

18.RTP MAY 2019, IPCC RTP MAY 2019

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?

SOLUTION

REFERENCE:

According to AS 26 Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset. Further AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

ANALYSIS:

In the given case, advertisement expenditure of ₹ 3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

CONCLUSION:

The accounting treatment by the company of debiting the entire advertising expenditure of ₹3 crores to the Profit and Loss account of the year is correct.

19. QP NOV 20

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 amount of expenditure to be charged to Profit and Loss Account for the year ended 31st March, 2020?

What is the carrying amount of the intangible asset as on 31st March, 2020?

SOLUTION

REFERENCE:

As per AS 26, The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. AS 26 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

Carrying amount is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.

ANALYSIS:

i. Expenditure to be charged to Profit and Loss account for the year ending 31.03.2019

₹ 42 lakhs is recognized as an expense because the recognition criteria were not met until Ist November, 2018. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

ii. Carrying value of intangible asset as on 31.03.2019

At the end of financial year, on 31st March 2019, the production process will be recognized (i.e., carrying amount) as an intangible asset at a cost of ₹ 38 (80-42) lakhs (expenditure incurred since the date the recognition criteria were met, i.e., from Ist November 2018)

iii. Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020

	(₹ in lacs)
Carrying Amount as on 31.03.2019	38
Expenditure during 2019 – 2020	90
Book Value	128
Recoverable Amount	(82)
Impairment loss to be charged to Profit and loss account	46

₹ 46 lakhs to be charged to Profit and loss account for the year ending 31.03.2020.

iv. Carrying value of intangible asset as on 31.03.2020

	(₹ in lacs)
Book Value	128
Less: Impairment loss	(46)
Carrying amount as on 31.03.2020	82

20.IPCC RTP NOV 2014

A company with a turnover of ₹ 500 crores and an annual advertising budget of ₹ 4 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 50 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 4 crore incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by the company correct?

SOLUTION

FACTS:

Company had an annual advertising budget of ₹ 4 crores and had debited it to Profit and Loss Account as expenditure.

REFERENCE:

According to AS 26 Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset. Further AS 26 mentions that expenditure on advertising and promotional activities should be recognised as an expense when incurred.

ANALYSIS:

In the given case, advertisement expenditure of ₹ 4 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 50 crores. Here, no intangible asset or other asset is acquired or created that can be recognised.

CONCLUSION:

The accounting treatment by the company of debiting the entire advertising expenditure of ₹ 4 crores to the Profit and Loss account of the year is correct.

21. IPCC RTP MAY 2015, IPCC RTP NOV 2017

During 2014-15, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount (₹)
Completion of detailed programme and design	25,000
Coding and Testing	20,000
Other coding costs	42,000
Testing costs	12,000
Product masters for training materials	13,000
Packing the product (1,000 units)	11,000

What amount should be capitalized as software costs in the books of the company, on Balance Sheet date?

SOLUTION

REFERENCE:

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model.

ANALYSIS:

Particulars	₹
Completion of detailed program and design	25,000
Coding and Testing	20,000
Cost to be recognized as expense to establish technological feasibility/asset recognition criteria	**45,000**
Other coding costs	42,000
Testing costs	12,000
Product masters for training materials	13,000
Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost	**67,000**
Packing the products (1,000 units) It should be recognized as expenses and charged to P & L A/c	11,000

22. IPCC RTP NOV 2015

AB Ltd. launched a project for producing product X in October, 2013. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2015. 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.

SOLUTION

FACTS:

AB Ltd. had incurred ₹ 20 lakhs for research and management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management wants to defer the expenditure write off to future years.

REFERENCE:

According to AS 26 Intangible Assets, No intangible asset arising from research or from the research phase of an internal project should be recognised. Expenditure on research or on the research phase of an internal project should be recognised as an expense when it is incurred.

ANALYSIS:

In the given case, the company spent ₹ 20 lakhs for research of a new product. It is clear that the product cannot be manufactured and sold in the market for the next 10 years. The expenses amounting Rs.20 lakhs incurred on the research has to be written off in the current year ending 31st March, 2015.

CONCLUSION:

The contention of the management to defer the expenditure write off to future years is incorrect.

23. IPCC RTP MAY 2016

On 31-03-2015, the Balance Sheet of Alpha Ltd. shows an item of Intangible assets at ₹ 30 Lakhs. The asset was acquired on 1-4-2010 for ₹ 80 lakhs and was available for use on that date. The company has been following a policy of amortizing intangible assets over a period of 8 years on straight line basis. How you will deal in the books of accounts if the company determines by applying the best estimate of its useful life on 1-4-2015, and the amortization period to be 10 years, being the best estimate of its useful life from the date, it was available for use.

SOLUTION

REFERENCE:

As per AS 26 Intangible Assets, the depreciable amount of an intangible asset should be allocated on a systematic basis over its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date it is available for use. The amortization should commence when the asset is available for use. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

ANALYSIS:

The company has been following a policy of amortization over a period of 8 years. As on 01-4-2015, 5 years have passed and the carrying amount stands at ₹ 30 lakhs. If the same treatment were to be continued, this would have been amortized over the next 3 years. But the revised estimate of remaining useful life would extend the period by another 5 years to amortize the carrying amount, the Company would be advised to amortise the carrying value over the next 5 years.

CONCLUSION:

After revision in estimated useful life, the amount of ₹ 30 lacs would be amortised over next 5 years.

24. IPCC RTP MAY 2017

A Pharma Company spent ₹33 lakhs during the accounting year ended 31st March, 2016 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure. Comment.

SOLUTION

FACTS:

Pharma Company had incurred ₹ 33 lakhs for research and are of the view that it may take four years to establish whether the drug will be effective or not. The Management wants to treat the expenditure as deferred revenue expenditure.

REFERENCE:

As per AS 26 'Intangible Assets', no intangible asset arising from research or from the research phase of an internal project should be recognized. Expenditure on research or on the research phase of an internal project should be recognized as an expense when it is incurred.

ANALYSIS:

As per the reference above, the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of ₹33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2016.

CONCLUSION:

The contention of the management to treat the expenditure as deferred revenue expenditure is incorrect.

25. RTP NOV 21

A company is showing an intangible asset at ₹ 88 lakhs as on 01.04.2021. This asset was acquired for ₹ 120 lakhs on 01.04.2017 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.

SOLUTION

REFERENCE:

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

ANALYSIS:

Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis. The period of 15 years is more than the maximum period of 10 years specified as per AS 26. Accordingly, the company would be required to restate the carrying amount of intangible asset as on 01.04.2021 at ₹ 72 lakhs i.e. ₹ 120 lakhs less ₹ 48 lakhs [(₹ 120 Lakhs / 10 years) × 4 years = 48 Lakhs] .

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

CONCLUSION:

The policy of amortization followed by company for intangible assets over a period of 15 years is incorrect.

Journal Entry

	Rs.	Rs.
Revenue Reserve A/c Dr.	16,00,000	
To Intangible Assets A/c		16,00,000
[Adjustment to reserves due to restatement of the carrying amount of intangible asset]		

26. MOCK TEST OCT 21 SERIES 1 / ICAI PRACTICAL QUESTION 18

During 20X1-X2, 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 cost to be recognized in the books of accounts as per AS 26.

SOLUTION

REFERENCE:

As per AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria have been established upon completion of detailed program design or working model.

ANALYSIS:

Particular	₹
Completion of detailed program and design (Phase 1)	50,000
Coding and Testing (Phase 2)	40,000
Cost to be recognized as expense to establish technological feasibility/asset recognition criteria	**90,000**
Other coding costs (Phase 3 & 4)	63,000
Testing costs (Phase 3 & 4)	18,000
Product masters for training materials (Phase 5)	19,500
Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost	1,00,500
Packing the products (1,500 units) (Phase 6) – It should be recognized as expenses and charged to P & L A/c	16,500

27. QP DEC 21

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 assets 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 was ₹ 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 assets as on 31st March,2020;
iii. Expenditure to be charged to profit and Loss Account for the year ended 31st March,2021;
iv. Carrying amount of the intangible assets as on 31st March,2021.

SOLUTION

REFERENCE:

As per AS 26, The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Further AS 26 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

Carrying amount is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.

a) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2020**

35 lakhs is recognized as an expense because the recognition criteria were not met until IstJanuary 2020. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

b) **Carrying value of intangible asset as on 31.03.2020**

At the end of financial year, on 31st March 2020, the production process will be recognized (i.e., carrying amount) as an intangible asset at a cost of ₹ 32 (67-35) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from IstJanuary 2020).

c) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2021**

	(₹ in lacs)
Carrying Amount as on 31.03.2020	32
Expenditure during 2020 – 2021	105
Book Value	137
Recoverable Amount	(89)
Impairment loss	48

₹ 48 lakhs to be charged to Profit and loss account for the year ending 31.03.2021.

d) **Carrying value of intangible asset as on 31.03.2021**

	(₹ in lacs)
Book Value	137
Less: Impairment loss	(48)
Carrying amount as on 31.03.2021	89

28. RTP MAY 2022

PQR Ltd. has acquired a Brand from another company for ₹ 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.

SOLUTION

REFERENCE:

AS 26 - Intangible Assets provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use.

ANALYSIS:

There is no persuasive evidence that the useful life of the intangible asset will exceed 10 years. Hence, PQR Ltd. should amortise Brand cost over it's Useful life.

CONCLUSION:

The contention of PQR Ltd. that no amortization needs to be provided is not correct.

29. RTP MAY 2022

X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards

SOLUTION

FACTS:

X Ltd. has incurred expense on business communication and branding. It wants to amortize the entire expenditure over the period in which it expects the benefits to flow.

REFERENCE:

As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as on expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria.

An intangible asset should be recognized if, and only if:

1. It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and
2. The cost of the asset can be measured reliably.

ANALYSIS:

In the given case, no intangible assets or other asset is acquired or created that can be recognized. X Ltd. should debit the cost to the profit and loss statement during the year ended 31st March, 2021.

CONCLUSION:

The accounting treatment given by X Ltd. is not correct.

30.MTP MARCH 2022 TEST SERIES I

Sudesh Ltd. acquired a patent at a cost of ₹ 2,40,00,000 for a period of 5 years and the product life-cycle was also 5 years. The company capitalized the cost and started amortizing the asset at 48,00,000 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 were expected to be ₹ 36,00,000, ₹ 46,00,000, ₹ 44,00,000, ₹ 40,00,000 and ₹ 34,00,000. Find out the amortization cost of the patent for each of the years if the patent was renewable and Sudesh Ltd. got it renewed after expiry of five years.

SOLUTION

REFERENCE:

As per AS 26 - Intangible Assets, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

ANALYSIS:

The entity amortised ₹ 48,00,000 per annum for the first two years i.e. ₹ 96,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows (₹)	Amortization Ratio	Amortization Amount (₹)
I	-	0.20 (48L/240L)	48,00,000 (Given)
II	-	0.20 (48L/240L)	48,00,000 (Given)
III	36,00,000	0.180 (36L/200L)	25,92,000 (144L X 0.180)
IV	46,00,000	0.230 (46L/200L)	33,12,000 (144L X 0.230)
V	44,00,000	0.220 (44L/200L)	31,68,000 (144L X 0.220)
VI	40,00,000	0.200 (40L/200L)	28,80,000 (144L X 0.200)
VII	34,00,000	0.170 (34L/200L)	24,48,000 (144L X 0.170)
Total	2,00,00,000		2,40,00,000

It may be seen from above that from third year onwards, the balance of carrying amount ₹ 1,44,00,000 has been amortized in the ratio of net cash flows arising from the product.

31. MTP APRIL 2022 SERIES 2, QP NOV 18(GROUP 2 OLD]

PIL Ltd. is showing an intangible asset at ₹ 72 lakhs as on 31-3-2022. This asset was acquired for ₹ 120 lakhs as on 01-04-2016 and the same was used 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.

You are required to comment on the accounting treatment of asset with reference to AS 26 "Intangible Assets" and also give the necessary rectification journal entry in the books.

SOLUTION

FACTS:

The Company has been following the policy of amortization of the intangible asset over a period of 15 years on straight line basis.

REFERENCE:

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

ANALYSIS:

The period of 15 years is more than the maximum period of 10 years specified as per AS 26. The company would be required to restate the carrying amount of intangible asset as on 31.3.2022 at ₹ 48 lakhs i.e., ₹ 120 lakhs less ₹ 72 lakhs (₹ 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹ 24 Lakhs (₹ 72 lakhs – ₹ 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 48 lakhs will be amortized over remaining 4 years by amortizing ₹ 12 lakhs per year.

The necessary journal entry (for rectification) will be

Particulars	Amount	Amount
Revenue Reserves Dr.	₹ 24 Lakhs	
To Intangible Assets		₹ 24 Lakhs
(Adjustment to reserves due to restatement of the carrying amount of intangible asset)		

32. RTP NOV 22

K Ltd. launched a project for producing product X in October, 2021. The Company incurred ₹ 40 lakhs towards Research and Development expenses upto 31st March, 2022. 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.

SOLUTION

FACTS:

K Ltd. had incurred ₹ 40 lakhs for research and development came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management wants to defer the expenditure write off to future years.

REFERENCE:

According to AS 26 - Intangible Assets, Expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

ANALYSIS:

In the given case, the company spent ₹ 40 lakhs for research of a new product. It is clear that the product cannot be manufactured and sold in the market for the next 10 years. The expenses amounting Rs. 40 lakhs incurred on the research has to be written off in the current year ending 31st March, 2022.

CONCLUSION:

The contention of the management to defer the expenditure write off to future years is incorrect.

33.MTP SEP 22 (SERIES 1)

Honey Ltd. is in the process of developing a new production method. During the financial year ended 31st March, 2021, total expenditure incurred on development of this production method was ₹ 98,00,000. On 1st Jan, 2021, 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, 2022 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, 2021.

(2) The expenditure to be shown in Statement of Profit and Loss for the year ended 31st March, 2022.

(3) The carrying amount of the Intangible asset on 31st March, 2022.

SOLUTION

REFERENCE:

As per AS 26, The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. Further AS 26 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

Carrying amount is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.

ANALYSIS:

(i) **Carrying value of intangible asset as on 31.03.2021**

At the end of financial year, on 31st March 2021, the production process will be recognized (i.e., carrying amount) as an intangible asset at a cost of ₹ 30 (98-68) lacs (expenditure incurred since the date the recognition criteria were met, i.e., from 1st January, 2021).

(ii) **Expenditure to be charged to Profit and Loss account for the year ended 31.03.2022**

	(₹ in lacs)
Carrying Amount as on 31.03.2021	30
Expenditure during 2021-2022	72
Book Value	102
Recoverable Amount	(52)
Impairment loss	50

50 lakhs to be charged to Profit and loss account for the year ending 31.03.2022.

(iii) **Carrying value of intangible asset as on 31.03.2022**

	(₹ in lacs)
Book Value	102
Less: Impairment loss	(50)
Carrying amount as on 31.03.2022	52

34. MTP OCT 22 (SERIES 2)

Surya Ltd. had the following transactions during the year ended 31 st March, 2021.

(i) It acquired the business of Gomati Limited on a going concern basis for ₹ 25,00,000 on 1st June,2020. The fair value of the Net Assets of Gomati Limited was ₹ 18,75,000. Surya Ltd. believes that due to popularity of the products of Gomati Limited in the market, its goodwill exists.

(ii) On 20th August, 2020, Surya Ltd. incurred cost of ₹ 6,00,000 to register the patent for its product. Surya Ltd. expects the Patent's economic life to be 8 years.

(iii) On 1st October, 2020, Surya Ltd. has taken a franchise to operate an ice cream parlour from Volga Ltd. for ₹ 4,50,000 and at an Annual Fee of 10 % of Net Revenues (after deducting expenditure). The franchise expires after six years. Net Revenue for the year ended 31st March, 2021 amounted to ₹ 1,50,000.

Surya Ltd. follows an accounting policy to amortize all Intangibles on Straight Line basis (SLM) over the maximum period permitted by the Accounting Standards taking a full year amortization in the year of acquisition. Goodwill on acquisition of business is to be amortized over 5 years (SLM).

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31st March, 2021.

SOLUTION

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31 st March 2021

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

Notes to Accounts (Extract)

		₹	₹
1.	Intangible assets		
	Goodwill (Refer to note 1)	5,00,000	
	Patents (Refer to Note 2)	5,25,000	
	Franchise (Refer to Note 3)	3,75,000	14,00,000

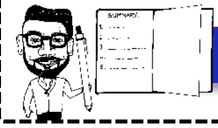
Working Notes:

		₹
(1)	Goodwill on acquisition of business	
	Cash paid for acquiring the business (purchase consideration)	25,00,000
	Less: Fair value of net assets acquired	(18,75,000)
	Goodwill	6,25,000
	Less: Amortization. over 5 years (as per SLM)	(1,25,000)
	Balance to be shown in the balance sheet	5,00,000
(2)	Patent	6,00,000
	Less: Amortization (over 8 years as per SLM)	(75,000)
	Balance to be shown in the balance sheet	5,25,000

(3)	Franchise	4,50,000
	Less: Amortization (over 6 years)	(75,000)
	Balance to be shown in the balance sheet	3,75,000

AS 29 – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

NO.	QUESTIONS	R1	R2	R3	SPECIAL POINT
1	ICAI ILLUSTRATION NO 1				
2	RTP NOV 2018, RTP MAY 2019 Q20, IPCC RTP NOV 2018, IPCC RTP MAY 2019, MTP April 2022 Series 2				
3	MOCK TEST PAPER 1 Q NO 1 D, IPCC RTP MAY 2016				
4	MOCK TEST PAPER 2 Q NO 1 B / ICAI ILLUSTRATION 2				
5	Q PAPER MAY 2018 OLD GROUP 2 Q NO 1				
6	Q Paper Nov 2018 Old Group 2 Q No 1 c / RTP MAY 20, QP NOV 20				
7	RTP NOV 19, RTP MAY 2018, IPCC RTP NOV 2016, IPCC RTP MAY 2018, RTP NOV 19, RTP MAY 2021, MTP March 2022 (Series 1), MTP Sep 2022 (Series 1)				
8	RTP NOV 20				
9	RTP MAY 21				
10	QP NOV 19				
11	QP NOV 19, QP NOV 20				
12	IPCC RTP Nov 2017 / MOCK TEST OCT 21 SERIES 2				
13	RTP NOV 21				
14	RTP NOV 21				
15	MOCK TEST OCT 21 SERIES 1				
16	ICAI PRACTICAL QUESTION 17				
17	RTP May 22				
18	MAY 2022 EXAM				
19	MTP April 2022 Series 2				
20	RTP NOV 22				
21	MTP OCT 22 (SERIES 2)				



Let's Get Started....With Class Work

I. ICAI ILLUSTRATION NO I

At the end of the financial year ending on 31st December, 20X1, 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)	50%	-
Lose (Low damages)	40%	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.

SOLUTION

REFERENCE:

According to AS 29 (Revised) '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 recognised 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 **not remote.**

(iv) The amount of the **obligation cannot be measured** with sufficient reliability to be recognised as provision.

ANALYSIS:

1. The probability of winning of first five cases is 100%. And hence, **Question** of providing for contingent loss **does not arise.**
2. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS-29, We make 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 remote, 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:
   A. Expected Loss in first five cases - NIL
   B. Expected loss in next ten cases = 40% of ₹ 1,20,000 + 10% of ₹ 2,00,000
   = ₹ 48,000 + ₹ 20,000 = ₹ 68,000
   C. Expected loss in remaining five cases = 30% of ₹ 1,00,000 + 20% of ₹ 2,10,000
   = ₹ 30,000 + ₹ 42,000 = ₹ 72,000

CONCLUSION:

Overall expected loss to be disclosed as **Contingent Liability ₹ 10,40,000** (₹ 68,000 x 10 + ₹ 72,000 x 5). Since to disclose contingent liability on the basis of maximum loss will be highly unrealistic.

2. RTP NOV 2018, RTP MAY 2019 Q20, IPCC RTP NOV 2018, IPCC RTP MAY 2019, MTP April 2022 Series 2

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? You are required to explain in brief giving reasons for your answer.

SOLUTION

FACTS:

A law suit has been filed against M/s. XYZ Ltd. for alleged infringement of Copyrights. The Directors are of the view that the claim can be successfully resisted by the Company.

REFERENCE:

As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a **provision should be recognized** when

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

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

c) a **reliable estimate** can be made of the **amount of the obligation.**

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

ANALYSIS:

The directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be **no outflow** of the resources. Hence, **no provision** is required.

CONCLUSION:

The company will **disclose the same as contingent liability** by way of the following note: "Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

3. MOCK TEST PAPER I Q NO I D, IPCC RTP MAY 2016

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

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

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

SOLUTION

FACTS:

Sun Ltd. and X Ltd. has entered into contract which will result in profit of 1 crore to Sun Ltd if goods are delivered in time. Sun Ltd. is required to pay 1.5crore in case of delay in delivery.

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Further AS 29 states that, **Provision should not be measured as the excess of compensation to be paid over the profit.**

(i) **ANALYSIS:** Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is **probable that Sun Ltd. will fail to deliver the goods** within the schedule and it is also possible to estimate the amount of compensation.

CONCLUSION: Sun Ltd. should provide for provision amounting **₹ 1.5 crores.**

(ii) **ANALYSIS:** The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. **The provision for loss can be recognized to the actual estimated value.**

CONCLUSION: Provision should be made for the full amount of compensation amounting **₹ 1.50 crores.**

4. MOCK TEST PAPER 2 Q NO 1 B / ICAI ILLUSTRATION 2

EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:

i) The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of Rs. 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

ii) The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 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, 20X2.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

(i) Since the company is **not appealing** against the addition of ₹ 0.66 crore, the same **should be provided** for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and also **disclosed as a contingent liability** of ₹ 2.10 crore.

(ii) The arrears for the period from **June, 20X1 to March, 20X2 are required** to be **provided** for in the accounts of the company for the year ended on 31st March, 20X2.

5. Q PAPER MAY 2018 OLD GROUP 2 Q NO 1

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.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

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

As at 31st March, 2017 = ₹ 80,000 x .02 + ₹ 50,000 x .03

= ₹ 1,600 + ₹ 1,500 = ₹ 3,100

As at 31st March, 2018 = ₹ 50,000 x .02 + ₹ 1,80,000 x .03

= ₹ 1,000 + ₹ 5,400 = ₹ 6,400

Amount debited to Profit and Loss Account for year ended 31st March, 2018

Particulars	₹
Balance of provision required as on 31.03.2018	6,400
Less: Opening Balance as on 1.4.2017	(3,100)
Amount debited to profit and loss account	3,300

Note: No provision will be made on 31st March, 2018 in respect of sales amounting ₹ 80,000 made on 19th January, 2016 as the warranty period of 2 years has already expired.

6. Q Paper Nov 2018 Old Group 2 Q No 1 c / RTP MAY 20, QP NOV 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) 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)

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

(i) ANALYSIS: The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus **an obligating event.** At the **balance sheet date, however, there is no obligation** to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is **probable**. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. **Ten percent of costs** that arise through the extraction of oil are **recognized as a liability when the oil is extracted.**

CONCLUSION: **Provision is recognized for the best estimate of ninety per cent** of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. **No provision** is required for the cost of extraction of oil at balance sheet date.

(ii) ANALYSIS: The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019. **At 31 March 2020, it is probable that an outflow of resources** embodying economic benefits will be required to settle the obligation as Brew Ltd goes into Liquidation. The **obligating event is the giving of the guarantee,** which gives rise to a legal obligation.

CONCLUSION:

A. **No provision** is required to be recognized as on **31st March 2019.** The guarantee is to be disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

B. **Provision is recognized** for the best estimate of the obligation as on **31st March 2020.**

7. RTP NOV 19, RTP MAY 2018, IPCC RTP NOV 2016, IPCC RTP MAY 2018, RTP NOV 19, RTP MAY 2021, MTP March 2022 (Series 1), MTP Sep 2022 (Series 1)

XYZ Ltd. has not made provision for warrantee in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warrantees on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

SOLUTION

FACTS:

XYZ Ltd. had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

REFERENCE:

1. AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a **present obligation,** as a result of past events, that probably requires an **outflow of resources** and a **reliable estimate** can be made of the amount of obligation, a provision should be recognised.
2. **Further,** it mentions, 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 as separate asset when, and only when, it is **virtually certain** that reimbursement will be received if the enterprise settles the obligation.
3. The amount recognised for the **reimbursement should not exceed the amount of the provision.**

ANALYSIS:

It is apparent that XYZ Ltd had not made provision for warranty in respect of certain goods considering that the they can claim the warranty cost from the original supplier. However, the **provision for warranty should have been made** as per AS 29 and the amount claimable as **reimbursement should be treated as a separate asset** in the financial statements of the company **rather than omitting the disclosure of such liability.**

CONCLUSION:

The accounting treatment adopted by XYZ Ltd. with respect to warranty is **not correct.**

8. RTP NOV 20

a) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

SOLUTION

A Contingent liability** is a **possible obligation** that arises from past events and the existence of which will 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

*A present obligation that arises from past events but is **not recognized because:***

(i) *It is **not probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or*

(ii) *A **reliable estimate** of the amount of the obligation **cannot be made.***

*An enterprise **should not recognize a contingent liability** but **should be disclosed.** A contingent liability is disclosed, **unless** the possibility of an outflow of resources embodying economic benefits is **remote.***

- ***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 one or more uncertain future events **not wholly within the control** of the enterprise.*
- *An enterprise **should not recognize a contingent asset,** since this may result in the recognition of income that may never be realized. However, when the realization of income is **virtually certain,** then the related asset is not a contingent asset anymore and its **recognition is appropriate.***
- *A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable.*
- *Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.*

b) Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement of provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized.

ANALYSIS:

Alpha Ltd. has the **obligation to deliver the goods** within the scheduled time as per the contract. It is **probable that Alpha Ltd. will fail** to deliver the goods within the schedule and it is also **possible to estimate the amount of compensation.**

CONCLUSION:

Alpha Ltd. should provide for the contingency amounting **₹ 2 crores.**

Note : As per AS 29, Provision should not be measured as the excess of compensation to be paid over the profit.

9. RTP MAY 21

Explain whether provision is required in the following situations in line with AS 29:

(i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;

(ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

(iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

A **contingent liability** is -

(a) a **possible obligation** that arises from past events and the existence of which will 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

(b) a **present obligation** that arises from past events but is **not recognised because:**

(i) it is **not probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) a **reliable estimate** of the amount of the obligation **cannot be made.**

Contingent Liability should be **disclosed unless remote.**

ANALYSIS:

i. **Provision is required to be recognized** when there is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation. **Disclosures are required** for the provision.

ii. There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources **–No provision is required** to be recognised for Contingent Liability. **Disclosures are required** for the contingent liability.

iii. There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – As the likelihood is remote, **no provision** is required to be recognised for the contingent liability. **No disclosure** is required.

10. QP NOV 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.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

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

As at 31st March, 2018 = ₹ 60,000 x .02 + ₹ 40,000 x .03

= ₹ 1,200 + ₹ 1,200 = ₹ 2,400

As at 31st March, 2019 = ₹ 40,000 x .02 + ₹ 1,35,000 x .03

= ₹ 800 + ₹ 4,050 = ₹ 4,850

Amount debited to Profit and Loss Account for year ended 31st March, 2019

	₹
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	(2,400)
Amount debited to profit and loss account	2,450

Note: No provision will be made on 31st March, 2019 in respect of sales amounting ₹ 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

11. QP NOV 19, QP NOV 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.

SOLUTION

1.

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. **15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.**

CONCLUSION:

Provision is recognized for the best estimate of 85% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. No provision is required for the cost of extraction of oil at balance sheet date.

2.

REFERENCE:

As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

ANALYSIS:

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring.

CONCLUSION:

As at the balance sheet date, no such expenditure has been incurred hence no provision is required.

12. IPCC RTP Nov 2017 / MOCK TEST OCT 21 SERIES 2

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.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

1. The cost of overhauling aircraft is **not recognized as a provision because it is a future obligation** and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts.
2. Even a **legal requirement to overhaul does not require the company to make a provision** for the cost of overhaul because there is no present obligation to overhaul the aircrafts.
3. An **obligation might arise to pay fines or penalties** under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime.

CONCLUSION:

No provision is required to be recognized for **overhaul of aircrafts.** A **provision should be recognized** for the best estimate of any **fines and penalties** if airline continues to operate aircrafts for more than five years.

13. RTP NOV 21

A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts.

You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

SOLUTION

FACTS:

NPO is charging 5% Contingency charges in it's invoice for unforeseen liabilities. The decision to levy 5% contingency charges was **based on assessment only as actual liability on this account cannot be estimated.**

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

It is clear that for the contingencies considered by the company, **neither a present obligation exists** because of past event, **nor a reliable estimate** can be made of the amount of the obligation.

CONCLUSION:

Provision cannot be recognized for such contingencies. The accounting treatment by the NPO is **incorrect.**

14. RTP NOV 21

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

SOLUTION

REFERENCE:

As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused, there may be no obligation to remedy the consequences. **The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified.**

ANALYSIS:

Where details of a proposed new law have yet to be finalised, an **obligation arises only when the legislation is virtually certain** to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated.

CONCLUSION:

The oil company **should provide for such clean-up cost** in the year in which the law is virtually certain to be enacted.

15. MOCK TEST OCT 21 SERIES 1

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

(i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of ₹ 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

(ii) The company had committed to supply a consignment worth ₹ 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a *compensation of 15% is to be paid on the value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth ₹ 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth ₹ 30 lakhs which was in transit.*

SOLUTION

(i)

REFERENCE:

As per AS 29, 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.** 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.

ANALYSIS:

In the given case, The company has appointed a lawyer to defend the case for a fee of Rs. 2 Lakhs. 50% of the fees has been paid and balance 50% will be paid after finalization of the case. There are 75% chances that the penalty may not be levied. In the given case, there are 75% chances that the penalty may not be levied.

CONCLUSION:

a. Saharsh Ltd. **should not make the provision** for penalty.
b. A **provision should be made for remaining 50% fees of the lawyer** in the financial statements of financial year 2019-2020.

(ii)

REFERENCE:

As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to **settle a provision is expected to be reimbursed by another party,** the reimbursement should be recognized 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 recognized for the **reimbursement should not exceed the amount of the provision.**

ANALYSIS:

In the given case, reimbursement became virtually certain since before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation.

Loss due to accident		₹ 30,00,000
Insurance claim receivable by company = ₹ 30,00,000 x 90%	=	₹ 27,00,000
Loss to be recognised in the books for 2019-2020		₹ 3,00,000
Insurance claim receivable to be recorded in the books		₹ 27,00,000

Compensation claim by dealer against company to be provided for in the books

= ₹ 30,00,000 x 15% = ₹ 4,50,000

Since, As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the value of delayed/lost consignment.

16. ICAI PRACTICAL QUESTION 17

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. With reference to AS-29, how would you deal with this in the annual accounts of the company at the Balance Sheet date?

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an **obligating event.** At the balance sheet date, however, there is **no obligation to rectify the damage** that will be caused by extraction of *the oil. An outflow of resources embodying economic benefits in settlement is* ***probable.*** *However, there is no obligation to rectify the damage that will be caused by extraction of oil,* ***as no oil has been extracted*** *at the balance sheet date. Ten percent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.*

CONCLUSION:

Provision is recognized for the best estimate of ninety percent *of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it.* ***No provision is required for the cost of extraction of oil*** *at balance sheet date.*

17. RTP May 22

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

a. Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.

b. A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

c. The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

SOLUTION

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

(i) an entity has a **present obligation** (legal or constructive) as a result of a past event;

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

(iii) a **reliable estimate** can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

i) **ANALYSIS:** On 31st March, 2020, it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation.

CONCLUSION: On 31st March,2020 **Provision should be recognised** for ₹ 3,00,000 for the amount which may be required to settle the obligation.

ii) **ANALYSIS:** Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e., at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations.

CONCLUSION: No provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.

iii) **ANALYSIS:** The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole.

CONCLUSION: Provision is recognized for the **best estimate** of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience = 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair / replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

Therefore, Provision should be recognised on 31st March,2020 for Rs. 50,000 for an amount equivalent to estimated cost of repair/ replacement.

18. MAY 2022 EXAM

Alloy Fabrication Limited is engaged in manufacturing of iron and steel roads. The company is in the process of finalisation of the account 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 for 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 a ₹ 50 Lakhs has been received. The company has appointed to defend the case for a fee of ₹ 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will paid after finalisations of the case. There are 70% chances that the penalty may not be levied.

SOLUTION

(i) **REFERENCE:** AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS: In the given case, there is **no present obligation but a future one,** therefore no provision is recognized as per AS 29. The cost of replacement of lining of furnace is not recognized as a provision because it is a future obligation. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

CONCLUSION: The treatment by company for **not recognizing of provision is correct.**

(ii) **REFERENCE:** As per AS 29, Provision is a liability which can be measured only by using a substantial degree of estimation. 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. 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.

ANALYSIS: In the given case, there are 70% chances that the penalty may not be levied. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

Also, The company has appointed to defend the case for a fee of Lakhs. 60% of the fees have been paid in advance and rest 40% will paid after finalization of the case.

CONCLUSION: Alloy Fabrication Ltd. **should not make the provision for penalty.** A provision should be made for **remaining 40% fees of the lawyer** amounting` 2,00,000 in the financial statements of financial year 2021-2022.

19. MTP April 2022 Series 2

What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?

SOLUTION

As per AS 29, Restructuring is a programme that is planned and controlled by management, and **materially changes** either:

(a) the **scope of a business** undertaken by an enterprise; or

(b) the **manner in which** that business **is conducted.**

Restructuring provision should include **only the direct expenditures** arising from the restructuring, which are those that are both:

(a) **necessarily** entailed by the restructuring; and

(b) **Not associated with the ongoing activities** of the enterprise.

A restructuring provision **does not include** such costs as:

(a)Retraining or relocating continuing staff;

(b) Marketing; or

(c) Investment in new systems and distribution networks.

20. RTP NOV 22

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

(i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries / provisions have been made in the books.

(ii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

SOLUTION

REFERENCE: Principles for recognition of provisions:

As per AS 29, A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) a reliable estimate can be made of the amount of the obligation.

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

Accounting treatment under the given scenarios:

(i) **ANALYSIS:** On 31st March, 2022 there is a present obligation. It is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000.

CONCLUSION: Provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.

(ii) **ANALYSIS:** Under new regulation, an entity is required to upgrade its facilities by 31st March, 2023. However, on 31st March, 2022, i.e., at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations.

CONCLUSION: No provision should be recognised on 31st March, 2022 for upgrading the facilities by 31st March, 2023.

21. MTP OCT 22 (SERIES 2)

A Company dealing in software provides after sales warranty for 2 years to its customer. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 3% provision

More than 1 year: 4% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2019	1,20,000
29th January, 2020	75,000
15th October, 2020	2,70,000

You are required to calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2020 and 31st March, 2021. Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2021.

SOLUTION

REFERENCE:

AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised.

ANALYSIS:

Provision to be made for warranty

As at 31st March, 2020 = ₹ 1,20,000 x .03 + ₹ 75,000 x .04

= ₹ 3,600 + ₹ 3,000 = ₹ 6,600

As at 31st March, 2021 = ₹ 75,000 x .03 + ₹ 2,70,000 x .04

= ₹ 2,250 + ₹ 10,800 = ₹ 13,050

Amount debited to Profit and Loss Account for year ended 31st March, 2021

	₹
Balance of provision required as on 31.03.2021	13,050
Less: Opening Balance as on 1.4.2020	(6,600)
Amount debited to profit and loss account	6,450

Note: No provision will be made on 31st March, 2021 in respect of sales amounting ₹ 1,20,000 made on 19th January, 2019 as the warranty period of 2 years has already expired.