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AS 11 The effects of changes in foreign exchange rates

Concept paper

DEFINITIONS

EXCHANGE RATE →
It is the ratio of exchange between two currencies
Eg → $1 = ₹65

REPORTING CURRENCY →
Reporting currency is the currency used in presenting the financial statements.

FOREIGN CURRENCY →
Foreign currency is a currency other than the reporting currency of an enterprise.

CLOSING RATE →
Closing rate is the exchange rate at the balance sheet date.

FORWARD EXCHANGE CONTRACT →
Forward exchange contract means an agreement to exchange different currencies at a forward rate.

EXCHANGE DIFFERENCE →
Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

MONETARY ITEMS →
Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

NON-MONETARY ITEMS →
Non-Monetary items are assets and liabilities other than monetary items.

Foreign Currency Transaction

A transaction denominated in foreign currency or that requires settlement in foreign currency.

INITIAL RECOGNITION

A 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.

Types of transaction	Initial Recognition	Subsequent recognitions at B/S Date	Recognition of difference
Monetary Transaction	Spot Rate	Closing Rate on B/S date	Exchange difference in P & L
Non-monetary transaction	-	-	-
Carried at historical cost	Spot Rate	Spot Rate (i.e rate on the date of transaction)	On exchange difference
Carried at fair value	Spot rate	Rate on the date of valuation	Valuation difference in P & L

Foreign Currency Operation

Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

Integral Foreign Operations

Integral Foreign operations is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.

Non-Integral Foreign Operations

Non-Integral Foreign operations is a foreign operation that is not an integral foreign operations

Translation of financial statement of Integral foreign operations

Integral Foreign Operations

- **Monetary items** → Closing rate
- **Non-Monetary items** → Carrying value measured at
  - Historical Cost → no need to remeasure.
  - Fair value or NRV → Rate on the date of valuation
- **P&L items** → Rate on date of transaction (OR) Average rate
- **Contingent liabilities** → Closing rate

Non-Integral Foreign Operations

- **Monetary & Non-Monetary Items** → Closing rate
- **P&L items** → Rate on date of transaction (OR) Average rate
- **Contingent liabilities** → Closing rate

Change in the classification of foreign Operation

Integral to Non-Integral

Accounting treatment

Exchange gain or loss from the date of reclassification should be transferred to FCTR.

Non Integral to Integral

Accounting treatment

Exchange gain or loss from the date of reclassification should be transferred to P&L statement & the balance in FCTR will continue in the balance sheet till the date of sale of foreign operation.

Forward Exchange Contract

A Forward contract is a customized contract between two parties to buy or sell an asset at a specified price on a future date.

NEED TO ENTER INTO FORWARD CONTRACTS?

1. For managing or minimising the foreign exchange fluctuation risks.
2. For trading or speculation purposes.

Forward contract meant for

Hedging

- The premium or discount arising at the inception of a forward exchange contract should be amortized as expense or income over the life of the contract.

Trading / Speculation

- If a forward exchange contract is intended for trading or speculation purpose, the premium or discount on the contract is ignored.
- At each balance sheet date the value of the contract is marked to the current market value and the gain or loss, so arising, is recognised.

Note for student...

AS 11 – THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

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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. To Foreign Loan Account	216,00,000	 216,00,000
Mar. 31, 2016	Foreign Exchange Difference Account Dr. To Foreign Loan Account [4,50,000 x(49-48)]	4,50,000	 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 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	

3. 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

AS 11

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.

4. 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.**

5. 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".

6. 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.

7. 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

8. 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.

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**

9. 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**

10. 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.

II. 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.

12. 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.**		

13. 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**		

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)

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. 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.

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 Government Grant

Government Grant 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 assitance 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.

RECOGNITION OF GOVERNMENT GRANT

Government grants available to the enterprise are considered for inclusion in accounts :—

i) where there is reasonable assurance that the enterprise will comply with conditions attached to them; and

ii) where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made.

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

NATURE OF INCENTIVE

Capital Approach → If incentive is in nature of Promoters contribution → CAPITAL SUBSIDY

Income Approach → If related to revenue → CREDITED TO P&L

Government Grant related to specific fixed Assets [depreciable assets]

Refer Question on page no. AS 12.4

OPTION 1

Should be presented in the balance sheet

Deduct from cost or carrying amount of Asset and charge depreciation on revised value of Asset.

Or

OPTION 2

Alternatively

Government Grant may be treated as Deferred Income which should be recognised in the statement of Profit and loss on the systematic and rational basis over the useful life of an asset.

Government Grant related to non-depreciable Asset

If a grant requires certain obligations to be fulfilled in the future periods then amortise over such period of fulfilling the obligations.

Or

If there is no such obligation to be fulfilled then transfer to Capital Reserve immediately.

Non Cash Grant [i.e in kind]

Received Free of cost

Recognize at Nominal Value

Received at Concessional Price

Recognize at Actual Acquisition cost

Government Grant related to Revenue.

When received :-
Treat liability until expenditure incurred if any.

When expenditure is made then :-
Either deduct from such expense or separately shown as other Income in P&L.

Government Grant of the nature of Promoter's contribution

should be credited to Capital Reserves and treated as a part of shareholders fund.

Contingencies related to Government Grant

should be treated in accordance with Accounting standard [AS] 4, Contingencies and Events Occurring After the Balance sheet Date.

Refund of Government Grant

to be shown as an extraordinary item as per AS-5

treatment

a) Any unamortised balance not yet charged to P&L shall be reversed.
b) Balance if any shall be transferred to P&L.
c) If Grant was earlier credited to Capital Reserve then Capital Reserve shall be reversed.

Question for Government Grant related to specific fixed assets (depreciable assets)

FACTS

Original Cost of an asset = 10,00,000 & Useful life of an asset = 10 years & Residual life of an asset = 7 Years

Date	Particulars	LF	Dr.	Cr.
	Alternative 1			
	Fixed Asset A/c Dr. To Cash / Bank A/c (Fixed Asset Acquired)		10,00,000	10,00,000
	Cash / Bank A/c Dr. To Fixed Asset (Government grant received)		1,00,000	1,00,000
	Depreciation A/c Dr.		90,000	
	To Fixed Asset A/c (Being depreciation charged for the 1st Year)			90,000
	DepreciationA/c Dr. To Fixed Asset A/c (Being depreciation charged for the 2nd year)		90,000	90,000
	DepreciationA/c Dr. To Fixed Assets A/c (Being Depreciation charged for the 3rd Year)		90,000	90,000
	REFUND OF GOVERNMENT GRANT			
	Fixed asset A/c Dr. To Cash / Bank (Being government grant refunded)		1,00,000	1,00,000
	Depreciation A/c To Fixed Asset WN → WDV = 6,30,000 + 1,00,000 7,30,000 7,30,000 / 7 Years = Rs. 1,04,285		1,04,285	1,04,285

Date	Particulars	LF	Dr.	Cr.
	Alternative 2			
	Fixed Asset A/c Dr. To Cash / Bank (Being the fixed asset acquired)		10,00,000	10,00,000
	Cash/ Bank A/c Dr. To deferred govt Grant (Being government grant received)		1,00,000	1,00,000
	Depreciation A/c Dr. To Fixed Assets (Being the depreciation charged for 1st year)		1,00,000	1,00,000
	Deferred Government Grant a/c Dr. To P & L A/c (Being proportionate government grant taken to P & L A/c)		10,000	10,000
	Depreciation A/c Dr. To Fixed Asset A/c (Being the depreciation charged for 1st year)		1,00,000	1,00,000
	Deferred Government Grant A/c To P & L A/c (Being proportionate government grant taken to P & L A/c)		10,000	10,000
	Depreciation A/c Dr. To Fixed Asset A/c (Being the depreciation charged for 1st Year)		1,00,000	1,00,000
	Deferred Government Grant A/c Dr. To P & L A/c (Being proportionate government grant taken to P & L A/c)		10,000	10,000
	REFUND OF GOVERNMENT GRANT			
	Deferred Government Grant A/c Dr. P & L A/c Dr. To Cash / Bank (Being grant refunded)		70,000 30,000	1,00,000
	Depreciation A/c Dr. To Fixed Asset		1,00,000	1,00,000

Note from student...

AS 12 – ACCOUNTING FOR GOVERNMENT GRANTS

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI - ILLUSTRATION 1						
2	ICAI - ILLUSTRATION 9						
3	INTER QP NOV 20						
4	QP JULY 21						
5	QP MAY 23						
6	ICAI - ILLUSTRATION 11						
7	ICAI - ILLUSTRATION 2						
8	ICAI - ILLUSTRATION 4						
9	ICAI - ILLUSTRATION 6						
10	INTER QP MAY 19						
11	INTER RTP NOV 2018						
12	INTER RTP MAY 2019						
13	INTER QP MAY 18 / OCT 20 MOCK TEST/ MTP MARCH 2022						
14	ICAI - ILLUSTRATION 8, RTP MAY 2015						
15	RTP NOV 2015						
16	RTP MAY 2017						
17	MTP APRIL 2022						
TEST IN TIME PASS IN TIME							
1	INTER QP JAN 21						
2	QP MAY 2022						

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.)
Ist	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. To Depreciation Account (Being Depreciation transferred to P/L Account)	7,00,000	7,00,000

2. 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. To Bank A/c (Being grant refunded)	16 lakhs	16 lakhs

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**

3. 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.

1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
1st 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	Dr.	60	
To Bank Account			60
Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	Dr.	19.337	
To Machinery Account			19.337
Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
Profit & Loss Account	Dr.	22.253	
To Depreciation Account			22.253

(Being depreciation transferred to Profit and Loss Account amounting to ₹ (2.916 + 19.337= 22.253)		

4. 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.

5. 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

6. 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	90 lakhs
	To Bank A/c		
	(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".**

7. 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.	50,00,000	
	To Bank Account			50,00,000
	(Being fixed assets purchased)			
	Bank Account	Dr.	10,00,000	
	To Deferred Government Grant Account (Being grant receive d from the government)			10,00,000
	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L Account)			
2nd	Depreciation Account	Dr.	9,00,000	
	To Fixed Assets Account			9,00,000
	(Being depreciation charged on SLM)			
	Profit & Loss Account	Dr.	9,00,000	
	To Depreciation Account			9,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grants Account	Dr.	2,00,000	
	To Profit & Loss Account			2,00,000
	(Being proportionate government grant taken to P/L Account)			

8. 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.**

9. 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. To Bank Account (Being government grant on asset refunded)		7,00,000	 7,00,000

10.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.**

11. 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.

12. 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.

13.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.

14. 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.

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	Dr.	25	
	To Bank Account			25
	(Being fixed asset purchased)			
	Bank Account	Dr.	10	
	To Fixed Asset Account			10
	(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.	6	
	To Bank Account			6
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.2)	Dr.	3.5	
	To Fixed Asset Account			3.5
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.5	
	To Depreciation Account			3.5
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. **Depreciation for Year 1**

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.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.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. 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.

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 Investment

Investments are assets held by an enterprise for earning income by way of dividends, interest and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not investments.

CLASSIFICATION OF INVESTMENT

CURRENT INVESTMENT
- Readily realisable
- Intended to be held for not more than 1 year

LONG TERM INVESTMENT

Investment other than current Investment

INVESTMENT PROPERTY

Investment in land or building that is not intended to be occupied for use in their operation

↓

Valued at cost as per AS-10

TYPES OF ACQUISITION	COST OF INVESTMENT
In cash / Bank	Cash price including charges such as brokerage, fees and duties.
By issue of shares / other securities	Fair value of securities issued
In exchange for another asset	Fair value of asset given up fair value of investment acquired, whichever is more clearly evident

Accounting for Interest accrued / dividend declared

- Pre-acquisition Period → Deducted from cost of Investment
- Post-acquisition Period → Recognised as an Income

COST OF INVESTMENT = PURCHASE PRICE + ACQUISITION CHARGE

brokerage, fees & duties payable.

CARRYING AMOUNT OF INVESTMENT

Valued at the Balance sheet date

Current Investment → Lower of cost or fair value

Long term Investment → Carried at cost → If permanent decline → then reduce carrying amount

Reclassification of Investment

Where long-term investment are reclassified as current Investment → Transfers are made at the lower of cost and carrying amount at the date of transfer.

Where investments are reclassified from current to long-term. → Transfers are made at the lower of cost and fair value at the date of transfer.

Disposal of Investments

On disposal of an investment → The difference between the carrying amount and the disposal proceeds, net of expenses is recognised in P&L A/c

When disposing of a part of the holding of an individual investment → The carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment.

ACCOUNTING TREATMENT

Right Share Issue

If

Subscribed

Cost to be added

Sold in market [not subscribed]

General Rule

Transfer sales proceeds to P&L A/c

Exception

Where the investment are acquired on Cum-right basis and 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.

Bonus Issue

No amount is entered in the capital column of investment A/c

Note for student...

AS 13 – ACCOUNTING FOR INVESTMENT

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	INTER QP MAY 19						
2	QP DEC 21						
3	ICAI ILLUSTRATION 6						
4	ICAI ILLUSTRATION 7						
5	ICAI ILLUSTRATION 8						
6	ICAI ILLUSTRATION 9						
7	ICAI P.Q. 10						
8	ICAI P.Q. 11						
9	ICAI P.Q. 12						
10	ICAI P.Q. 13						
11	ICAI P.Q. 14						
12	RTP NOV 2015						
TEST IN TIME PASS IN TIME							
1	ICAI P. Q. 1						
2	ICAI P. Q. 2						
3	ICAI P. Q. 3						

1. **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.**

2. 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.

3. 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.

4. 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.

5. 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

6. 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	To Bal b/d To Bank	25,000	3,75,000	31.10.20X1	By Bank (dividend	—	10,000

20.6.20X1		5,000	80,000				
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**

$(3,75,000 + 80,000 + 1,50,000 - 10,000) / 45,000 \times 20,000 =$ ₹2,64,444

Reference: The students are also advised to refer the full bare text of AS 13 (Revised) "Accounting for Investments".

7. ICAI P.Q.10

On 1st April, 20X1, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹ 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 year ended 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) x13,000 = ₹ 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

8. 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

9. 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) Less: Brokerage @ 1% Less: Cost of Debentures (1,18,000 / 1,20,000) x 20,000 = Profit on sale	20,000 (200) 19,800 (19,667)
	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

10. 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/d To Bank	30,000 5,000	4,50,000 80,000	31.10.20X1	By Bank (dividend on shares acquired 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.

11. 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**

12. 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**

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. ICAI Practical Question No 1

On 1st April, 2009, XY Ltd. has 15,000 equity shares of ABC Ltd. at a book value of ₹ 15 per share (face value ₹ 10 per share). On 1st June, 2009, XY Ltd. acquired 5,000 equity shares of ABC Ltd. for ₹ 1,00,000. ABC Ltd. announced a bonus and right issue.

(1) Bonus was declared, at the rate of one equity share for every five shares held, on 1 st July 2009.

(2) Right shares are to be issued to the existing shareholders on 1 st September 2009. The company will issue one right share for every 6 shares at 20% premium. No dividend was payable on these shares.

(3) Dividend for the year ended 31.3.2009 were declared by ABC Ltd. @ 20%, which was received by XY Ltd. on 31st October 2009.

XY Ltd.

(i) Took up half the right issue.

(ii) Sold the remaining rights for ₹ 8 per share.

(iii) Sold half of its share holdings on 1st January 2010 at ₹ 16.50 per share. Brokerage being 1%.

You are required to prepare Investment account of XY Ltd. for the year ended 31 st March 2010 assuming the shares are being valued at average cost.

2. ICAI Practical Question No 2

The following information is presented by Mr. Z (a stock broker), relating to his holding in 9% Central Government Bonds.

Opening balance (face value) ₹ 1,20,000, Cost ₹ 1,18,000 (Face value of each unit is ₹ 100).

1.3.2008 Purchased 200 units, ex-interest at ₹ 98.

1.7.2008 Sold 500 units, ex-interest out of original holding at ₹ 100.

1.10.2008 Purchased 150 units at ₹ 98, cum interest.

1.11.2008 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.

3. ICAI Practical Question No 3

Mr. Purohit furnishes the following details relating to his holding in 8% Debentures (₹ 100 each) of P Ltd., held as Current assets:

1.4.2009 Opening balance – Face value ₹ 1,20,000, Cost ₹ 1,18,000

1.7.2009 100 Debentures purchased ex-interest at ₹ 98

1.10.2009 Sold 200 Debentures ex-interest at ₹ 100

1.1.2010 Purchased 50 Debentures at ₹ 98 cum-interest

1.2.2010 Sold 200 Debentures ex-interest at ₹ 99

Due dates of interest are 30th September and 31st March.

Mr. Purohit closes his books on 31.3.2010. Brokerage at 1% is to be paid for each transaction. Show Investment account as it would appear in his books. Assume FIFO method.

Market value of 8% Debentures of P Limited on 31.3.2010 is ₹ 99.

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

Borrowing cost are interest and other costs incurred by an enterprise in connection with the borrowing of fund.

Borrowing cost may include :

- Interest and commitment charges
- Amortization discount / premium on loan
- Amortization of ancillary costs
- finance charges
- Exchange differences relating to foreign currency borrowings

QUALIFYING ASSET [QA]

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

[Substantial Period of time - generally 12 months, could be shorter or longer time]

Examples

- manufacturing plants
- Power generation facilities
- A tall bridge that usually takes more than a year to build.

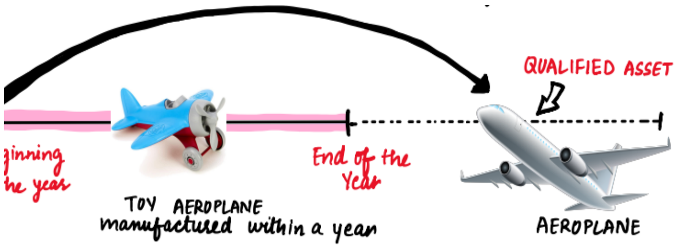
ELIGIBLE BORROWING COSTS

- 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 incurred.

EXPENDITURE ON A QUALIFYING ASSET INCLUDES

- Expenditure that has resulted in payment of cash.
- Transfer of other asset
- Assumption of interest bearing liabilities
- Previously Capitalised

It should be reduced by :-
- Any progress payment received
- Grant received in connection with asset.



COST TO BE WRITTEN OFF AS EXPENSE OF THE PERIOD

- All cost other than eligible borrowing costs
- Costs incurred for assets other than qualifying assets.

TESTS FOR RECOGNITION OF BORROWING COSTS

(i) Will the qualifying asset [in which borrowing cost will be capitalised] result in future economic benefits to the enterprise.

(ii) Can we reliably measure costs to be capitalised.

AMOUNT TO BE CAPITALISED

when funds borrowed specifically

The amount of borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

when funds borrowed generally

Step 1 → Compute Capitalisation Rate

$$= \frac{\text{Borrowing Cost on General Borrowing}}{\text{Weighted Average of General Borrowing outstanding during the period}} \times 100$$

Step 2 → Amount eligible for capitalisation

= *Expenditure incurred on qualifying asset X Capitlisation*

Maximum borrowing cost to be Capital

Capitalisation not to exceed Borrowing Cost incurred during that period.

QUESTION

- Advise X Limited on the Weighted Average cost of Borrowing and the interest cost to be capitalized based on the following:
- Total Borrowings and interest costs of X Limited for year ending 31st March 2005 are as follows:

Date	Loan	Amount	Interest
1-04-2004	18% Bank Loan	1000	180
1-10-2004	14% Debentures	2000	140
1-07-2004	16% Term Loan	3000	360
	Total	6000	680

Qualifying assets in which these borrowed funds are utilized are:

Asset	Rs '000	Period
Factory Shed	2500	12 Months
Plant 1	1500	9 Months
Plant 2	1000	7 Months

Write down of the asset value

COMMENCEMENT OF CAPITALISATION

The capitalisation of borrowing cost as part of the cost of a qualifying asset should commence when all the following conditions are satisfied

- Expenditure for the acquisition, construction or production of a qualifying asset is being incurred;
- Borrowing cost are being incurred; and
- Activities that are necessary to prepare the asset for its intended use or sale are in progress

SUSPENSION OF CAPITALISATION

should be suspended during the extended periods in which active development is interrupted

↓

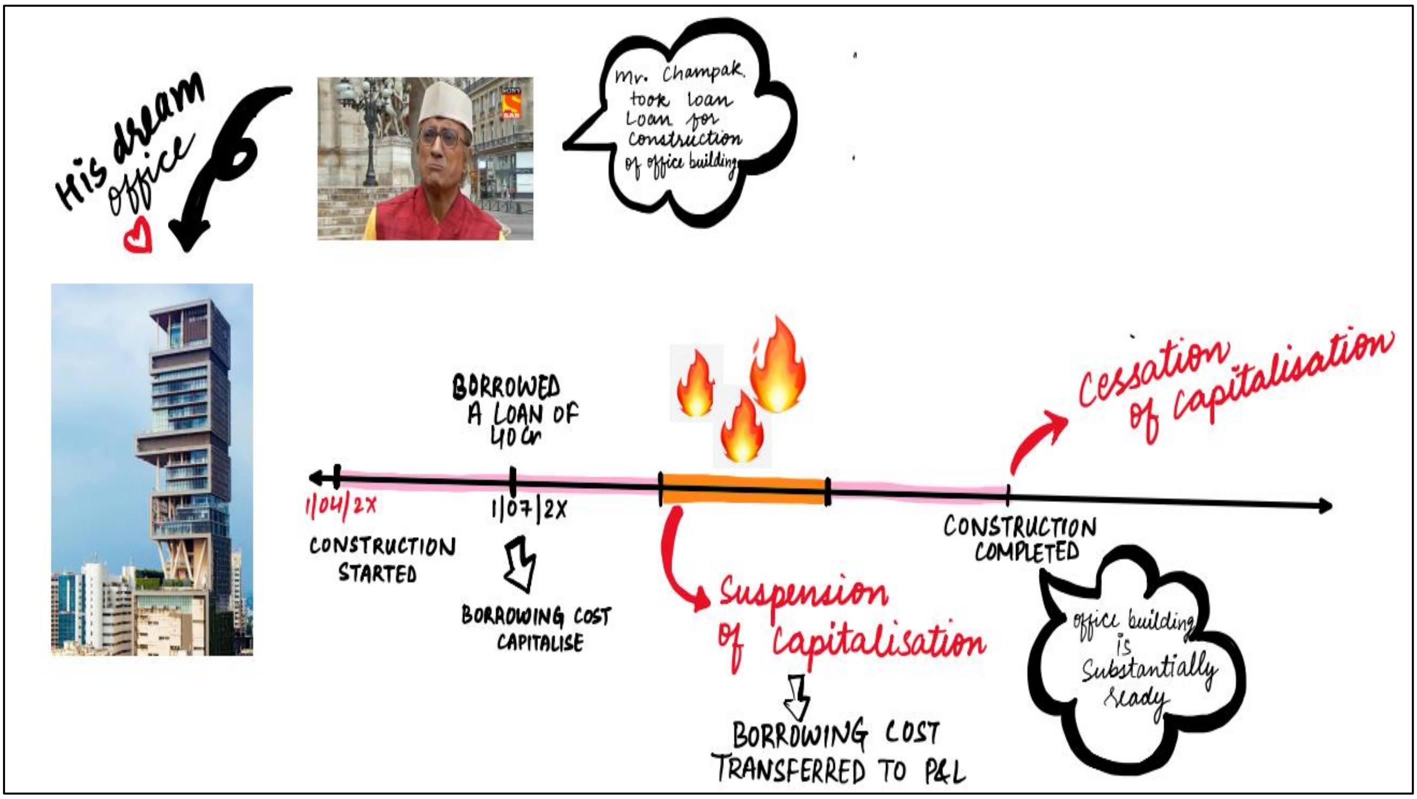
Capitalisation may continue subject to principle of prudence

↓

Capitalisation is not suspended during the period when there is a temporary delay which is necessary for getting the asset ready.

CESSATION OF CAPITALISATION

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.



Exchange difference on foreign currency borrowings

Exchange gain → Credited to P&L

Exchange loss → lower of the following treated as part of borrowing cost
- Actual exchange loss
- Difference between interest on local currency borrowings and interest on foreign currency borrowings.

QUESTION

Vidya Ltd. took a loan of USD 20,000 at 6% p.a. on 1st April, for a specific capital expansion project. The interest was payable annually. The exchange rate at the date of the loan was 1 USD = Rs.45.00. However, the Company could have taken a corresponding Rupee Loan from Banks at 12% p.a. on that date. At the end of the year, the exchange rate was 1 USD = Rs.48.00. How will you treat the Borrowing Costs and exchange differences in the above case.

Analyse the impact of the following changes independently. What would be the accounting treatment if the Rupee Loan were to carry interest at 14% p.a.. What will be the treatment if the exchange rate at the end of the year were 1 USD = Rs.46.00

SOLUTION

Particulars	Situation 1 Interest at 12%	Situation 2 Interest at 14%	Situation 3 1 USD = Rs.46.00
1. Interest on Local Currency Borrowings.	\$20,000 x Rs.45 x 12% = Rs.1,08,000	\$20,000 x Rs.45 x 14% = Rs.1,26,000	\$20,000 x Rs.45 x 12% = Rs.1,08,000
2. Interest on Foreign Currency Borrowings	\$20,000 x 6% x Rs.48 = Rs.57,600	\$20,000 x 6% x Rs.48 = Rs.57,600	\$20,000 x 6% x Rs.46 = Rs.55,200
3. Interest Difference between Foreign & Local Currency Borrowings = (1) – (2)	Rs.50,400	Rs.68,400	Rs.52,800
4. Exchange Difference in Principal repayable at the end of the year	\$20,000 x (48 – 45) = Rs.60,000	\$20,000 x (48 – 45) = Rs.60,000	\$20,000 x (46 – 45) = Rs.20,000

5. Further Amt to be treated as Borrowing Costs = (3) or (4), whichever is **less**.	Rs.50,400	Rs.60,000	Rs.20,000
6. Exchange Difference to be taken to P&L Account as per AS – 11 = (4) – (5)	Rs.9,600	Nil	Nil
7. Borrowing Costs under AS – 16 = (2)+(5)	**Rs.1,08,000**	**Rs.1,17,600**	**Rs.75,200**

Note for student...

AS 16 – BORROWING COSTS

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ILLUSTRATION 1 (ICAI)						
2	ILLUSTRATION 2 (ICAI)						
3	ILLU. 5 RTP MAY 13 SIMILAR Q. – MAY 16 – 5 MARKS & ICAI – P.Q. 11						
4	MOCK TEST OCT 21 SERIES 2						
5	QP MAY 2023						
6	ICAI P. Q. 11						
7	INTER QP NOV 20						
8	QP MAY 22						
9	INTER RTP MAY 2019						
TEST IN TIME PASS IN TIME							
1	INTER QP MAY 19						
2	IPCC QP MAY 18						

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 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.

4. 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.**

5. 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 45/200	1,68,750	-
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

6. 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**

7. 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.

8. 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:

Ist April, 2021	10,00,000 x 12/12	10,00,000
Ist August, 2021	10,00,000 x 12/12 14,00,000 x 8/12	10,00,000 9,33,333
Ist 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

9. 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.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. 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%.

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.
   b) ₹ 5,000.
   c) ₹ 7,000.
   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.
   b) 19th June, 20X1.
   c) 18th July, 20X1.
   d) 2nd June, 20X1

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

AS 17 Segment Reporting

Segment

Distinguishable component of an enterprise could be

Business Segment

Geographical Segment

[based on location of customers and location of assets.]

A business segment [it is a segment based on products and services it provides] is a component of an enterprise which satisfies the following conditions :–

(i) It is a distinguishable component of an enterprise.

(ii) It is engaged in providing an individual product or service or a group of related products or services and

(iii) It is subject to risks & returns that are different from those of other business segments.

A Geographical segment [it is the area or location in which products and services are manufactured or marketed] is a component of an enterprise, which satisfies the following conditions :–

(i) It is a distinguishable component of an enterprise.

(ii) It is engaged in providing product or services within a particular economic environment and

(iii) It is subject to risks and returns that are different from those of components operating in other economic environment

REPORTABLE SEGMENT

are either business segment or geographical segment for which segment information is required to be disclosed by this standard [AS-17]

To be reportable if any one or more conditions applicable
- Revenue atleast 10%
- Profit or loss atleast 10%.
- Segment Assets atleast 10%.

Those which are not reportable segment as per above criteria are either included as reportable segment at discretion of the management or included in unallocated reconciling items

Total Revenue attributed less than 75% or more of the total enterprise revenue [external revenue] otherwise further segment will be added to reportable segments.

TO BE REPORTED IN

Primary & Secondary reporting format

Business Segment Primary & Geographic secondary when there are:
- *Difference in products & services that enterprise produces, or*
- *There are difference in products & services as well as geographic location*

Geographic segment primary & business segment secondary when there are: Difference in geographical location [of assets or customers]

IMPORTANT POINTS

SEGMENT REVENUE

Includes

1. Directly attributable Revenue
2. Allocable revenue from enterprise common revenue
3. Inter Segment Revenue

Excludes

1. Extraordinary items
2. Interest & Dividend [unless financing Business]
3. Gain on sale of investment.

SEGMENT EXPENSE

Includes

1. Directly attributable Expense
2. Allocable expense from enterprise common expense
3. Inter Segment expense

Excludes

1. Extraordinary items
2. Interest [unless financing Business]
3. Loss on sale of investment.
4. Income tax expense
5. General Enterprise expense

SEGMENT ASSET

Operating asset

Directly Attributable + Reasonably attributable

Includes

- Interest & Dividend income

Exclude

- Income tax assets :- Assets used for general enterprise or head office purposes

SEGMENT LIABILITIES

Operating liabilities

Directly Attributable + Reasonably attributable

Includes

- Interest Expense

Exclude

- Income tax liabilities :- borrowings and other liabilities that are incurred for financing rather than operating purposes.

Note for student...

AS 17 – SEGMENT REPORTING

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ILLUSTRATION 1						
2	ILLUSTRATION 4						
3	QP May 18						
4	QP JAN 21						
5	May 22 Exam (Similar to ICAI – P.Q.10)						
6	QP MAY 23						
7	May 22 RTP						
TEST IN TIME PASS IN TIME							
1	QP NOV 2019 (Group 1)						
2	QP NOV 20						

1. 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 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 ₹ ('000)	Bright Bar Division ₹ ('000)	Fitting Division ₹ ('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

3. 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:

Its segment **assets** are **10% or more of the total assets** of all segments.

ANALYSIS:

Segment assets do not include income tax assets.

Calculation of revised total assets: (in Crores)

Particulars	Segment P	Segment Q	Segment R	Total
Value of Assets	4.00	6.00	5.00	15.00
Deferred Tax Asset	1.00	0.90	0.80	2.7
Revised value of Assets	3.00	5.1	4.2	12.3

CONCLUSION:

Thus, all the three segments hold **more than 10% of the total assets**, **all segments** are reportable segments. The **contention of the accountant** that all three segments are reportable segments is **correct.**

4. 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:

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 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.**

5. May 2022 Exam (Similar to ICAI – P.Q.10)

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.

6. QP MAY 23

The Accountant of X. Ltd. provides the following data regarding its five segment.

	A	B	C	D	E	(₹ in Crore)
Segment Assets	50	20	15	10	5	100
Segment Results	(85)	10	10	(15)	5	(75)
Segment Revenue	250	50	40	60	30	430

The account is of the opinion that segment 'A' along should be reported.

Is he justified in his view? Example his in the light of provisions of AS – 17 Segment Reporting.

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:

On the basis of **revenue criteria, segments A, B and D** are reportable segments.

On the basis of the **result criteria, segments A, B, C and D** are reportable segments (since their results in absolute amount are 10% or more of ₹100 crore).

On the basis of **asset criteria, all** segments **except E** are reportable segments.

Since all the segments except E are covered in at least one of the above criteria. Hence, all segments except E have to be reported upon in accordance with Accounting Standard (AS) 17.

CONCLUSION:

Hence, the **opinion of chief accountant** that only segment A alone should be reported, is **wrong** as all segments are reportable except E.

7. 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.***

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Test In Time...Pass In Time

1. QP NOV 2019 (Group I)

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'.

2. 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.

MCQs

1. As per AS 17, reportable segments are those whose total revenue from external sales and inter-segment sales is
   a) 10% or more of the total revenue of all segments
   b) 10% or more of the total revenue of all external segments
   c) 12% or more of the total revenue of all segments
   d) 12% or more of the total revenue of all external segments

2. Which of the following statements is correct?
   a) Management has a discretion to include a segment as a reportable segment even if it passes the 10% materiality test.
   b) Management has a discretion to include any segment as a reportable segment if it fails the 12% materiality test.
   c) It is mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.
   d) It is not mandatory for the management to include the segment as a reportable segment if it passes the 10% materiality test.

3. Which of the following statements is correct?
   a) The overall test of 75% considers only external revenue to compute the threshold limit.
   b) The overall test of 75% considers only internal revenue to compute the threshold limit.
   c) The overall test of 75% considers both internal and external revenue to compute the threshold limit.
   d) It is management choice whether they want to include both external and internal revenue for computing threshold limit.

4. Which of the following statements is correct?
   a) The 10% test computed on the basis of revenue, considers both internal and external revenue to compute the threshold limit.
   b) The 10% test computed on the basis of revenue, considers only external revenue to compute the threshold limit.
   c) The 10% test computed on the basis of revenue, considers only internal revenue to compute the threshold limit.
   d) It is management choice whether they want to include both external and internal revenue for computing threshold limit.

5. Which of the following statements is correct?
   a) In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or net loss respectively of all segments taken together becomes reportable segment.
   b) In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit (after netting the losses) of all segments taken together becomes reportable segment.
   c) In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or loss (whichever is higher in absolute figures) of all segments taken together becomes reportable segment.
   d) In case of 10% test based on profit/loss, we need to consider that any segment whose profit or loss is 10% or more than the net profit or loss (whichever is lower in absolute figures) of all segments taken together becomes reportable segment.

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

AS 18

Related party disclosure

AS-18 Deals with

Related Party relations and Transactions between reporting enterprise & its related parties.

This statement deals only with Related Party Relationships described in (A) to [E] below:—

a) Enterprises that directly, or indirectly through one or more intermediaries, controls, or are controlled by, or are under common control with, the reporting enterprise this includes holding companies, subsidiaries and fellow subsidiaries;
b) Associate 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 venture;
c) Individuals owning, directly or indirectly, an interest in voting power of the reporting enterprise that govern them controls or significant influence over the enterprise, and relatives of any such individual;
d) Key management personnel and relatives of such personnel; and.
e) Enterprises over which any person described in (c) or (d) is able to excercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

In Context of this statement, the following are deemed not to be Related Parties :-

a) Two companies simply because they have a director in common, notwithstanding paragraph 1(d) or (e) above [unless the director is able to affect the policies of both companies in mutual dealings];

b) 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; and.

c) The parties listed below, the course of their normal dealing with an enterprise by virtue only of those dealings [although they may circumscribe the freedom of action of the enterprise or participate in its decision - making process];

(i) Providers of finance;
(ii) Trade unions;
(iii) Public utilities;
(iv) Government departments and government agencies including government sponsored bodies.

DISCLOSURES

- *Related party disclosures requirement as laid down in this statement do not apply in circumstances where providing such disclosures would conflict with the reporting enterprises duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.*
- *No disclosure is required in consolidated financial statements in respect of intra group transactions.*
- *No disclosure is required in the financial statements of state controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.*
- *No disclosure is required in the financial statements of state controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.*
- ***If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:***
  i. the name of the transacting related party;
  ii. a description of the relationship between the parties;
  iii. a description of the nature of transactions;
  iv. volume of the transactions either as an amount or as an appropriate proportion;
  v. any other elements of the related party transactions necessary for an understanding of the financial statements;

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

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

- **The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:**

  a) Purchases or sales of goods (finished or unfinished);
  b) Purchases or sales of fixed assets;
  c) Rendering or receiving of services;
  d) Agency arrangements;
  e) Leasing or hire purchase arrangements;
  f) Transfer of research and development;
  g) Licence agreements;
  h) Finance (including loans and equity contributions in cash or in kind);
  i) Guarantees and collaterals; and
  j) Management contracts including for deputation of employees.

Note for student...

AS 18 – RELATED PARTY DISCLOSURES

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 1						
2	QP JULY 21						
3	ICAI PRACTICAL Q 7						
4	QP MAY 23						
5	RTP MAY 21						
TEST IN TIME PASS IN TIME							
1	ICAI Q PAPER NOV 2018						
2	QP MAY 19						

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, 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.**

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.

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. 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.

3. 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.

4. QP MAY 23

Answer the following with respect to AS-18:

(i) ABC Ltd. sold goods of ₹ 2,00,000 to its associate company for the 1st quarter ending 30.06.2022. After that the relined party relationship ceased to exist. However, goods were supplied so any other ordinary customer. Decide whether transactions of the entire year have to be disclosed as related party transaction.

(ii) If the majority of directors of Arjun Ltd. constitute the majority of the Board of another Company Bheem Ltd. in their individual capacity as professionals (and not by virtue of their being Directors in Arjun Ltd.). Are both the companies related?

(iii) Asha Ltd. Sell all the manufactured furniture of ₹ 1,00,00,000 to Sasha Ltd. As per agreement. Sasha Ltd. Is the only customer to Asha Ltd. In the financial statement, Asha Ltd. Wants to present sasha company as a related party. Comment on the disclosure requirement.

SOLUTION:

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 and CONCLUSION:

(i) Transactions of ABC Ltd. with its associate company for the first quarter ending 30.06.2022 only are required to be disclosed as related party transactions as the company has the **ability to exercise significant influence** only till 30.6.2022.

The transactions for the period in which related party relationship did **not exist need not be reported.**

(ii) In the given case, Arjun Ltd. cannot be said to control the composition of board of directors of Bheem Ltd. as the directors have been appointed in their individual capacity as professionals and not by virtue of their being directors in Arjun Ltd.

Hence, it **cannot be concluded** that the companies are related merely because the **majority of the directors** of one company **became the majority** of the directors of the second in their individual capacity as professionals.

(iii) In the context of AS 18, a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a **significant volume of business cannot be construed as Related Party Relationship** merely by **virtue of the resulting economic dependence**. There is an economic dependence between the companies but no one controls or exercise significant influence on the other.

In the given case, Asha Ltd. need **not report** Sasha Company as its related party in its financial statements.

5. 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 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:

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.

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Test In Time...Pass In Time

1. 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.

2. 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.

MCQs

1. According to AS-18 Related Party Disclosures, which ONE of the following is not a related party of Skyline Limited?
   a) A shareholder of Skyline Limited owning 30% of the ordinary share capital
   b) An entity providing banking facilities to Skyline Limited in the normal course of business
   c) An associate of Skyline Limited
   d) Key management personnel of Skyline Limited

2. Are the following statements in relation to related parties true or false, according to AS-18 Related Party Disclosures?

(A) A party is related to another entity that it is jointly controlled by.
(B) A party is related to another entity that it controls.

Statement (A)	Statement (B)
a) False	False
b) False	True
c) True	False
d) True	True

3. Which of the following is not a related party as envisaged by AS-18 Related Party Disclosures?
   a) A director of the entity
   b) The parent company of the entity
   c) A shareholder of the entity that holds 1% stake in the entity
   d) The spouse of the managing director of the entity

4. According to AS-18 Related Party Disclosures, related party transaction is a transfer of resources or obligations between related parties – provided a price is charged for such transfer.
   a) True b) False

5. According to AS-18 Related Party Disclosures, parties are considered to be related, if and only if at the end of 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.
   a) True b) False

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

AS 19

Accounting for Leases

A lease is an agreement whereby the lessor conveys to lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

FINANCE LEASE

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

SITUATIONS

a) Ownership of the asset transferred to the lessee by the end of the lease term.

b) The lease has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value.

c) The lease term is for the major part of the lease.

d) The present value of minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

e) The leased asset is of specialised nature such that only the lessee can use it.

OPERATING LEASE

An operating lease is a lease other than a finance lease

SITUATIONS

a) Similar to hiring arrangements

b) leasing of general asset

c) lease may not be over a long period.

d) Ownership of the asset is not transferred.

Minimum lease Payment [MLP]

For lessor

MLP = lease Rent + Guaranteed Residual value by lessee & Independent third party + Option price

For lessee

MLP = lease rental over the lease term + Guaranteed Residual value or option price by lessee.

For lessor

Gross Investment in the lease is aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor & any unguaranteed residual value accruing to the lessor.

> Gross Investment in the lease = Minimum lease payment + Unguaranteed residual value.

Unearned finance income is difference between –

a) The gross investment in the lease
b) The present value of

- The 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 = Gross Investment - Present Value of Gross [at implicit int. rate]

Interest Rate Implicit in the lease [IRR] is the discount rate that, at the inception of the lease, causes the aggregate present value of

a) The minimum lease payments under a finance lease from the standpoint of the lessor; and
b) Any unguaranteed residual value accruing to the lessor to be equal to the fair value of the leased asset.

It is IRR from lessor's point of view.

> Net Investment in the lease = Gross Investment – unearned finance Income

For lessee

> Gross investment in the lease in case of lessee is NOT APPLICABLE.

> Unearned finance income in case of lessee is NOT APPLICABLE

= Gross Investment [Gross Investment – present value (at implicit interest rate] of gross investment].

= Present value [at implicit rate] of gross investment.

Rate of Interest

Is the rate of interest the lessee would have to pay on similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term and with a similar security, the funds necessary to purchase the assets.

ACCOUNTING TREATMENT

FINANCE LEASE

LESSOR

1. Lease Receivable A/c To Asset A/c To Profit A/c [Net Investment] Net Investment = Present Value of Gross Investment Present Value of Gross Investment = Minimum Lease Payment + Unguaranteed Residual Value Unguaranteed Residual Value = Expected Residual Value of Assets - Guaranteed Residual Value [Some more complications can be there]	Dr.
2. No Entry [as asset is treated as sold]	
At the end of each year	
3. Lease Receivable A/c To Interest A/c [Unwinding of interest]	Dr.
Receipt of Installment	
4. Bank A/c To Lease Receivable A/c [With actual lease payment]	Dr.
5. Interest A/c To Profit & Loss A/c [Interest rate = Implicit in the lease]	Dr.

LESSEE

1. Asset A/c To Lessor A/c [Fair value or present value of minimum lease payment whichever is lower]	Dr.
2. Depreciation A/c To Asset A/c	Dr.
3. Interest A/c To Lessor [Interest Due]	Dr.
4. Lessor A/c To Cash / Bank A/c [Interest Paid]	Dr.
5. Profit/Loss A/c To Depreciation A/c To Interest A/c [Interest Rate = Interest rate implicit in lease, Incremental borrowing rate]	Dr.

BALANCE SHEET

LESSOR

Presentation in books of lessor	
Non Current Assets	
Other Current Assets	
Lease Receivables A/c	XXX
[At Net Investment]	

LESSEE

Name of the Company……		
Balance Sheet as at….		
Particulars	**Amt**	**Amt**
A. Equities & Liabilities		
Non Current Liabilities		
Long Term Borrowings [Lessor]		
		XXX
B. Assets		
Non Current Assets		
PPE & Intangible Assets		
PPE on Lease	XXX	
(-) Depreciation	XXX	XXX

OPERATING LEASE

LESSOR

1. Cash/ Bank A/c To Lease Rent [SLM / Systematic pattern of user's benefit)	Dr.
2. Depreciation A/c To Asset	Dr.

LESSEE

Lease Rent A/c To Cash/ Bank A/c [SLM / Systematic pattern of user's benefit]	Dr.

	Books of lessor	**Books of lessee**
Assets	Continues to appear in his books	Asset does not appear in the books
Depreciation	Charged	Not Charged
Impairment	Charged	Not Charged
Lease Rent	Income recognised on SLM	Expense recognised on SLM

Sale and lease back transactions

FINANCE LEASE

Defer any excess or deficiency of sale proceeds over carrying amount & amortise it over lease term in proportion of depreciation on leased asset

OPERATING LEASE

Sale Price = Fair value

Recognise profit or loss immediately

Sale Price > Fair value

Defer excess over fair value & amortise it over a period for which asset is expected to be used.

Sale Price < Fair value

- If loss is compensated by future lease payments at below market price then defer it & amortise in proportion to lease payments over expected period of use.
- Else, recognised it

Note for student...

AS 19 – ACCOUNTING FOR LEASES

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI Illustration 1						
2	ICAI ILLUSTRATION 2						
3	ICAI Example						
4	ICAI PRACTICAL Q 4 (Similar to ICAI P.Q.10)						
5	ICAI P. Q. 16 (Similar to ICAI P.Q.11)						
6	MTP 2 (Q No 1 d), IPCC RTP Nov 2018 Q19a (Similar to ICAI P.Q.12)						
7	RTP Nov 2015/ (Nov 2004) Nov 2012						
8	(RTP Nov, 2012)						
9	MTP SEP 22 Series 1						
TEST IN TIME PASS IN TIME							
1	QP NOV 19						
2	QP JAN 21 (Similar to ICAI ILLU.3) / ICAI PQ14						

1. **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

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 **lease liability should be recognised at ₹ 18,55,850 as per AS 19.**

2. 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 1st year to 5th 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.

3. 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.

$$\text{Total lease rent} = 120\% \text{ of } Rs.5 \text{ Lakhs} \times \frac{\text{Output During lease period}}{\text{Total Output}}$$

$$6 \text{ Lakhs} \times \frac{60{,}000 \text{ Units}}{1{,}25{,}000 \text{ Units}} = Rs.2.88 \text{ Lakhs}$$

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.

4. ICAI PRACTICAL Q 4 (Similar to ICAI P.Q.10)

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** 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):

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.**

5. ICAI PRACTICAL QUESTION 16 (Similar to ICAI P.Q.11)

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.**

6. Mock Test Paper 2 (Q No 1 d), IPCC RTP Nov 2018 Q19a (Similar to ICAI P.Q.12)

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% + 7020/39695 x (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**

7. (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

REFERENCE:

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

<u>REFERENCE:</u>

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.	1,72,582	
To Machinery account			1,72,582
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr	4,31,455	
To Depreciation account			1,72582
To Finance charges account			2,58,873
(Being the depreciation and finance charges transferred to profit and loss account)			

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

8. (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, 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

(iii) **minimum lease** payments from the stand point of the lessor and

(iv) 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:

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 of 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.)

9. 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, 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:

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 ₹	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

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**

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. **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.

2. **QP JAN 21 (Similar to ICAI ILLU.3) / ICAI PQ14**

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.

MCQs

1. A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs (Fair value ₹ 50 lakhs) and same machinery was leased back by B Ltd. to A Ltd. The lease back is in nature of operating lease. The treatment will be
   a) A Ltd. should amortise the profit of ₹ 10 lakhs over lease term.
   b) A Ltd. should recognise the profit of ₹ 10 lakhs immediately.
   c) A Ltd. should defer the profit of ₹ 10 lakhs.
   d) B Ltd. should recognise the profit of ₹ 10 lakhs immediately.

2. In case of an operating lease – identify which statement is correct:
   a) The lessor continues to show the leased asset in its books of accounts.
   b) The lessor de-recognises the asset from its Balance Sheet.
   c) The lessor discontinues to claim depreciation in its books.
   d) The lessee recognises the asset in its Balance Sheet.

3. In case of finance lease, if the asset is returned back to the lessor at the end of the lease term - the lessee always claims depreciation based on which of the following:
   a) Useful life.
   b) Lease term.
   c) Useful life or lease term whichever is less.
   d) Useful life or lease term whichever is higher.

4. AS 19 lays down 5 deterministic conditions to classify the lease as a finance lease. To classify the lease as an operating lease – which statement is correct?
   a) Any 1 condition fails.
   b) Majority of the 5 conditions fail.
   c) All 5 conditions fail.
   d) Any 2 conditions fails.

5. The basis of classification of a lease is:
   a) Control Test.
   b) Risk and reward Test.
   c) Both control test and risk and reward test.
   d) Only reward Test

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

AS 20 Earning per share

- Earning per share is a measure of performance of the company.
- This AS requires the entity to calculate and present the EPS on the face of statement of profit & loss for current and previous year.

Formula for calculating B-EPS

$$= \frac{\text{Net profit or loss attributable to Equity shareholders}}{\text{Weighted average number of Equity shares outstanding during the year.}}$$

Calculation of Net profit or loss attributable to Equity shareholders

	Net profit or loss for the period	xxx
less →	Preference dividend	[xxx]

Preference dividend:

- Amount of Preference dividend on Non-Cumulative preference shares provided for the year.
- Full amount related to cumulative preference shares irrespective whether declared or not

less →	Tax on preference dividend	[xxx]
	Net profit attributable to the equity shareholders	xxx

Calculation of weighted average number of equity shares outstanding during the period

	Equity outstanding at the beginning of the year	xxx
Add	Equity shares issued during the year * $\frac{\text{days/month}}{365 / 12 \text{ month}}$	xxx
less	Equity shares bought back * $\frac{\text{days/month}}{365 / 12 \text{ month}}$	(xxx)
		xxx

Special Cases for calculation of weighted average number of Equity shares outstanding during the period

a) Partly paid up shares

Multiply no. of Equity shares × $\frac{\text{Partly Paid up value}}{\text{Issue price}}$

Example → Opening on 01/04/22 = 100,000 shares of ₹10 fully paid
On 01/10/22 = 10,000 shares of ₹10, ₹8 paid up.

Solution $= 100{,}000 \times \frac{12}{12} + 10{,}000 \times \frac{8}{10} \times \frac{6}{12}$

$= 100{,}000 + 4000$

$= 104{,}000$

(b) Bonus shares / Bonus element in Right issue / share split / Reverse share

Here equity shares are issued to existing shareholders for no additional consideration.
Shares are included in weighted average from the beginning of reporting period.
It also impacts the calculation of EPS of previous years retrospectively

c) Right shares
In case of Right issue, shares are issued to existing shareholders at a price below current market price. Therefore, Right issue normally has an element of bonus.

Calculate therotical Ex-right Fair value per share

$$= \frac{\text{Fair value of the share prior to right} + \text{amount received from excercise of right}}{\text{No. of shares outstanding prior to right issue} + \text{Shares issued on exercise of right.}}$$

Calculation of Adjusting Factor.

$$= \frac{\text{Fair value per share immediately prior to exercise of Rights}}{\text{Theoretical Ex-right fair value per share}}$$

Shares to be restated for Right issue

= No. of shares outstanding prior to issue * Adjustment Factor.

DILUTED EARNING PER SHARE

Reduction in Basic EPS calculated on the assumption that potential shares are issued

Example :- convertible debentures, convertible Preference shares, ESOP etc

Formula

$$= \frac{\text{Earning attributable to Equity shareholders} + \text{Adjustment in Earning due to Potential Equity Shares}}{\text{Weighted average equity shares} + \text{Adjustment in shares due to Potential Equity shares.}}$$

- If it is less than Basic EPS
  - ↓
  - Dilutive
- If it is more than Basic EPS
  - ↓
  - Anti-Dilutive
  - ↓
  - The effect of the same is to be ignored while calculating Dilutive EPS.

Special Case in dilutive EPS

a) Diluted EPS in case of share options

Calculation of Element of Potential Equity Shares

$$\Rightarrow \text{Option Issued} - \left[\text{Option Issued} \times \frac{\text{Exercise Price}}{\text{Fair Value}}\right]$$

Note → In this case no effect would be given in earnings [Numerator]

b) More than one potential Equity shares

Note

1. **Concept Question**

XYZ Ltd. has 10,00,000 Equity Shares outstanding and the net profit attributable to these shares is Rs. 35,00,000. The average fair value of the share during the year is Rs. 75. The company had issued the following potential equity shares :

a. 1,00,000 10% Preference Shares of Rs. 100 each to be converted into 2 Equity Shares.
b. Options to subscribe 2,50,000 Equity shares at Rs. 60 each
c. 2,00,000 12% Convertible Debentures of Rs. 100 each to be converted into 3 shares.

Find out the Basic EPS and Diluted EPS given that the Corporate Dividend Tax is 10% and the income tax applicable to the company is 30%.

SOLUTION:

Increase in earnings available to equity share holders on conversion of Potential Equity Shares.

Particulars	Increase in Earnings	Increase in No. of Equity shares	EPS incremental	Rank
10% Preference shares (1,00,000 x 100) x 10% + 10,00,000 x 10%				
Options [2,50,000 – (2,50,000 x 60/75)]				
12% Convertible Debentures [(2,00,000 x 100) x 12%] – 30%				

Calculation of Diluted EPS

Particulars	Net profit	No. of Equity shares	EPS (Rs.)	Remarks
Net Profit as Reported				
Option				
12% Convertible Debentures				
10% Pref. shares				

RESTATEMENT

If the number of equity or potential equity shares outstanding

Increases as a result of a bonus issue or share split

OR

Decreases as a result of a reverse share split (consolidation of shares)

The calculation of basic and diluted earnings per share should be adjusted for all the periods presented.

If these changes **occur after the balance sheet** date **but before** the date on which the financial statements are **approved by the board of directors**

The per share calculations for those financial statements and any prior period financial statements presented **should be based on the new number of shares.**

An enterprise is encouraged to provide **a description of equity share transactions or potential equity share transactions,** other than bonus issues, share splits and reverse share splits (consolidation of shares) **which occur after the balance sheet date** when they are of such importance that **non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.**

EXAMPLES OF SUCH TRANSACTIONS INCLUDE:

(a) the issue of shares for cash;

(b) the issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;

(c) the cancellation of equity shares outstanding at the balance sheet date;

(d) the conversion or exercise of potential equity shares, outstanding at the balance sheet date, into equity shares;

(e) the issue of warrants, options or convertible securities; and

(f) the satisfaction of conditions that would result in the issue of contingently issuable shares.

Note: Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements. Although they may be of such significance that they **may require a disclosure** in the **report of the approving authority** to enable users of financial statements to make proper evaluations and decisions.

Note for student...

AS 20

AS 20 – EARNING PER SHARE

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	QP MAY 18 / ICAI P Q 14						
2	QP NOV 18						
3	NOV 2015, NOV 2004						
4	QP DEC 21						
5	QP IPCC-II NOV, 2009						
6	QP NOV, 09 (NEW)						
7	QP NOV 19						
8	EXAM NOV 22						
9	Concept Question 1						
10	Concept Question 2						
11	Concept Question 3						
12	Concept Question 4						
13	Concept Question 5						
14	Concept Question 6						
15	Concept Question 7						
16	Concept Question 8						
17	Concept Question 9						
18	Concept Question 10						
19	Concept Question 11						
20	Concept Question 12						
21	Concept Question 13						
22	Concept Question 14						
23	Concept Question 15						
24	Concept Question 16						
TEST IN TIME PASS IN TIME							
1	MAY 2022 EXAM						
2	QP MAY 2013						

1. 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)

$$= \frac{\textit{Profit for the current year}}{\textit{Weighted average number of shares outstanding}}$$

= 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

2. 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

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.

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

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

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

$$\text{Diluted EPS} = \frac{\textit{Adjusted net profit for the current year}}{\textit{Weighted average no of Equity shares}}$$

= 2,54,20,000 / 54,00,000 = ₹ 4.71 (Approx.)

3. 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.)

1. **WORKING NOTES:**
2. Computation of theoretical ex-rights fair value per share

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

$$= \frac{(Rs.25 \times 10{,}00{,}000\ shares) + (Rs.20 \times 2{,}50{,}000\ shares)}{10{,}00{,}000\ shares + 2{,}50{,}000\ shares}$$

$$= \frac{\text{Rs. } 3{,}00{,}00{,}000}{12{,}50{,}000 \text{ shares}} = \text{Rs. } 24$$

3. Computation of adjustment factor

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

$$= \frac{\text{Rs. } 25}{\text{Rs. } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

4. **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.

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

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

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

5. 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	No. of equity shares	Period O/S	Weighted average no. of equity shares
1.4.2008	1500	12	1500 x 12/12 = 1500
1.8.2008	600	8	600 x 8/12 = 400
31.3.2009	500	0	(500 x 0/12 = 0)

Total weighted average equity shares	1900

Weighted Average Number of Equity Shares outstanding during the period = 1,900 Shares

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

$= \frac{Rs.2,75,000}{1,900\ shares} = Rs. 144.74$

6. 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 2008	5,00,000 shares
Average fair value of one equity share during the year 2008	Rs.20
Weighted average number of share under option during the year 2008	1,00,000 shares
Exercise price per share under option during the year	Rs.15

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.

7. 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

8. 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= $\frac{\text{Profit for the current year}}{\text{Weighted average number of shares outstanding}}$	2.40
Number of shares under option	6,00,000 Shares
Number of shares that would have been 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.

9. Concept Question 1

Calculate Weighted Average Number of Equity Shares

Date	Particulars	No. of shares Issued	No. of shares bought back	No. of shares outstanding
01.04.14	Opening bal.	10,000		
30.06.14	Issue Cash	5,000		
01.01.15	Buy back	-	1,000	
31.03.15	Closing bal.	15,000	1,000	

10. Concept Question 2

Calculate Weighted Average Number of Equity Shares- Partly Paid Shares

Date	Particulars	No. of shares Issued	Face value per share	Paid up value per share
01.04.14	Opening balance	10,000	Rs. 10	Rs. 10
30.06.14	Issue cash	5,000	Rs.10	Rs. 5

11. Concept Question 3

The equity share are of two types:

A. Voting equity shares 3000 shares of Rs 100 each;

B. Non-voting equity shares 2000 shares of Rs100 each entitled for dividend at 50% more than on 'A' type share.

Net profit attributable to equity shareholders- Rs. 1,40,000.

Calculate EPS for both classes of shares.

12. Concept Question 4

Compute EPS from the given information relating to equity shares of A Ltd. and B Ltd. Two companies amalgamated w.e.f. 1.10.2023. A Ltd. issued the required no. of shares on the basis of the agreed valuation.

NO. OF OUTSTANDING EQUITY SHARES AS ON 1.4.2023	A Ltd.	B Ltd.
(NO. IN LAKHS)	500	200
Agreed value per share for acquisition	120	30
Date of acquisition 1.10.2023		
Profit after tax (Rs. in lakhs) of which	1200	350
Profit after tax of B Ltd. during 1.10.2023 – 31.3.2024 (Rs. in lakhs)		200

13. Concept Question 5

Compute EPS: Bonus Shares

Net profit 2013-14	
Net profit 2014-15	
No. of equity shares till 31.12. 2014	
Bonus issue as on 1.1. 2015	

EPS 2013-14 (Restated)	
EPS 2014-15	

14. Concept Question 6

ABC Ltd. has 10,000 equity shares outstanding on 1-1-14. Find out the weighted average number of equity shares for the year 2014, for the purpose of calculation of Basic EPS in each of the following cases :

a. The company issued 2,000 equity shares for cash on 1-1-14
b. The company issued 2,000 equity shares for cash on 1-4-14
c. The company issued 2,000 equity shares for cash on 1-10-14
d. The company issued 2,000 equity shares for cash, 50% paid up, on 1-10-14
e. The company issued 2,000 equity shares as Bonus shares on 1-4-14
f. The company issued 2,000 equity shares for cash on 1-7-14 and 3,000 Bonus shares on 1-10-14.

SOLUTION:

Weighted Average Number of equity shares.

a) 10,000 + 2,000 = 12,000 shares

b) Weighted Average No. of equity shares = 10,000 + 2,000 x 9/12
= 11,500 shares

c) Weighted Average No. of equity shares = 10,000 + 2,000 x3/12
= 10,500

d) Weighted Average No. of equity shares = 10,000 + (2,000 x 50%) x 3/12
= 10,250 shares

e) Weighted Average No. of equity shares = 10,000 + 2,000

AS 20

	= 12,000 shares
f) Weighted Average No. of equity shares	= 10,000 + 3,000 + 2,000 x 6/12
	= 14,000 shares

15. Concept Question 7

Find out the Basic EPS for the year 2014 from the following particulars :

Shares outstanding on 1-1-14	5,00,000
Issue of shares for cash on 1-7-14, fully paid up	1,70,000
Bonus shares on 1-4-14 in the ratio	1:2
Profit for the year	15,00,000

SOLUTION:

Particulars	Rs.
Profit for the year	15,00,000
No. of shares at the end of the year	
Shares as on 1.1.14	5,00,000
Bonus shares 5,00,000/2	2,50,000
Issue of shares for cash 1,70,000 x 6/12	85,000
	8,35,000

$$EPS = \frac{Profit\ for\ the\ year}{Weight\ Average\ No.of\ Shares\ outstanding}$$

$$EPS = \frac{15,00,000}{8,35,000}$$

$$EPS = 1.80$$

16. Concept Question 8

Calculate Basic EPS for the year from the following information :

No. of Equity Shares in the beginning	6,00,000
12% Preference Share Capital in the beginning	15,00,000
10% Debentures	20,00,000

Fresh issue of shares at the end of 3rd month	1,20,000
Profit for the year (after tax)	21,00,000

SOLUTION:

Calculation of EPS

	Particulars		Rs.
A	Profit for the year (after tax)		
	Less : Preference dividend	15,00,000 x 12%	
	Profit available to equity shareholders		
B	No. of equity shares in the beginning		
	Add: Fresh issue of shares at the end of 3rd month	1,20,000 x 9/12	
C	EPS A/B		

17. Concept Question 9

Calculate Basic EPS from the following :

Net Profit before tax for the year	Rs. 15,00,000
Number of shares outstanding on Jan. 1	1,00,000
10% Preference Share Capital	Rs. 5,00,000
Issue of Bonus Shares to Equity Shareholders on (Oct. 1)	50,000
Fresh issue of equity shares fully paid on Nov. 1	60,000
Buy-back of Equity shares on Dec. 1 (Number)	12,000
Tax rate	30%

Note: Calendar year has been adopted as financial year by the company.

SOLUTION :

Calculation of EPS :

	Particulars	Rs.
A	Net profit before tax	
	Less : Tax @ 30%	
	Profit after tax	
	Less : Preference dividend	
	10% x 5,00,000	
	Profit available to equity shareholders	
B	No. of equity shares on 1st January	
	Issue of Bonus shares	
	Issue of equity shares 60,000 x 2/12	
	Less : Buy back of equity shares	
	12,000 x 1/12	
C	EPS A/B	

18. Concept Question 10

PQR Ltd. has 5,00,000 shares outstanding in the beginning of the year. The fair value of the share was Rs. 45. It issued Right shares in the ratio of 2 : 5 @ Rs. 36 per shares midway during the year. Find out the Basic EPS for the year given that the company earned a net profit of Rs. 25,00,000 for the year.

SOLUTION :

$$\textbf{Theoretical ex} - \textbf{right price}$$

$$= \frac{F.V.of\ existing\ shares\ +\ amount\ realized\ on\ right\ shares}{Total\ no\ of\ shares}$$

$$Theoretical\ ex - right\ price\ = \frac{5,00,000\ x\ 45\ +\ 2,00,000\ x\ 36}{5,00,000\ +\ 2,00,000}$$

$$Theoretical\ ex - right\ price\ = 42.43$$

$$Adjustment\ Factor = \frac{F.V.}{Theoretical\ ex - right\ price}$$

$$Adjustment\ Factor = \frac{45}{42.43}$$

$$Adjustment\ Factor = 1.06$$

$$Basic\ EPS = \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{25,00,000}{\left(5,00,000\ X\ 1.06\ X\ \frac{6}{12}\right) + \left(7,00,000\ X\ \frac{6}{12}\right)}$$

$$Basic\ EPS = \frac{25,00,000}{6,15,000}$$

$$Basic\ EPS = 4.06$$

19. Concept Question II

R Ltd. has 100,000 equity shares outstanding in the beginning of the year. After 3 months, it issued Right shares in the ratio of 1 : 5 @ Rs.20 per share. The fair value of shares before Right issue was Rs.30 per share. Net profit for the current year is Rs.18,00,000 and for the previous year was Rs.14,00,000. Find out the Basic EPS for the current year and restate Basic EPS for the previous year.

SOLUTION:

$$Theoretical\ ex - right\ price = \frac{F.V.of\ existing\ shares\ +\ amount\ realized\ on\ right\ shares}{Total\ no\ of\ shares}$$

$$Theoretical\ ex - right\ price = \frac{30\ X\ 1,00,000 + 20\ X\ 20,000}{1,00,000 + 20,000}$$

$$Theoretical\ ex - right\ price = \frac{34,00,000}{1,20,000}$$

$$Theoretical\ ex - right\ price = 28.33$$

$$Adjustment\ Factor = \frac{F.V.}{Theoretical\ ex - right\ price}$$

$$Adjustment\ Factor = \frac{30}{28.33}$$

$$Adjustment\ Factor = 1.06$$

$$Basic\ EPS = \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{18,00,000}{\left(1,00,000\ X\ 1.06\ X \frac{3}{12}\right) + (1,20,000\ X \frac{9}{12})}$$

$$Basic\ EPS = \frac{18,00,000}{1,16,500}$$

$$Basic\ EPS = 15.45$$

$$Previous\ Year\ Basic\ EPS = \frac{14,00,000}{1,00,000\ X\ 1.06}$$

$$Previous\ Year\ Basic\ EPS = 13.21$$

20. Concept Question 12

Convertible Debentures – Diluted / Ant diluted EPS

S.NO.	PARTICULARS	SITUATION 1	SITUATION 2
A	Net profit for 2014-15 (Rs) No. of equity shares outstanding	7,50,000 1,50,000	7,50,000 1,50,000
B	Basic EPS		
C	No. of 10% convertible debentures of Rs.100 each		
D	Conversion ratio		
E	No. of equity shares on conversion		
F	Interest expenses		
G	Income Tax relating to interest @ 35%		
H	Adjusted net profit for the year		
I	Total No. of equity Shares		
J	Revised EPS		
K	Effect		
L	Reported EPS 2014 - 15 Basic EPS Diluted EPS (Rs)		

21. Concept Question 13

Vidya Ltd. provides the following information for the year :

No. of shares outstanding	5,00,000
Net Profit for the year (after tax)	Rs. 11,00,000

The company had 1,00,000 15% Debentures of Rs. 100 each. These debentures are compulsorily convertible into 4 equity shares per debenture. Find out the Basic EPS and Diluted EPS given that the tax rate is 35%.

SOLUTION:

$$Basic\ EPS = \frac{Net\ Profit}{Weighted\ average\ no\ of\ shares}$$

$$Basic\ EPS = \frac{11,00,000}{5,00,000}$$

$$Basic\ EPS = 2.2$$

Calculation of Diluted EPS

Saving in debenture interest	= (1,00,000 x 100) x 15%
	= 15,00,000
Loss of Tax shield on interest	= 15,00,000 x 35%
	= 5,25,000
Effective profit	= 11,00,000 + 15,00,000 – 5,25,000
	= 20,75,000

$$Diluted\ EPS = \frac{20,75,000}{5,00,000 + (1,00,000\ X\ 4)}$$

$$Basic\ EPS = 2.31$$

In the given problem the potential equity shares are anti-dilutive as the diluted EPS i.e. 2.31 is more than the basic EPS i.e. Rs. 2.20. The company should not disclose anti-dilutive EPS. Therefore, Company will disclose 2.20 as basic as well as diluted EPS.

22. Concept Question 14

Vidya Ltd. has given option to its employees to subscribe 1,00,000 Equity Shares @ Rs. 15 within a period of one year. At present, the fair value of the share is Rs. 25. The company has 5,00,000 Equity Shares outstanding and the net profit for the current year is Rs. 16,00,000. Find out the Basic EPS and the Diluted EPS for the year.

SOLUTION: BASIC EPS

	Rs
Net Profit	
Weighted average no of shares	
EPS	

Calculation of diluted EPS

No of shares issued without consideration

A	No. of shares to be issued under option	1,00,000
B	No. of shares that would have been issued at FV 1,00,000x15/25	60,000
C	Shares issued without consideration	40,000

$$\textbf{Diluted EPS} = \frac{16{,}00{,}000}{5{,}40{,}000}$$

$$\textbf{Diluted EPS} = 2.96$$

23. Concept Question 15

XYZ Ltd. has 10,00,000 Equity Shares outstanding and the net profit attributable to these shares is Rs. 35,00,000. The average fair value of the share during the year is Rs. 75. The company had issued the following potential equity shares :

a. 1,00,000 10% Preference Shares of Rs. 100 each to be converted into 2 Equity Shares.
b. Options to subscribe 2,50,000 Equity shares at Rs. 60 each
c. 2,00,000 12% Convertible Debentures of Rs. 100 each to be converted into 3 shares.

Find out the Basic EPS and Diluted EPS given that the Corporate Dividend Tax is 10% and the income tax applicable to the company is 30%.

SOLUTION:

Increase in earnings available to equity share holders on conversion of Potential Equity Shares.

Particulars	Increase in Earnings	Increase in No. of Equity shares	EPS incremental	Rank
10% Preference shares (1,00,000 x 100) x 10% + 10,00,000 x 10%				
Options [2,50,000 – (2,50,000 x 60/75)]				
12% Convertible Debentures [(2,00,000 x 100) x 12%] – 30%				

Calculation of Diluted EPS

Particulars	Net profit	No. of Equity shares	EPS (Rs.)	Remarks
Net Profit as Reported				
Option				
12% Convertible Debentures				
10% Pref. shares				

24. Concept Question 16

From the Books of A Ltd., following information's are available as on 1.4.2001 and 1.4.2002 :

1. Equity shares of Rs. 10 each outstanding 1,00,000
2. Partly paid Equity shares of Rs. 10 each Rs. 5 paid 1,00,000
3. Options outstanding at an exercise price of Rs. 60 for one equity Shares Rs. 10 each. Average Fair value of equity share during both Years Rs. 75. - 10,000

AS 20

4. 10% convertible preference shares of Rs. 100 each Conversion ratio 2 equity shares for each preference share - 80,000
5. 12% convertible debentures of Rs. 100 conversion ratio 4 equity shares for each debenture - 10,000
6. 10% dividend tax is payable for the years ending 31.3.2003 and years ending 31.3.2002.
7. On 1.10.2002 the partly paid shares were fully paid up.
8. On 1.1.2003 the company issued 1 bonus share for 8 shares held on that date.

Net profit attributable to the equity shareholders for the years ending 31/3/2003 and 31/3/2002 were Rs. 10,00,000.

Calculate :

a. Earnings per share years ending 31.3.2003 and 31.3.2002.
b. Diluted earnings per share years ending 31/3/2003 and 31/3/2002.
c. Adjusted earnings per share and diluted EPS for the year ending 31/3/2002, assuming the same information for previous year, also assume that partly paid shares are eligible for proportionate dividend only.
d. Tax Rate = 30%

SOLUTION:

Calculation of Basic EPS for the year ended 31.3.2002 **Rs.**

A. Net profit

B. Weighted Avg. no. of shares (1,00,000 + 1,00,000 x 5/10)

C. Basic EPS

Calculation of Basic EPS for the year ended 31.3.03 **Rs.**

A. Net profit for the year

Weighted Avg. no. of shares

1,00,000 + [1,00,000 x 5/10 x 6/12 + 1,00,000 x 6/12 + 1/8 x 2,00,000]

Basic EPS

Diluted EPS

Increase in earnings attributable to equity shareholders on conversion of Potential Equity Shares.

	Increase in Earning	Increase in No. of Equity shares	EPS (Incremental)	Rank
Option				
10% convertible preference shares				
12% Convertible Debenture				

Calculation of Diluted EPS

Particulars	Net profit attributable to equity shares	Year ending 31.3.2003		Year ending 31.3.02	
		No. of shares	Net profit per share	No. of shares	Net profit per share
Net Profit as reportable					
Option					
12% Debentures					
10% Pref. shares					

Diluted EPS for year ending 31.3.2003 =

Diluted EPS for year ending 31.3.2002 =

Restated Basic EPS Rs.

a) Net Profit

b) No. of shares [1,50,000 + 25,000 (Bonus shares)]

Re-stated Basic EPS

Re-stated diluted EPS for the year ending 31.3.2002

Particulars	Net Profit Attributable to Equity share holder	No. of shares	EPS Rs.
Net Profit as Reported			
Option			
12% Convertible Debenture			
10% Preference shares			

Diluted EPS (Restated) for the year ending 31.3.2002 = Rs.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. **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?

2. **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.

MCQs

1. AB Company Ltd. had 1,00,000 shares of common stock outstanding on January 1. Additional 50,000 shares were issued on July 1, and 25,000 shares were reacquired on September 1. The weighted average number of shares outstanding during the year on Dec. 31 is
   a) 1,40,000 shares
   b) 1,25,000 shares
   c) 1,16,667 shares
   d) 1,20,000 shares

2. As per AS 20, potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would
   a) Decrease net profit per share from continuing ordinary operations.
   b) Increase net profit per share from continuing ordinary operations.
   c) Make no change in net profit per share from continuing ordinary operations.
   d) Decrease net loss per share from continuing ordinary operations.

3. As per AS 20, equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements are
   a) Dilutive potential equity shares
   b) Contingently issuable shares
   c) Contractual issued shares
   d) Potential equity shares

4. In case potential equity shares have been cancelled during the year, they should be:
   a) Ignored for computation of Diluted EPS.
   b) Considered from the beginning of the year till the date they are cancelled.
   c) The company needs to make an accounting policy and can follow the treatment in (a) or (b) as it decides.
   d) Considered for computation of diluted EPS only if the impact of such potential equity shares would be material.

5. Partly paid up equity shares are:
   a) Always considered as a part of Basic EPS.
   b) Always considered as a part of Diluted EPS.
   c) Depending upon the entitlement of dividend to the shareholder, it will be considered as a part of Basic or Diluted EPS as the case may be.
   d) Considered as part of Basic/ Diluted EPS depending on the accounting policy of the company.

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

AS 22

Accounting for taxes on income

Objective

- To bring matching between accounting income to be reported and tax expense to be charged.
- Recognizing tax expenses in profit and loss A/c

Difference between taxable income and accounting income

Timing difference

The difference between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

For example

- Penalty paid for infringement of law
- Donations disallowed as per section 80G of the Income Tax Act.
- Tax holiday profits.
- Taxable income based on presumptive taxable sec 44 AD.

Permanent difference

The difference between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

For example

- Expenditure mentioned in section 43 B
- Difference in method / rate of depreciation
- Amortisation of preliminary expenses 35 AD
- Carry forward of loss
- Expenses incurred for amalgamation
- Provision for doubtful debts.
- Voluntary retirement compensation
- Municipal taxes on House Property.

Note – Permanent differences do not result in deferred assets or deferred tax liabilities

Creation of DTA or DTL

DTA

Accounting Income < Taxable income

or

Accounting expenditure > Taxable expenditure

Timing difference × Rate of tax

Accounting Income > Taxable Income

or

Accounting expenditure < Taxable expenditure

Timing difference × Rate of tax

JOURNAL

Create Deferred tax Asset [DTA]

Deferred tax Asset [DTA] A/c Dr.
To Tax Expense A/c

JOURNAL

Create Deferred Tax liability [DTL]

Tax Expense A/c Dr.
To Deferred tax liability [DTL] A/c

Reversal of Deferred tax Asset [DTA]

Tax Expense A/c Dr.
To Deferred tax Asset [DTA] A/c

Note → For recognising DTA, consideration of prudence is important. There must be reasonable certainity of future taxable income against which such DTA can be realised.

Reversal of Deferred Tax liability [DTL]

Deferred tax liability [DTL] A/c Dr.
To Tax Expense A/c

DTA / DTL should be measured using substative enacted tax rate. Current tax is measured using tax rate applicable for the relevant previous year. Deferred tax assets and liabilities should not be discounted to their present value.

Special Cases

a) Cases of b/f loss or unabsorbed depreciation

Deferred tax assets in case of B/f loss or unabsorbed depreciation is recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax can realised

b) Situations of MAT paying entities

- A tax is required to be pay current tax on higher of following amount:
  - ✓ Tax calculated on taxable income using normal tax rate
  - ✓ Tax calculated on book profit using MAT rate
- DTA/DTL on timing difference should be created using tax rate and not MAT rate

DTA shall be reviewed at every balance sheet date to check reasonable certanity or virtual certanity.

DISCLOSURES

- Distinguish DTA & DTL from current tax assets & liabilities
- DTA & DTL under a separate heading in balance sheet
- Break up of DTA & DTL into major components in notes to accounts
- If DTA relating to unabsorbed depreciation & c/f of losses recognised, nature of supporting evidence

ITC Enduring Value

Statement of Profit and Loss for the year ended 31st March, 2015

	Note	For the year ended 31st March, 2015 (₹ in Crores)	For the year ended 31st March, 2014 (₹ in Crores)
Gross Income	19	**51932.14**	**48175.80**
Gross Revenue from sale of products and services	20	49964.82	46712.62
Less: Excise Duty		13881.61	13830.06
Net Revenue from sale of products and services		36083.21	32882.56
Other operating revenue		424.19	356.04
Revenue from operations	21	36507.40	33238.60
Other income	22	1543.13	1107.14
Total Revenue		**38050.53**	**34345.74**
Expenses			
Cost of materials consumed	23	10987.83	10263.28
Purchases of Stock-in-Trade	24	3898.66	3021.47
Changes in inventories of finished goods, Work-in-progress, Stock-in-Trade and Intermediates	25	(214.53)	(128.41)
Employee benefits expense	26	1780.04	1608.37
Finance costs	27	57.42	2.95
Depreciation and amortisation expense		961.74	899.92
Other expenses	28	6581.85	6019.05
Total Expenses		**24053.01**	**21686.63**
Profit before tax		**13997.52**	**12659.11**
Tax expense:			
Current tax	29	4020.99	3791.13
Deferred tax	30	368.80	82.77
Profit for the year		**9607.73**	**8785.21**
Earnings per share (Face Value ₹ 1.00 each)	31 (i)		
Basic		₹ 12.05	₹ 11.09
Diluted		₹ 11.93	₹ 10.96

The accompanying notes 1 to 34 are an integral part of the Financial Statements.

In terms of our report attached
For Deloitte Haskins & Sells
Chartered Accountants

SHYAMAK R TATA
Partner

Kolkata, 22nd May, 2015

On behalf of the Board

K. N. GRANT *Director* Y. C. DEVESHWAR *Chairman*

R. TANDON *Chief Financial Officer* B. B. CHATTERJEE *Company Secretary*

Note for student...

AS 22 – ACCOUNTING FOR TAXES ON INCOME

QUESTIONS							
No.	QUESTIONS	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI ILLUSTRATION 2						
2	ICAI ILLUSTRATION 3						
3	QP MAY 18 (GROUP 1)						
4	QP NOV 20						
5	ICAI PRACTICAL Q 8						
6	ICAI – P.Q.9						
7	RTP NOV 2018						
TEST IN TIME PASS IN TIME							
1	QP JAN 21						
2	QP MAY 2019 (Group 1), RTP NOV 20						

1. 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)			

2. 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) Less: Current Tax (20,000X40%)	(2,00,000)	1,00,000	1,20,000 (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

3. 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.

4. 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

5. 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).

6. ICAI – P.Q.9

ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	**Amount of investment (₹ in Crores)**
Oscar Limited	2
Zee Limited	3
Star Limited	4
Sony Limited	1
Total	10

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) 8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.

(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.

(3) Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

SOLUTION:

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (₹ in Crores)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, **Timing differences** are those **differences between taxable income and accounting income** for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Particulars	Amount (₹ in Crores)	Rationale
Taxable Income	4	As per income tax laws
Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per **AS 22, deferred tax assets** should be **recognised** and carried forward only **to the extent** that there is a **reasonable certainty** that **sufficient future taxable** income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognise only current tax liability of ₹ 0.8 Crores.

7. 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).

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. QP MAY 2019 (Group I), RTP NOV 20

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

MCQs

1. As per AS 22 on 'Accounting for Taxes on Income', tax expense is:
   a) Current tax + deferred tax charged to profit and loss account
   b) Current tax-deferred tax credited to profit and loss account
   c) Either (a) or (b)
   d) Deferred tax charged to profit and loss account

2. G Ltd. has provided the following information:

Depreciation as per accounting records = ₹ 2,00,000

Depreciation as per tax records = ₹ 5,00,000

There is adequate evidence of future profit sufficiency.

How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

   a) Deferred Tax asset = ₹ 2,70,000.
   b) Deferred Tax asset = ₹ 1,35,000.
   c) Deferred Tax Liability = ₹ 2,70,000
   d) Deferred Tax Liability = ₹ 1,35,000.

3. State which of the followings statements are correct:

(1) There are no pre-conditions required to recognize deferred tax liability,

(2) Deferred tax asset under all circumstances can only be created if and only if there is reasonable certainty that future taxable income will arise.

   a) Both are correct.
   b) Only (1) is correct.
   c) Only (2) is correct.
   d) None of the statements are correct.

4. Which of the following statement are incorrect:
   a) Only timing differences result in creation of deferred tax.
   b) Permanent differences do not result in recognition of deferred tax.
   c) The tax rate used for measurement of deferred tax is substantively enacted tax rate.
   d) The entity has to recognize deferred tax liability/asset arising out of timing difference. There are no conditions which are required to evaluated for their recognition.

Answers							
1.	(c)	2.	(d)	3.	(a)	4.	(d)

AS 24

Discontinuing Operations

Discontinuing Operations

- Component of the entity which represents separate major line of business or Geographical area of operations
- Can be distinguished for operational purpose and financial reporting purpose
- Is discontinued as single plan by

Selling substantially in total either in
- Single transaction
- Demerger
- Spin off

Selling off components assets
- Individually [Piecemeal disposal] and setting its liabilities also individually

Termination through abandonment
[Stopping with an intention to sell later]

Note —
Simply because a component is reported as discontinuing operation can not by itself affects the fundamental assumption regarding going concern.

FOLLOWING ARE NOT NECESSARILY DISCONTINUING OPERATIONS

- Gradual or evolutionary phasing out of product line or class of service
- Closing down of a facility to a acheive productivity improvement or cost saving
- Shifting of production or marketing activity, from one location to another.
- Discontinuing, even if relatively abruptly several products within an ongoing line of business
- The context of CFS sale of a subsidiary with activities similar to parent or another subsidiary.

INITIAL DISCLOSURE EVENT [IDE]

Earliest of

- The enterprise having entered into a binding sale agreement for substantially all of the assets attributable to discontinuing operations

- The enterprises of board of directors or similar governing body having both.
  (i) Approved a detailed, formal plan for the discontinuance, and
  (ii) Made an announcement of the plan.

Note for student...

AS 24 – DISCONTINUING OPERATIONS

SECTION A (CONCEPT QUESTIONS)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	RTP MAY 21						
2	RTP May 15/ QP Nov, 2009 New						
3	RTP May 22						
TEST IN TIME PASS IN TIME							
1	QP JULY 21						
2	RTP NOV 19 / QP NOV 18						

1. 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 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:

- **Gradual** or evolutionary **phasing out** of a product line or class of service;
- **Discontinuing,** even if relatively abruptly, several products within an ongoing line of business
- **Shifting** of some production or marketing activities for a particular line of business from **one location to another**; and
- **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.

2. (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**, **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:

- **Gradual** or evolutionary **phasing out** of a product line or class of service;
- **Discontinuing,** even if relatively abruptly, several products within an ongoing line of business
- **Shifting** of some production or marketing activities for a particular line of business from **one location to another**; and
- **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.

3. 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.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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?

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.

MCQs

1. AB decided to dispose of its Clothing division as part of its long-term strategy.

(a) Date of Board approval - 1st March 20X1;
(b) Date of formal announcement made to affected parties - 15th March 20X1.
(c) Date of Binding Sale agreement – 1st July 20X1;
(d) Reporting date – 31st March 20X1 The date of initial disclosure event would be:

(a) 1st March 20X1
(b) 15th March 20X1
(c) 31st March 20X1
(d) 31st July 20X1

2. To qualify as a component that can be distinguished operationally and for financial reporting purposes, the condition(s) to be met is (are):
   a) The operating assets and liabilities of the component can be directly attributed to it.
   b) Its revenue can be directly attributed to it.
   c) At least a majority of its operating expenses can be directly attributed to it.
   d) All of the above

3. Identify which of the following statements is incorrect?
   a) A discontinuing operation is a component of an enterprise that represents a separate major line of business or geographical area of operations.
   b) A discontinuing operation is a component of an enterprise that can be distinguished operationally and for financial reporting purposes.
   c) A discontinuing operation is a component of an enterprise that may or may not be distinguished operationally and for financial reporting purposes.
   d) A discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

4. Identify the incorrect statement.

a) Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations.
b) The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 would always raise a question regarding the enterprise's ability to continue as a going concern.
c) For recognising and measuring the effect of discontinuing operations, AS 24 does not provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.

d) An enterprise shall include a description of the discontinuing operation, in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs.

Answers							
1.	(b)	2.	(d)	3.	(c)	4.	(b)

AS 26

Intangible Assets

An intangible asset is an
- Identifiable
- Non-monetary asset
- without physical substance
- Held for use in the production or supply of goods or services
- For rental to others or for administrative purposes.

Conditions

(i) Identifiable, non-monetary asset, without physical substance

(ii) Control over a resource when there is control over future economic benefits from intangible assets.

(iii) Expectation of future economic benefit flowing to the entity.

Cost of Intangible assets

↓

Should be recognised initially at cost.

Recognition Criteria of Intangible assets

- Probable future economic benefit flow to the enterprises
- Cost of intangible asset can be measured reliably.

Management should make estimate of future benefit on reasonable and supportive assumption.

Types of Intangible assets

- Purchased
- Internally Generated

Asset Generation Process

Research Phase

It is the activity that aimed at inventing or creating a new product, method or system.

↓

Research cost

↓

Treated as expense and charged to P&L A/c

Development Phase

It is the activity that convert the results of research to a marketable product

↓

Development cost

↓

If development phase generate the intangible asset, then such assets should be capitalised. If it meets the intangible asset recognition criteria and other criteria.

SEPARATE ACQUISITION

↓

If an intangible asset is acquired separately; cost of the intangible assets can usually be measured reliably.

↓

Purchase Price	xxx
Import duties and other taxes, if any net of refundable duties;	xxx
Directly attributable expenditure which makes the intangible assets ready for its intended use Eg → Professional fee for clearance of customs.	
less → Trade discounts and rebates.	xxx
	xxx

Internally Generated Goodwill.

- Is not recognised as an asset
- Because it is not an identifiable resource
- controlled by the enterprise
- That can be measured reliably at cost.

Internally generated brands, masterhead, publishing titles customer lists and items similar in substance should not be recognised as intangible assets.

COST OF INTERNALLY GENERATED INTANGIBLE ASSETS

INCLUDES

- Expenditure on materials and services
- Salaries, wages and other employment related costs
- Any expenditure that is directly attributable to the generation of intangible assets;
- Overheads are necessary for the generation of the asset and that can be allocated on reasonable basis.

EXCLUDES

- Selling, administrative and other general overheads unless such overheads are directly attributable in the generation of the intangible,
- Inefficiencies and initial operating losses incurred before an asset acheives planned performance, and
- Expenditure on staff training.

PAST EXPENSE

Expenditure on intangible item once charged as expense in annual or interim financial report shall not be treated as asset later on.

SUBSEQUENT EXPENDITURE

Expenditure incurred subsequent to purchase or completion of intangible asset shall be treated as expenses except in following case when it will be capitalized.

1. If it will result into future economic benefits higher than originally assessed standard performance and
2. The expenditure can be measured and attributed to the asset reliably.

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation

Systematic allocation of depreciable amount of an intangible asset over its useful life

Amortisation Period

The depreciable amount of an intangible asset should be amortised on a systematic basis over the best estimate of its useful life which in general shall not exceed 10 years from the date when asset is available for use.

When best estimate of useful life over 10 years is considered for amortisation then

1. Estimate the recoverable amount atleast annually and provide for the impairment loss if any and.
2. Disclose the reason why life exceeding 10 years is justified and factors considered in determining the useful life.

AMORTISATION METHOD

The amortisation method used should reflect the **pattern in which the assets economic benefits are** consumed by the enterprise. If that pattern cannot be determined reliably, the **straight-line method** should be used.

The amortised amount should be treated as an expense unless another accounting standard (like AS-2, AS-10, AS-26) permits or requires it to be included in the carrying amount of another asset.

REVIEW OF AMORTISATION PERIOD & METHOD

Both amortisation method and period should be reviewed at least at each financial year end if the previously estimated life or expected pattern of economic benefit has significantly changed then the change in life or method of amortisation should be made and accounted in accordance with AS-5

IMPAIRMENT LOSSES

Review of carrying amount, ascertainment of recoverable amount and recognition or reversal of impairment loss will be as per AS-28.

If an intangible asset was acquired in Amalgamation in the nature of purchase and impairment loss occurs before the end of 1st accounting period, then the value of intangible asset (credited) and goodwill / capital reserve (debited) shall be adjusted by the amount of impairment loss unless the impairment is caused by some specific events which occurs after the date of acquisition in that case it will be accounted as per AS-28.

In following cases recoverable amount shall be estimated at least at each financial year and even if there is no indication of impairment loss.

1. An intangible asset which is not yet available for use and
2. An intangible asset which is being amortized for a period exceeding 10 years from the date asset is available for use (It will apply even when the life which was originally less than 10 years is increased and aggregating to over 10 years)

If any impairment loss is found it should be recognized as per AS-28.

RETIREMENT AND DISPOSAL

An intangible asset which is disposed of or from which no future economic benefit or disposal value is expected should be written off and resultant gain / loss should be charged to profit and loss account.

Net disposal proceeds > carrying amount	Recognise as income in P & L A/c
Net disposal proceeds < carrying amount	Recognise as expense in P & L A/c

Note for student...

AS 26 – INTANGIBLE ASSETS

SECTION A (CONCEPT)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	QP DEC 21						
2	RTP MAY 21						
3	RTP NOV 21						
4	MTP 2 (Q No 1 C)						
5	IPCC RTP May 2015, IPCC RTP Nov 2017						
6	MTP Oct 21 Series 1 / P Q 18						
7	MTP OCT 22 (Series 2)						
TEST IN TIME PASS IN TIME							
1	QP JAN 21						
2	QP NOV 20						

1. 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 "Intangible Assets",** 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:

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

2. 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		
(1) 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

3. 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 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:

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]		

4. **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**

5. 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 "Intangible Assets" 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

6. Mock test Oct 21 Series I / 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 "Intangible Assets" 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

7. 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).

AS 26

Prepare an extract showing the Intangible Assets section in the Balance Sheet of Surya Ltd. as at 31st March, 2021.

	Note No.	₹
Assets		
(1) Non-current assets		
Intangible assets	1	14,00,000

SOLUTION

Surya Ltd.

Balance Sheet (Extract relating to intangible asset) as on 31 st March 2021

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

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. 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?

MCQs

1. Which of the following is not covered within the scope of AS 26?
   a) Intangible assets held-for-sale in the ordinary course of business
   b) Assets arising from employee benefits
   c) (a) & (b) both
   d) Research and development activities

2. Intangible asset is recognised if it:
   a) meets the definition of an intangible asset
   b) is probable that future economic benefits will flow
   c) the cost can be measured reliably
   d) meets all of the above parameters

3. Sun Limited has purchased a computer with various additional software. These are integral part of the computer. Which of the following are true in the context of AS 26:
   a) Recognise Computer and software as tangible asset
   b) Recognise tangible and intangible separately
   c) Recognise computer and software as intangible asset
   d) Does not recognize the software as an asset.

4. Hexa Ltd developed a technology to enhance the battery life of mobile devices. Hexa has capitalised development expenditure of ₹ 5,00,000. Hexa estimates the life of the technology developed to be 3 years but the company has forecasted that 50% of sales will be in year 1, 35% in year 2 and 15% in year 3. What should be the amortisation charge in the second year of the product's life?
   a) ₹ 2,50,000
   b) ₹ 1,75,000
   c) ₹ 1,66,667
   d) ₹1,85,000

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

AS 28 Impairment of assets

Impairment of assets means decline in value of assets due to change in technological or legal environment or due to physical damage to assets.

Non applicability
- Inventories
- Assets arising under construction contracts
- Financial assets including investments covered AS-13
- Deferred tax assets

Impairment testing
- Individual Assets
- Cash Generating Assets
- Goodwill
- Corporate assets.

Step1 → Impairment on Individual Assets

Indicators of Impairment

External Indicators
- Significant fall in the market value of asset
- Significant changes in the technology, market, economic or legal requirement which will adversely affect the operations of the asset.
- Interest rate have increased resulting into increase in discount rate used by the enterprise consequently reducing recoverable amount of the asset.
- Carrying amount of net assets is more than its market capitalization

Internal Indicators
- Obsolescence / physical damage of an asset
- Significant internal changes adversely affecting the operations of an asset like plan to discontinue, restructure or disposal etc.
- Internal evidence that performance of an asset will worse than expected.

VALUE IN USE

Value in Use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Estimating the value in use of an asset involves the following steps :—

Step 1 → Estimating the future cash flows arising from continuing use of the asset and from its ultimate disposal

and

Step 2 → Applying the appropriate discount rate to these future cash flow.

Note: Exclusion

- Future Cash inflow/outflow expected to arise from **future restructuring plans** to which entity is **not yet committed to be ignored.**
- Any **future capital expenditure** enhancing the capacity of asset to be excluded
- Cashflow from **financing or tax receipts** should be excluded.

Note: Inclusions

Net cashflow from **continuing use** of assets [i.e. cashflows after deducting outflows directly attributable].

Net cashflow from disposal of asset towards the end [add this in last years cashflow]

Note: If it is not possible to determine Net Selling price, due to non availability of active market or no basis for reliable estimate then Recoverable Amount = Value in Use.

If Value in Use of the asset is not available then Net selling price cannot be considered as Recoverable amount and Impairment of such asset will be done in CGU

DETERMINATION OF NET SELLING PRICE

1st Preference: Price in a binding sale agreement in an arm's length transaction. This price should be adjusted for incremental costs directly attributable to the disposal of the asset

2nd Preference: Market Price - Cost of disposal

3rd Preference: next best possible information available, at the balance sheet date.

Step 2 Calculation of carrying amount and recoverable amount

Carrying Amount

	Cost	xxx
less	Accumulated Depreciation	xxx
less	Accumulated Impairment	xxx
		xxx

Recoverable amount

Higher of

Net selling cost (or) Value in Use

Step 3 RECOGNITION AND MEASUREMENT

CASE - I

Recoverable amount > Carrying amount

↓

Ignore the difference

↓

Asset is carried at Book value.

↓

Note → Even if there is no impairment loss still following to be reviewed.
- Remaining useful life
- Depreciation Method, and
- Residual value

CASE - II

Recoverable Amount < carrying amount = Impairment Loss

↓

Treatment will depend on whether asset is valued at

↓

COST MODEL

Written off as an expense directly to P&L A/C

REVALUATION MODEL

↓

Revaluation Surplus exist

- adjust Impairment loss to the extent of Revaluation surplus
- Remaining Balance [if any] in P&L

No Revaluation Surplus exist

↓

Written off in P&L A/C

CASE - III

When Impairment loss is greater than Carrying amount

↓

Enterprise should recognise Liability only if required by other Accounting standard

Step 4

JOURNAL ENTRIES FOR CASE-II

COST MODEL

Impairment loss A/c Dr
To Asset A/c

Profit and loss A/c Dr
To Impairment loss

REVALUATION MODEL

No Revaluation Surplus

Impairment loss A/c Dr
To Asset A/c

Profit and loss A/c Dr
To Impairment loss

Revaluation Surplus Available

Impairment loss A/c Dr
To Asset A/c

Revaluation Surplus A/c Dr
Profit & loss A/c Dr
To Impairment loss A/c

CASH GENERATING UNIT (CGU)

Cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

When so far there is an indication that asset is impaired, the Recoverable Amount of Individual Asset to be determined.

*If it is **not possible to determine Recoverable Amount of Individual asset,** then entity should recognise Recoverable Amount of Cash Generating Unit to which the asset belong.*

GOODWILL

- Can be allocated on reasonable and consistent Basis
  - ↓ Perform Bottom up test only.
- Cannot be allocated on reasonable & consistent basis
  - ↓ Perform Bottom up and Top down test, Both

CORPORATE ASSET

- Can be allocated on reasonable and consistent Basis
  - ↓ Perform Bottom up test only.
- Cannot be allocated on reasonable & consistent basis
  - ↓ Perform Bottom up and Top down test, Both

Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash generating unit under review and other cash generating units.

- *Corporate assets do not generate separate cash inflows, the recoverable amount of individual corporate asset cannot be determined unless management decided to dispose of the asset.*
- *If there is indication that corporate asset may be impaired, recoverable amount is determined with reference to cash generating unit to which corporate asset belongs*

AS 28.6

REVERSAL OF IMPAIRMENT LOSS

INDIVIDUAL ASSETS

asset carried at cost model

Transfer Reversal amount to P&L A/c [Income]

Asset at Revaluation model

Write back Reversal to Revaluation Reserve to the extent it was adjusted, any surplus will be recognised as revenue in P&L a/c

CASH GENERATING UNIT

First, assets other than goodwill on a pro-rata basis based on carrying amount of each asset in the unit

and

- The impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur, and
- Subsequent external events have occurred that reverse the effect of that event.

Note:

Maximum amount of reversal.

Carrying Amount of asset Net of Depreciation [Assuming No Impairment]	XXX
(-) Carrying Amount of asset Net of Depreciation [After Impairment]	(XXX)
Maximum Reversal Possible	XXX

The carrying amount should not be Increased above the lower of →

(a) Its Recoverable amount or

(b) Carrying amount that would have been determined had no impairment loss has been recognised for the the asset in prior period.

Note : In case of increased carrying amount of the asset due to reversal of an impairment loss should not exceed the Carrying Amount that would have determined had no Impairment Loss been recognized for the asset in prior period.

AS 28

AS 28 – IMPAIRMENT OF ASSETS

SECTION A (CONCEPT)							
No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
1	ICAI – P.Q. 8						
2	ICAI – P.Q. 9						
3	ICAI – P.Q. 11						
4	ICAI – CA FINAL ILLU. 8						
5	ICAI – ILLU. 2						
6	ICAI – ILLU. 4						
7	ICAI – P.Q. 6						
8	ICAI – P.Q. 7						
9	ICAI – P.Q. 10						
TEST IN TIME PASS IN TIME							
1	ICAI – ILLU. 1						
2	ICAI – ILLU. 3						

1. ICAI – P.Q. 8

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.20X1 at ₹ 500 lakhs. As at that date the value in use is ₹ 400 lakhs and the net selling price is ₹ 375 lakhs.

From the above data:

i. Calculate impairment loss.
ii. Prepare journal entries for adjustment of impairment loss.
iii. Show, how impairment loss will be shown in the Balance Sheet.

SOLUTION

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

Recoverable amount = ₹ 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

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

ii. Journal Entries

	Particulars	Dr. Amount (₹ inlakhs)	Cr. Amount (₹ in lakhs)
(i)	Impairment loss account Dr.	100	
	To Provision for Accumulated Impairment Loss Account		100
	(Being the entry for accountingimpairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairmentloss to profit and loss account)		

iii. Balance Sheet of Venus Ltd. as on 31.3.20X1

	(₹ in lakhs)
Fixed Asset	

Asset less depreciation	500
Less: Impairment loss	(100)
	400

2. ICAI – P.Q. 9

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed. Discuss the applicability of Impairment loss.

SOLUTION

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

3. ICAI – P.Q. 11

A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 20X1 was ₹ 4.15 crores. Depreciation estimated for the financial year 20X1-20X2 is ₹ 25 lakhs. Estimated Net Selling Price as on 31st March, 20X1 was ₹ 30 lakhs, which is expected to decline by 20 percent by the end of the next financial year.

Its value in use has been computed at ₹ 35 lakhs as on 1st April, 20X1, which is expected to decrease by 30 per cent by the end of the financial year.

i. Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 20X2?

ii. How much will be the amount of write off for the financial year ended 31st March, 20X2?

iii. If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer to questions (i) and (ii) above?

iv. If the value in use was zero and the enterprise were required to incur a cost of ₹ 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

SOLUTION

As per **AS 28 "Impairment of Assets"**, if the recoverable amount* of an assetis less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is **recognized as an expense** in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. In the given case, recoverable amount (higher of asset's net selling price and value in use) will be ₹ 24.5 lakhs on 31.3.20X2 according to the provisions of AS 28 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 20X2	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 20X2 [₹ 60 lakhs – ₹ 24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (₹ 35.50 lakhs – ₹ 12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil

Amount of write off (impairment loss) (₹ 60 lakhs – Nil)	60.00
Entire book value of plant will be written off and charged to profit and loss account.	

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 20X2

	(₹ in lakhs)
Opening book value as on 1.4.20X1 (₹ 500 lakhs – ₹ 415 lakhs)	85
Less: Depreciation for financial year 20X1–20X2	(25)
Closing book value as on 31.3.20X2	60
Estimated net selling price as on 1.4.20X1	30
Less: Estimated decrease during the year (20% of ₹ 30 lakhs)	(6)
Estimated net selling price as on 31.3.20X2	24
Estimated value in use as on 1.4.20X1	35.0
Less: Estimated decrease during the year (30% of ₹ 35 lakhs)	(10.5)
Estimated value in use as on 31.3.20X2	24.5

* Recoverable amount is the higher of an asset's net selling price and its value in use.

4. ICAI – CA Final Illustration 8

Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for 20 million and CGU B for ₹ 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ₹ 10 million. The recoverable amounts are based on value-in-use of 18 million for CGU A and 38 million for CGU B.

Determine whether the carrying values of CGU A and B are impaired.

SOLUTION:-

The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	B	Total
Carrying value of CGUs	20	30	50
Allocation of office building	4	6	10
(office building is allocated in the ratio of Carrying value of CGU's)	-	-	-
Carrying value of CGU after Allocation of corporate asset	24	36	60
Recoverable Amount	18	38	56
Impairment Loss	6	-	

The impairment loss will be allocated on the basis of 4/24 against the building (₹ 1 million) and 20/24 against the other assets (₹ 5 million).

5. ICAI - ILLUSTRATION 2

X Ltd. is having a plant (asset) carrying amount of which is ₹ 100 lakhs on 31.3.20X1. Its balance useful life is 5 years and residual value at the end of 5 years is ₹ 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:

For the year ended on	Estimated cash flow (₹ in lakhs)
31.3.20X2	50
31.3.20X3	30
31.3.20X4	30
31.3.20X5	20
31.3.20X6	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.20X1 is ₹ 60 lakhs.

SOLUTION

Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.20X2	50	0.909	45.45
31.3.20X3	30	0.826	24.78
31.3.20X4	30	0.751	22.53

31.3.20X5	20	0.683	13.66
31.3.20X6	20	0.620	12.40
			118.82
Present value of residual price on 31.3.20X6 = 5 X 0.620			3.10
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			121.92

If net selling price of plant on 31.3.20X1 is ₹ 60 lakhs, the recoverable amount will be higher of ₹ 121.92 lakhs (value in use) and ₹ 60 lakhs (net selling price), hence recoverable amount is ₹ 121.92 lakhs.

6. ICAI - ILLUSTRATION 4

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

SOLUTION

Treatment of Impairment Loss

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

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

Working Note:

Calculation of carrying amount of the Property, Plant and Equipment at the end of the fourth year on revaluation

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

Reference: The students are advised to refer the full text of AS 28 "Impairment of Assets" (issued 2002).

7. ICAI – P.Q. 6

A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognized as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognized as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit for an individual magazine title?

SOLUTION

It is likely that the **recoverable amount** of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for

each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.
Therefore, it is likely that individual magazine titles generate cash inflows that are **largely independent of each other** and that each magazine title is a **separate cash-generating unit.**

8. ICAI – P.Q. 7

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

SOLUTION

As per **AS 28 "Impairment of Assets",** impairment loss is the amount by which the **carrying amount of an asset exceeds its recoverable amount,** where recoverable amount is the higher of an asset's net selling price* and its value in use*. In the given case, **recoverable amount will be nil** [higher of value in use (nil) and net selling price (negative ₹ 70,000)]. Thus impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹ 6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and **impairment loss of ₹ 6,00,000** has to be **recognized as an expense** immediately in the statement of Profit and Loss as per para 58 of AS 28.
Further, as per para 60 of AS 28, When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should **recognise a liability** if, and only if, that is required by another Accounting Standard. Hence, the entity should recognize liability for cost of disposal of ₹ 70,000 as per AS 10 & 29.

*Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price
= Selling price – Cost of disposal = Nil – ₹ 70,000 = (₹ 70,000)
*Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.

9. ICAI – P.Q. 10

From the following details of an asset

i. Find out impairment loss
ii. Treatment of impairment loss

AS 28

iii. Current year depreciation

Particulars of asset:

Cost of asset	₹ 56 lakhs
Useful life period	10 years
Salvage value	Nil
Current carrying value	₹ 27.30 lakhs
Useful life remaining	3 years
Recoverable amount	₹ 12 lakhs
Upward revaluation done in last year	₹ 14 lakhs

SOLUTION

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

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

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

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

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. ICAI – ILLUSTRATION 1

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and Equipment on 31-12-20X1. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
20X2	4000
20X3	6000
20X4	6000
20X5	8000
20X6	4000

Residual value at the end of 20X6	₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-20XX	₹ 40,000 lakhs
Useful life	8 years
Net selling price on 31-12-20X1	₹ 20,000 lakhs

Calculate on 31-12-20X1:

a) Carrying amount at the end of 20X1

b) Value in use on 31-12-20X1

c) Recoverable amount on 31-12-20X1

d) Impairment loss to be recognized for the year ended 31-12-20X1

e) Revised carrying amount

f) Depreciation charge for 20X2.

Note: The year 20XX is the immediate preceding year before the year 20X0.

2. ICAI – ILLUSTRATION 3

G Ltd., acquired a machine on 1st April, 20X0 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 20X4, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March, 20X6, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

MCQs

1. If there is indication that an asset may be impaired but the recoverable amount of the asset is more than the carrying amount of the asset, the following are true:
   a) No further action is required and the company can continue the asset in the books at the book value itself.
   b) The entity should review the remaining useful life, scrap value and method of depreciation and amortization for the purposes of AS 10.
   c) The entity can follow either (a) or (b).
   d) The entity should review the scrap value and method of depreciation and amortization for the purposes of AS 10.

2. In case Goodwill appears in the Balance Sheet of an entity, the following is true:
   a) Apply Bottom up test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   b) Apply Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   c) Apply both Bottom up test and Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.
   d) Apply either Bottom up test or Top down test if goodwill cannot be allocated to CGU (cash generating unit) under review.

3. In case of Corporate assets in the Balance Sheet of an entity, the following is true:
   a) Apply Bottom up test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   b) Apply Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   c) Apply both Bottom up test and Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.
   d) Apply either Bottom up test or Top down test if corporate assets cannot be allocated to CGU (cash generating unit) under review.

4. In case of reversal of impairment loss, which statement is true:
   a) Goodwill written off can never be reversed.
   b) Goodwill written off can be reversed without any conditions to be met.
   c) Goodwill written off can be reversed only if certain conditions are met.
   d) Goodwill written off can be reversed.

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

AS 29

Provisions, Contingent liabilities and Contingent assets

Concept Paper

DEFINITION

LIABILITY

A liability is 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.

OBLIGATING EVENT

An Obligating event is an event that creates an obligation that results in an enterprise having no realistic alternatives.

PRESENT OBLIGATION

An obligation is a present obligation is based on evidence available its existence on the balance sheet date is considered probable i.e more likely than not.

POSSIBLE OBLIGATION

An Obligation is a possible obligation if based on the evidence available, its existence at the balance sheet date is considered not probable. It must be noted that for contingent liability the existence of possible obligation should be 'Not Probable' whereas for 'provision' it should be 'Probable'

PROVISIONS

A liability which can be measured only by using a substantial degree of estimation

RECOGNITION

- Present obligation as a result of past events.
- Probable that outflow of resources embodying economic benefits will be required to settle the obligation.
- Reliable estimate can be made of the amount

MEASUREMENT

- Using best estimate of the expenditure required to settle the present obligation at balance sheet date
- should not be discounted
- should consider related risks and uncertainties
- Related future events to be considered when there is sufficient objective evidence that they will occur.
- Gains from disposal of asset not to be considered.
- Consider reimbursement.

CONTINGENT LIABILITIES

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

1) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

2) A reliable estimate of the amount of the obligation cannot be made.

EXAMPLE

1. Lawsuit
2. Product Warranty
3. Pending Investigation or Pending Cases.
4. Book Guarantee
5. Lawsuit for theft of patent / knowhow

RECOGNITION PRINCIPLE OF CONTINGENT LIABILITY

An enterprise should not recognize the contingent liability but it **should be disclosed in financial statement.** The following conditions should be fulfilled for disclosure of contingent liability in financial statement -

- There should be **present obligation** arising out of past event, but not recognized as a provision.
- It is **not probable that an outflow of resources embodying economic benefit** will be required to settle the obligation.
- The **possibility of an outflow** of resources embodying economic benefit **is not remote.**
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In **some case** , an **enterprise is jointly and severally liable for an obligation in that case, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.**

SHIFTING FROM CONTINGENT LIABILITY TO PROVISIONS

Contingent liabilities are continuously assessed and if it becomes probables that an outflow of future economic benefits will be required to settle obligation, which is previously assessed as contingent liability, a provision is recognised.

CONTINGENT ASSETS

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 control of the enterprise.

To be called a 'contingent Asset' the following conditions must be fulfilled

- Possible assets as a result of past events
- Existence of contingent assets is to be confirmed by occurrence and non-occurrence of one or more future events.
- Future events not wholly within the control of the enterprise.

RECOGNITION PRINCIPLE OF CONTINGENT ASSETS

An enterprise should not **recognize** a contingent asset **because it may result in the recognition of income that may never be realized.** However, if realization is virtually certain then the related asset is recognised.

WHETHER DISCLOSURE IS REQUIRED OF CONTINGENT ASSETS

Contingent Assets are not **required to be disclosed in financial statement. Generally Board of** Directors report **discloses such contingent assets.**

Restructing

Restructing is a programme that is planned and controlled by management and materially changes either :–

- The scope of a business undertaken ; or
- The manner in which that business is conducted

Some Examples are

- Sale or termination of line of business
- Closure of business location in a country or region or the relocation of business activities
- Changes in management structure
- Fundamental re-organisation that have materially effect on the nature and focus of the enterprise operations

ONEROUS CONTRACT

In which unavoidable costs of meeting the contract exceed the economic benefits expected to be received under it.

Note for student...

AS 29 – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

No.	QUESTION	PAGE NO.	DATE	R1	R2	R3	REMARK
SECTION A (CONCEPT)							
1	ICAI ILLUSTRATION NO 1						
2	Q PAPER MAY 2018 OLD GROUP 2 Q NO 1						
3	ICAI PQ 17						
4	RTP NOV 18, RTP MAY 19 Q20, IPCC RTP NOV 18, IPCC RTP MAY 19, MTP April 22 Series 2						
5	RTP NOV 19, RTP MAY 18, IPCC RTP NOV 16, IPCC RTP MAY 18, RTP NOV 19, RTP MAY 21, MTP Mar 22 (Series 1), MTP Sep 22 (Series 1)						
6	MTP OCT 21 SERIES 1						
TEST IN TIME PASS IN TIME							
1	QP NOV 19, QP NOV 20						
2	MAY 2022 EXAM						

1. ICAI ILLUSTRATION NO 1

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. 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 -

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.

3. 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 per AS 29, **"Provisions, Contingent Liabilities and Contingent Assets"** a provision shall be recognised when:

- an entity has a **present obligation** (legal or constructive) as a result of a **past event;**
- it is **probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; and
- a **reliable estimate** can be made of the amount of the obligation. If these conditions are not met, no provision shall 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.

4. **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 shall be recognised when:

- an entity has a **present obligation** (legal or constructive) as a result of a **past event;**
- it is **probable that an outflow of resources** embodying economic benefits will be required to settle the obligation; and
- a **reliable estimate** can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

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."

5. RTP NOV 19, RTP MAY 2018, IPCC RTP NOV 2016, IPCC RTP MAY 2018, RTP NOV 19, RTP MAY 2021, MTP March 2022 (Series I), MTP Sep 2022 (Series I)

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.**

6. MOCK TEST OCT 21 SERIES I

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.

Nazar Hati Durghatna Ghati...

Test In Time...Pass In Time

1. 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.

2. 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.

MCQs

1. Which of the following best describes a provision?
   a) A provision is a liability of uncertain timing or amount.
   b) A provision is a possible obligation of uncertain timing.
   c) A provision is a credit balance set up to offset a contingent asset so that the effect on the statement of financial position is nil.
   d) A provision is a possible obligation of uncertain amount.

2. X Co is a business that sells second hand cars. If a car develops a fault within 30 days of the sale, X Co will repair it free of charge. At 1st March 20X1, X Co had made a provision for repairs of` 25,000. At 31st March 20X1, X Co calculated that the provision should be` 20,000. What entry should be made for the provision in X Co's income statement for the month 31st March 20X1?

a) A charge of` 5,000
b) A credit of` 5,000
c) A charge of` 20,000
d) A credit of` 25,000

3. Which of the following item does the statement below describe?

"A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity's control"

a) A provision
b) A current liability
c) A contingent liability
d) Deferred tax liability

4. Z Ltd has commenced a legal action against Y Ltd claiming substantial damages for supply of a faulty product. The lawyers of Y Ltd have advised that the company is likely to lose the case, although the chances of paying the claim is not remote. The estimated potential liability estimated by the lawyers are:

Legal cost (to be incurred irrespective of the outcome of the case) ₹ 50,000

Settlement if the claim is required to be paid ₹ 5,00,000

What is the appropriate accounting treatment in the books of Z Ltd.?

   a) Create a Provision of ₹ 5,50,000
   b) Make a Disclosure of a contingent liability of ₹ 5,50,000
   c) Create a Provision of ₹ 50,000 and make a disclosure of contingent liability of ₹ 5,00,000
   d) Create a Provision of ₹ 5,00,000

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