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FOR

CA INTERMEDIATE

2024

MARATHON / ONE SHOT / SUPER REVISION

Advanced Accounting PART 2

By – Nitin Goel

CA INTER MARATHON (SUPER REVISION/ONE SHOT)

ADVANCED ACCOUNTING

S.NO.	CHAPTER NAME
1	AS 21: Consolidated Financial Statements
2	AS 23: Accounting for Investment in Associates in CFS
3	AS 24: Discontinuing Operations
4	AS 25: Interim Financial Reporting
5	AS 26: Intangible Assets
6	AS 27: Financial Reporting of Interest in Joint Venture
7	AS 28: Impairment of Assets
8	AS 20: Earning per Share
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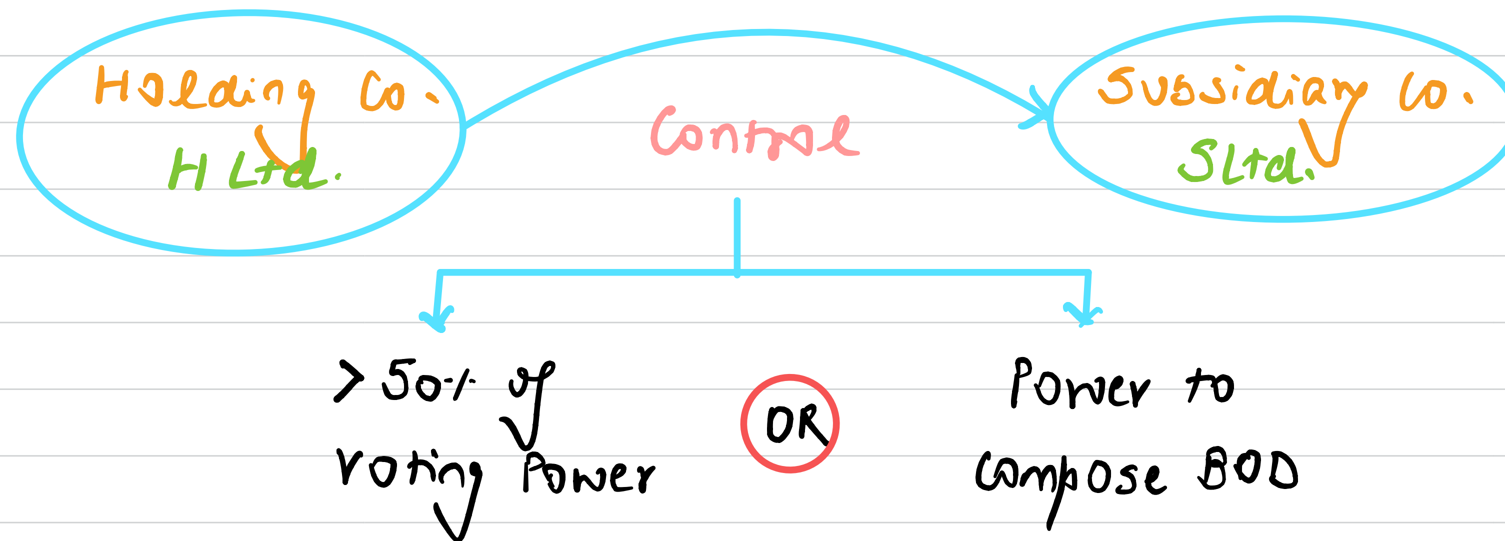
2024

AS 21: Consolidated Financial Statements

Advanced Accounting | Lecture - 01

By – Nitin Goel

AS 21 : Consolidated Financial Statements



H Ltd.	+	S Ltd.	⇒	Consolidated
1) Balance sheet		Balance sheet		Cons. Balance sheet
2) P&L		P&L		Cons. P&L
3) Cash flow statement		Cash flow statement		Cons. Cash flow statement
4) Notes to A/cs		Notes to A/cs		Cons. Notes to A/cs

- AS 21 does not mandate preparation of CFS, but mandates process of Consolidation
- If Parent / Holding Co. holds 100% Equity Share Capital, then Subsidiary is called Wholly Owned Subsidiary.

Example

Balance sheet as on 31/3/23

	H Ltd.	S Ltd.
Equity Share cap.	1300000	700000
Res. & Surplus	200000	100000
Liabilities	500000	200000
	2000000	1000000
PPE	1000000	700000
Inv. in 80% shares of S Ltd.	850000	-
Current Assets	150000	300000
	2000000	1000000

Prepare consolidated Balance Sheet assuming shares acquired on 1/4/22 and Bal. of Res. & Surplus of S Ltd. was 40000

Consolidated Bal. sheet

Equity share cap.	1300000
Res. & Surplus	248000
Minority Interest	160000
Liabilities	700000
	2408000
PPE	1700000
Goodwill	258000
Current Assets	450000
	2408000

1/4/22 — Acquire 80%

Res. & Surplus: 40000 → Cost of control

31/3/23 — B/S

Res. & Surplus: 100000

Cost of control

Cost of Investments	850000
− 80% of Net Assets of S Ltd	
~~Ass. - Liab.~~	
Sh. cap. + Res. & surplus	(592000)
(700000 + 40000) X 80%	
Goodwill	258000

Minority Interest (20%)

(7L + 3L − 2L) X 20% = 160000

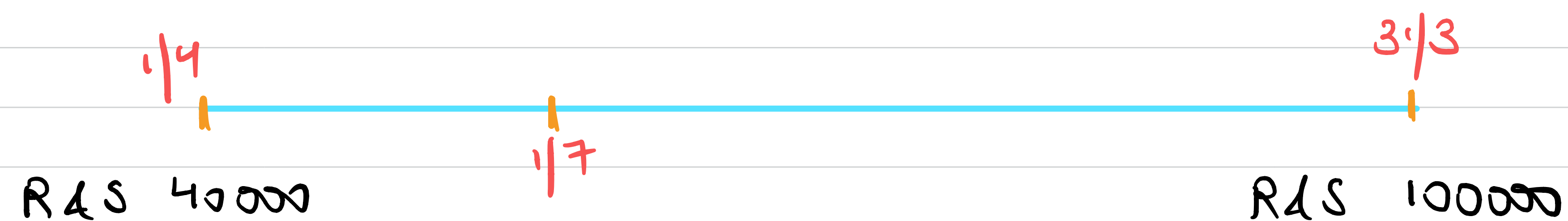
OR

Sh. cap.	(7L X 20%)	140000
Pre Profits	(40000 X 20%)	8000
Post Aq. Profits	(60000 X 20%)	12000
		160000

Cons. Res. & surplus

H Ltd.	200000
+ Post Aq. Profits (60000 X 80%)	48000
	248000

If Acquisition on 1/7/22



AOP : Std.

	Pre	Post
Res. & surplus	40000	60000
Time Adjustment		

Working Notes:

1) Analysis of Profits of S Ltd.

	PRE (Capital)	POST (Revenue) Gen. Res.	POST (Revenue) P&L A/c
P&L A/c	✓		✓
General Reserve	✓	✓	
Adjustment	✓	✓	✓
± Time Adjustment	+	-	-
Adjustment	✓	✓	✓
Balance	✓	✓	✓
	H / MI	H / MI	H / MI

2) Cost of Control (Goodwill / Capital Reserve)

It is calculated based on Net Assets of Subsidiary on the date of obtaining control.

Cost of Investments	xx
(−) Share of Holding co. in * Net Assets of Subsidiary co.	
Share Capital (H's Share)	(xx)
Pre Profits (H's Share)	(xx)
	xx +ve Goodwill / -ve Capital Reserve

* Net Assets can also be obtained based on Assets & Liabilities Approach.

3) Minority Interest (Also called as Non Controlling Interest)

- Represents share of Net Assets not owned by Parent / Holding on date of consolidation.
- Shown in Cons. B/S after Shareholder funds before Non current Liabilities
- If Minority Interest is negative, it is transferred to Consolidated P&L.

Minority Interest *

Share capital	xx
Pre Profits	xx
Post Profits	xx
Post General Res.	xx
	xx

* Can also be calculated based on Assets Less Liabilities Method.

4) Consolidated General Reserve / P&L

Holding General Res. / P&L A/c	xx
+ Post General Res. / P&L A/c (Share of Holding)	xx
	xx

Adjustment 1: Revaluation Adjustment

For the purpose of correctly calculating Cost of Control, AS-21 requires that Assets of subsidiary should be revalued on date of acquisition.

Step 1: Profit / Loss on Revaluation

	Market value on Date of Acquisition	xx
(−)	Book value on Date of Acquisition	(xx)
		xx *

* Adjustment in Pre Profits

Step 2: Additional Depreciation / Saving in Depreciation

	New Market value X Rate X Post Period	xx
(−)	Depreciation already charged	(xx)
		xx *

* Adjustment in Post Profits (after Time Adjustment)

Step 3: Asset value in Consolidated B/S would change.

Example:

1/4/22 ——————————— 31/3/23

Res. & surplus 20000 ——— 50000

H Ltd. acquires 70% shares in S Ltd. on 1/4/22 & on this date P&M valued at 200000 & Furniture at 40000

Dep. Rate: P&M: 10% p.a. Furniture 15% p.a.

S Ltd. B/S 31/3/23

P&M	135000
Furniture	42500

Acq. 1/4 ——————————— 31/3

Plant & Mach.

B.V. = 150000 $\left(135000 \times \frac{100}{90}\right)$ BV = 135000

M.V. = 200000

Furniture

B.V. = 50000 $\left(42500 \times \frac{100}{85}\right)$ BV = 42500

M.V. = 40000

AOP: S Ltd.

	Pre	Post
Res. & surp	20000	30000
Inc. of P&M	50000	
Dec. of Furn.	(10000)	
Additional Dep.		(5000)
Saving in Dep.		1500
	60000	26500

P&M: Additional Dep.

(200000 × 10%) − 15000 = 5000

Furniture: Saving in Dep.

(40000 × 15%) − 7500 = 1500

B/S

P&M: 135000 + 50000 − 5000 = 180000

Furniture: 42500 − 10000 + 1500 = 34000

Adjustment 2 : Elimination of Common Owing (Contra Items)

Common Transactions means transactions entered into between H Co. & S Co.
It may be as follows :

a) B/R and B/P
b) Debtors and Creditors
c) Loan Receivable / Loan Payable

Treatment : Cancel Mutual owing while preparing Consolidated B/S.

(It does not affect AOP, G/W / Cap. Res., Minority Interest or Cons. Res. & Surplus)

Note : If contra cancellation amount is not same, it can be due to cash in Transit.
It should be reported as cash Equivalent.

Case 1:

H Ltd.

Creditors 50000 (incl. 20000 to S Ltd.)	

S Ltd.

	Debtors 80000 (incl. 20000 from H Ltd.)

Cons. B/S

Creditors 30000 (50000 - 20000)	Debtors 60000 (80000 - 20000)

Case 2:

H Ltd.

B/P 55000 (incl. 20000 to S Ltd.)	

S Ltd.

	B/R 40000 (incl. 12000 of H Ltd.)

Cons. B/S

B/P 43000 (55000 - 12000)	B/R 28000 (40000 - 12000)

S Ltd. discounted/endorsed bills amounting 8000.

Case 3:

H Ltd.

Creditors 50000 (incl. 17000 to S Ltd.)	

S Ltd.

	Debtors 80000 (incl. 20000 from H Ltd.)

Cons. B/S

Creditors 33000 [50000 - 17000]	Debtors 60000 (80000 - 20000)
	Cash in Transit 3000

H Ltd. paid 3000 to S Ltd. on 31/3 but not received by S Ltd.

Adjustment 3: Unrealised Profit / Stock Reserve
(ie. Profits in Transaction b/w H & S)

If Parent / Holding & Subsidiary has Sale / Purchase transaction on which profit was earned but certain stock remains unsold, then such profit is unrealised & it should be eliminated in B/S, since it is not yet earned.

Sale by H to S (Downstream)

1) Cons. P&L xx
   - Unrealised Profit (xx) xx

2) Cons. B/S
   Stock: H xx
   S xx
   - URP (xx) xx

Sale by S to H (Upstream)

1) Deduction in AOP from Post Profits after Time Adjustment
   (Means Reduction from Holding & Minority Interest)

2) Same

Unrealised Profit = Stock still held from Inter co. transaction × Profit rate (% on sales)

Adjustment 4: Bonus Issue by Subsidiary

Entry: Reserves & Surplus A/c - Dr
To Share capital A/c

Not yet Adjusted (Unrecorded)

1) Reduce AOP with Bonus Amount (From Pre Profits)*

2) Share capital (Bonus Issue) (Effect in cost of control & Minority Interest)

Already Adjusted (Recorded)

1) Add Back Post General Reserve. (Before Time Adjustment)

2)

3) Share capital already Increased.

* If Pre not sufficient / Ques. specifies then Post Profits

NOTE: If Bonus Issue already Adjusted / Recorded:
Be careful in calculation of Holding Ratio, take Numerator & Denominator after Bonus Issue.

Adjustment 5: Dividend by Subsidiary

① Treatment in AOP

* Add Back total dividend paid in Post Profits Before Time Adjustment
* Deduct from Pre / Post Profits based on source of Dividend
  - Final Dividend : Last year (Mainly Pre)
  - Interim Dividend : During the year (Can be Pre, Post, Pre / Post)

② Treatment of Dividend Received by Holding

If Post Acq. Dividend : To be credited to P&L A/c
If Pre Acq. Dividend : To be credited to Investment A/c
(Pre Acquisition means where source of Dividend is Profits earned in Pre Acq. Period)

NOTE: Sometimes Pre Acquisition Dividend is Credited to P&L A/c, then

Rectification: If Wrong Entry Passed

✓	✗	Rectification Entry
Bank A/c - Dr To Investment A/c	Bank A/c - Dr To P&L A/c	P&L A/c - Dr To Investment A/c

(Share of H Ltd. in Total Dividend)

Effect : ① Cost of Control ② Consolidated P&L

Preparation of Consolidated P&L

1) Preparation as per Schedule III

2) All items of Income & expenses should be consolidated on line by line basis.

3) Elimination of Common Transactions

   Eg: Sale / Purchase within group or
   Income / Expense which is within group should be eliminated.

4) Unrealised Profit on stock should be adjusted along with Change in Inventories

5) Dividend by subsidiary: Eliminate dividend paid by S Ltd. & received by H Ltd

   Note: ICAI sometimes assume that dividend is not included in Sales & other income of H Ltd. & is therefore not deducted.

AS 21: CONSOLIDATED FINANCIAL STATEMENTS

Question 1 *(Inter Nov 2019) (5 Marks) / RTP Nov 2020 /ICAI Study Material)* *Pg no._____*

From the following data, determine Minority interest on the date of acquisition and on the date of consolidation in each case:

Case	Subsidiary Company	% shares owned	Cost	Date of acquisition 01.01.2019		Consolidation Date 31.12.2019	
				Share Capital	Profit & Loss A/c	Share Capital	Profit & Loss A/c
Case A	X	90%	2,00,000	1,50,000	75,000	1,50,000	85,000
Case B	Y	75%	1,75,000	1,40,000	60,000	1,40,000	20,000
Case C	Z	70%	98,000	40,000	20,000	40,000	20,000
Case D	M	95%	75,000	60,000	35,000	60,000	55,000
Case E	N	100%	1,00,000	40,000	40,000	40,000	65,000

Solution

Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share Capital as on 01.01.2019

B = Profit & Loss Account Balance on 01.01.2019

C = Share Capital as on 31.12.2019

D = Profit & Loss Account Balance on 31.12.2019

Case	Subs. Com.	% Shares owned	Minority % shares owned {E}	Minority interest as at date of acquisition [E]x [A+B]	Minority interest as at date of consolidation [E]x [C+D]
Case A	X	90%	10%	22,500	23,500
Case B	Y	75%	25%	50,000	40,000
Case C	Z	70%	30%	18,000	18,000
Case D	M	95%	5%	4,750	5,750
Case E	N	100%	Nil	Nil	Nil

Question 2 *(Inter May 2018) (20 Marks) / (RTP Nov 2019)* *Pg no._____*

The following summarised Balance Sheets of H Ltd. and its subsidiary S Ltd. were prepared as on 31st March, 2020:

	H Ltd.	S Ltd.
Equity & Liabilities		
Shareholders' Funds		
Equity Shares of ₹ 10 each, fully paid up	12,00,000	2,00,000
Reserves and Surplus		
General Reserve	4,35,000	1,55,000
Profit and Loss Account	2,80,000	65,000
Current Liabilities		
Trade Payables	3,22,000	1,23,000
	22,37,000	5,43,000

Assets		
Non-Current Assets		
Property, Plant & Equipment		
Machinery	6,40,000	1,80,000
Furniture	3,75,000	34,000
Non-Current Investments		
Shares in S Ltd. - 16,000 shares @ ₹ 20 each	3,20,000	-
Current Assets		
Inventories	2,68,000	62,000
Trade Receivables	4,70,000	2,35,000
Cash and Bank	1,64,000	32,000
	22,37,000	5,43,000

H Ltd. acquired the 80% shares of S Ltd. on 1st April, 2019. On the date of acquisition, General Reserve and Profit Loss Account of S Ltd. stood at ₹ 50,000 and ₹ 30,000 respectively. Machinery (book value ₹ 2,00,000) and Furniture (book value ₹ 40,000) of S Ltd. were revalued at ₹ 3,00,000 and ₹ 30,000 respectively on 1st April, 2019 for the purpose of fixing the price of its shares (rates of depreciation computed on the basis of useful lives : Machinery 10% and Furniture 15%). Trade Payables of H Ltd. includes ₹ 35,000 due to S Ltd. for goods supplied since the acquisition of the shares. These goods are charged at 10% above cost. The inventories of H Ltd. includes goods costing ₹ 55,000 purchased from S Ltd. You are required to prepare Consolidated Balance Sheet as at 31st March, 2020.

Solution

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 2020

Particulars	Note No.	Amount
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	12,00,000
(b) Reserves and Surplus	2	8,16,200
(2) Minority Interest		99,300
(3) Current Liabilities		
(a) Trade Payables	3	4,10,000
Total		**25,25,500**
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
(i) Property, Plant & Equipment	4	13,10,500
(ii) Intangible assets	5	24,000
(2) Current assets		
(a) Inventories	6	3,25,000
(b) Trade Receivables	7	6,70,000
(c) Cash at Bank	8	1,96,000
Total		**25,25,500**

Notes to Accounts

1	**Share Capital**			
	1,20,000 equity shares of ₹ 10 each			12,00,000
2	**Reserves and Surplus**			
	General Reserves		4,35,000	
	Add: 80% share of S Ltd.'s post-acquisition reserves		84,000	5,19,000

	Profit and Loss Account		2,80,000	
	Add: 80% share of S Ltd.'s post-acquisition profits		17,200	2,97,200
				8,16,200
3	**Trade Payables**			
	H Ltd.		3,22,000	
	S Ltd.		1,23,000	
	Less: Mutual transaction		(35,000)	4,10,000
4.	**Property, Plant & Equipment**			
	Machinery			
	H Ltd.		6,40,000	
	S Ltd.	2,00,000		
	Add: Appreciation	1,00,000		
		3,00,000		
	Less: Depreciation (20,000+10,000)	(30,000)	2,70,000	9,10,000
	Furniture			
	H Ltd.		3,75,000	
	S Ltd.	40,000		
	Less: Decrease in value	(10,000)		
		30,000		
	Less: Depreciation (6,000-1,500)	(4,500)	25,500	4,00,500
				13,10,500
5.	**Intangible Assets**			
	Goodwill			24,000
6.	**Inventories**			
	H Ltd.		2,68,000	
	S Ltd.		62,000	3,30,000
	Less: Inventory reserve			(5,000)
				3,25,000
7.	**Trade Receivables**			
	H Ltd.		4,70,000	
	S Ltd.		2,35,000	
	Less: Mutual transaction		(35,000)	6,70,000
8.	**Cash and Bank**			
	H Ltd.		1,64,000	
	S Ltd.		32,000	1,96,000

Working Notes:

1. Profit or loss on revaluation of assets in the books of S Ltd. and their book values as on 1.4.2019

Machinery	
Revaluation as on 1.4.2019	3,00,000
Less: Book value as on 1.4.2019	(2,00,000)
Profit on revaluation	1,00,000
Furniture	
Revaluation as on 1.4.2019	30,000
Less: Book value as on 1.4.2019	(40,000)
Loss on revaluation	(10,000)

2. Calculation of short/excess depreciation

	Machinery	Furniture
Upward/ (Downward) Revaluation	1,00,000	(10,000)
Rate of depreciation	10%	15%
Difference [(short)/excess]	(10,000)	1,500

3. Analysis of reserves and profits of S Ltd. as on 31.03.2020

	Pre-acquisition	Post-acquisition	
		Gen reserve	P&L
General reserve as on 31.3.2020	50,000	1,05,000	
Profit and loss account as on 31.3.2020	30,000		35,000
Upward Revaluation of machinery	1,00,000		
Downward Revaluation of Furniture	(10,000)		
Short depreciation on machinery			(10,000)
Excess depreciation on furniture			1,500
Less: Unrealised Profit (55,000*10/110)			(5,000)
	1,70,000	**1,05,000**	**21,500**

4. Minority Interest

Paid-up value of (2,00,000 x 20%)	40,000
Add: 20% share of pre-acquisition profits [(20% of 1,70,000)	34,000
20% share of post-acquisition reserves	21,000
20% share of post-acquisition profit	4,300
	99,300

5. Cost of Control or Goodwill

Cost of Investment		3,20,000
Less: Paid-up value of 80% shares	1,60,000	
80% share of pre-acquisition profits	1,36,000	(2,96,000)
Cost of control or Goodwill		**24,000**

Question 3 *(ICAI Study Material)* Pg no._____

On 31st March, 2021, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:

Particulars	Note No.	H Ltd. (₹ in Lacs)	S Ltd. (₹ in Lacs)
Equity and Liabilities			
(1) Shareholder's Funds			
a) Share Capital	1	12,000	4,800
b) Reserves and Surplus	2	5,499	3,000
(2) Current Liabilities			
a) Trade payables	3	1,833	1,014
b) Short term provisions	4	855	394
c) Other current liabilities (Dividend payable)		1,200	-
Total		21,387	9,208
Assets			
(1) Non-current assets			
a) Property, Plant and Equipment	5	9,468	5,486
b) Non-current Investments (Shares in S Ltd.)		3,000	

(2) Current assets			
a) Inventories		3,949	1,956
b) Trade receivables	6	2,960	1,562
c) Cash and cash equivalents		1,490	204
d) Short term loans and advances	7	520	
Total		21,387	9,208

Notes to Accounts

		H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
1	Share Capital		
	Authorized share capital:		
	Equity shares of ₹ 10 each, fully paid up	15,000	6,000
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up	12,000	4,800
2	Reserves and surplus		
	General Reserve	2,784	1,380
	Profit and Loss Account:	2,715	1,620
	Total	5,499	3,000
3	Trade Payables		
	Creditors	1,461	854
	Bills Payable	372	160
		1,833	1,014
4	Short term provisions		
	Provision for Taxation	855	394
5	Property, plant and equipment		
	Land and Buildings	2,718	-
	Plant and Machinery	4,905	4,900
	Furniture and Fittings	1,845	586
	Total	9,468	5,486
6	Trade receivables		
	Debtors	2,600	1,363
	Bills Receivable	360	199
	Total	2,960	1,562
7	Short term loans and advances		
	Sundry Advances	520	--

The following information is also provided to you:

a. H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 2020 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

b. On 1st April, 2020, S Ltd. declared a dividend @ 20% for the year ended 31st March, 2020. H Ltd. credited the dividend received by it to its Profit and Loss Account.

c. On 1st January, 2021, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 2020.

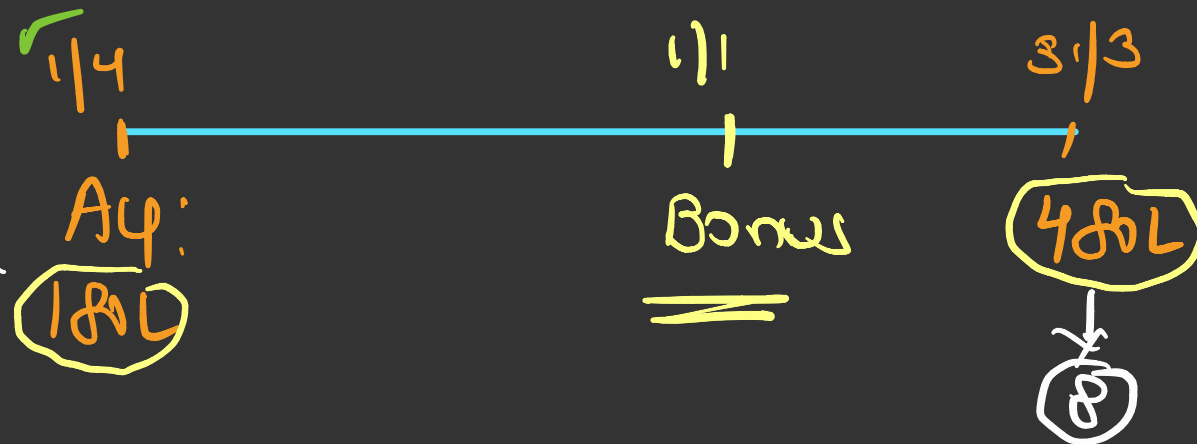
d. On 31st March, 2021, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.

e. On 31st March, 2021, S Ltd.'s inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2021.

Date of Acq: 31/3/20 or 1/4/20

% of holding = $\frac{180L}{480L} \times 100 = 37.5\%$ (Before / After)



Bonus scheme : 3 for 5

Existing = 5
Bonus = 3
8

Bonus Shares = $480L \times \frac{3}{8}$
= 180L

Before Bonus Sh. = 480 - 180 = 300L

Bonus Sh. to holding co.
$180L \times \frac{3}{5} = 108L$

% of holding

Without Bonus = $\frac{180L}{300L} \times 100 = 60\%$

With Bonus = $\frac{180L + 108L}{480L} = \frac{288L}{480L} \times 100 = 60\%$

AOP of Subd.

	Pre	Post: GR	Post: P&L
Gen. Res.	3000	(1620)	
P&L A/c	1200		420
+ Bonus Issue (180L × 10)		1800	
Dividend (3000L × 20%)			600
		180	1020
− Bonus Issue	(1800)		
− Dividend	(600)		
	1800	180	1020

Cost of Control

Cost of Investments	3000
- Pre Acq. Dividend (600L X 60%)	(360)
	2640
- Cost of Net Assets	
Sh. Capital (4800 X 60%)	(2880)
Pre Profits (1800 X 60%)	(1080)
Capital Res.	1320

Minority Interest

Share Cap. (4800 X 40%)	1920
Pre Profits (1800 X 40%)	720
Post GR (180 X 40%)	72
Post P&L (1020 X 40%)	408
	3120

Cons. Gen. Reserve

H Ltd.	2784
+ Post GR (180 X 60%)	108
	2892

Cons. P&L

H Ltd.	2715
- Pre Acq. Div.	(360)
	2355
+ Post Profits (1020 X 60%)	612
- Unrealised Profit/SR ($100 \times \frac{25}{125}$)	(20)
	2947

Consolidated Balance sheet

	Note No.	Amount (Lakhs)
Equity & Liabilities		
1) Shareholder funds		
a) Share capital	1	12000
b) Reserves & Surplus	2	7159
2) Minority Interest		3120
3) Current Liabilities		
a) Trade Payables (1833+1014-45)		2802
b) Short term Provision		1249
c) Other current Lia.		1200
TOTAL		27530
Assets		
1) Non current Assets		
a) PPE & Intangible Assets		
i) PPE		14954

2) Current Assets URP

a) Inventories (5905 - 20)		5885
b) Trade Receivables (4522 - 45)		4477
c) Cash & Cash Eq.		1694
d) Short term loans & Advances		520
TOTAL		27530

Notes to Accounts

1) Share Capital

Authorised:

1500 Lakh equity shares of 10 each 15000

Issued & Subsc.

1200 Lakh equity shares of 10 each 12000

2) Res. & Surplus

Cons. Gen. Res.	2892
Cons. P&L	2947
Capital Res.	1320
	7159

Question 4 *(ICAI Study Material)* *Pg no._____*

A Ltd. acquired 60% shares of B Ltd. @ ₹ 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	1,00,00,000
10% Debentures	10,00,000
Trade Payables	55,00,000
Property, Plant & Equipment	70,00,000
Investments	45,00,000
Current Assets	68,00,000
Loans & Advances	22,00,000

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹ 60,00,000. Calculate the Goodwill or Capital Reserve.

Solution

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., pre-acquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment.

Property, Plant & Equipment	70,00,000	
Less: Value Written off (70 Lakhs * 10%)	(7,00,000)	
	63,00,000	
Investments	60,00,000	
Current Assets	68,00,000	
Loans & Advances	22,00,000	2,13,00,000
Less: 10% Debentures	10,00,000	
Trade Payables	55,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x 20 per shar	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		**19,20,000**

Question 5 *(Inter Nov 2023) (15 Marks)* *Pg no._____*

GB Limited acquired 80% of equity shares of TB Limited on 1st April, 2016 at a cost of ₹ 58,00,000 when TB Limited had an Equity share capital of ₹ 50,00,000 and Reserves and Surplus of ₹ 4,64,000. The following information is provided:

Year	Profit/(Loss) of TB Limited (₹)
2016-17	(14,50,000)
2017-18	(23,20,000)
2018-19	(29,00,000)
2019-20	(6,96,000)
2020-21	1,90,000
2021-22	6,80,000
2022-23	12,70,000

You are required to calculate the minority interests and cost of control at the end of each year for the purpose of consolidation.

Solution

Year	Profit / (Loss)	Minority Interest (20%)	Additional Consolidated P & L (Dr.) Cr.	Minority's Share of losses borne by GB Ltd.		Cost of Control
				₹	Balance	
At the time of acquisition in 2016		10,92,800 (W.N.)	-			
2016-17	(14,50,000)	(2,90,000)	(11,60,000)			14,28,800 (W.N.)
Balance		8,02,800				
2017-18	(23,20,000)	(4,64,000)	(18,56,000)			14,28,800
Balance		3,38,800				
2018-19	(29,00,000)	(5,80,000)	(23,20,000)			14,28,800
		(2,41,200)				
	Loss of minority borne by Holding Co.	2,41,200	(2,41,200)	2,41,200	2,41,200	
Balance		Nil	(25,61,200)			
2019-20	(6,96,000)	(1,39,200)	(5,56,800)			14,28,800
	Loss of minority borne by Holding Co.	1,39,200	(1,39,200)	1,39,200	3,80,400	
Balance		Nil	(6,96,000)			
2020-21	1,90,000	38,000	1,52,000			14,28,800
	Profit share adjusted against losses of minority absorbed by Holding Co.	(38,000)	38,000	(38,000)	3,42,400	
Balance		Nil	1,90,000			
2021-22	6,80,000	1,36,000	5,44,000			
	Profit share adjusted against losses of minority absorbed by Holding Co.	(1,36,000)	1,36,000	(1,36,000)	2,06,400	14,28,800
Balance		Nil	6,80,000			
2022-23	12,70,000	2,54,000	10,16,000	(2,06,400)	Nil	14,28,800
		(2,06,400)	2,06,400			
Balance		47,600	12,22,400			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.2016

		Share of Holding Co.	Minority Interest
	100% (₹)	**80% (₹)**	**20% (₹)**
Share Capital	50,00,000	40,00,000	10,00,000
Reserve	4,64,000	3,71,200	92,800
		43,71,200	**10,92,800**
Less: Cost of investment		(58,00,000)	
Goodwill		14,28,800	

Question 6 *(Inter Nov 2019) (10 Marks)* *Pg no._____*

Consider the following summarized Balance Sheets of subsidiary MNT Ltd.

Liabilities	2018-19	2019-20
Share Capital		
Issued and subscribed 7500 Equity Shares of ₹100 each	7,50,000	7,50,000
Reserve and Surplus		
Revenue Reserve	2,14,000	5,05,000
Securities Premium	72,000	2,07,000
Current Liabilities and Provisions		
Trade Payables	2,90,000	2,46,000
Bank Overdraft	-	1,70,000
Provision for Taxation	2,62,000	4,30,000
	15,88,000	23,08,000
Assets		
Property, Plant & Equipment (Cost)	9,20,000	9,20,000
Less: Accumulated Depreciation	(1,70,000)	(2,82,500)
	7,50,000	6,37,500
Investment at Cost	-	5,30,000
Current Assets		
Inventory	4,12,300	6,90,000
Trade Receivable	2,95,000	3,43,000
Prepaid expenses	78,000	65,000
Cash at Bank	52,700	42,500
	15,88,000	23,08,000

Other Information:

1) MNT Ltd. is a subsidiary of LTC Ltd.
2) LTC Ltd. values inventory on FIFO basis, while MNT Ltd. used LIFO basis. To bring MNT Ltd.'s inventories values in line with those of LTC Ltd., its value of inventory is required to be reduced by ₹ 5,000 at the end of 2018-2019 and increased by ₹ 12,000 at the end of 2019-2020. (Inventory of 2018-19 has been sold out during the year 2019-20)
3) MNT Ltd. deducts 2% from Trade Receivables as a general provision against doubtful debts.
4) Prepaid expenses in MNT Ltd. include Sales Promotion expenditure carried forward of ₹ 25,000 in 2018-19 and ₹ 12,500 in 2019-20 being part of initial Sales Promotion expenditure of ₹37,500 in 2018-19, which is being written off over three years. Similar nature of Sales Promotion expenditure of LTC Ltd. has been fully written off in 2018-19.

Restate the balance sheet of MNT Ltd. as on 31st March, 2020 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by LTC Ltd. and MNT Ltd. uniform.

Solution

Working Note: **Adjusted revenue reserves of MNT Ltd.:**

Particulars	Amount	Amount
Revenue reserves as given		5,05,000
Add: Provision for doubtful debts [3,43,000 X 2/98)	7,000	
Add: Increase in value of inventory	12,000	19,000
		5,24,000
Less: Sales Promotion expenditure to be written off		(12,500)
Adjusted revenue reserve		**5,11,500**

Restated Balance Sheet of MNT Ltd. as at 31st March, 2020

Particulars	Note No.	Amount
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		7,50,000
(b) Reserves and Surplus	1	7,18,500
(2) Current Liabilities		
(a) Short term borrowings	2	1,70,000
(b) Trade Payables		2,46,000
(c) Short-term provision	3	4,30,000
Total		**23,14,500**
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment & Intangible Assets		
i) Property, Plant & Equipment	4	6,37,500
(b) Non-current Investment		5,30,000
(2) Current assets		
(a) Inventories (6,90,000 +12,000)	5	7,02,000
(b) Trade Receivables (343000/98X100)		3,50,000
(c) Cash & Cash Equivalents		42,500
(d) Other current assets	6	52,500
Total		**23,14,500**

Notes to Accounts

	Particulars		Amount
1	**Reserves and Surplus**		
	Revenue Reserve (refer W.N.)	5,11,500	
	Securities Premium	2,07,000	7,18,500
2	**Short term borrowings**		
	Bank overdraft		1,70,000
3	**Short-term provision**		
	Provision for taxation		4,30,000
4	**Property, Plant and Equipment**		
	Cost	9,20,000	
	Less: Depreciation to date	(2,82,500)	6,37,500
5	**Inventories**	6,90,000	
	Increase in value as per FIFO	12,000	7,02,000
6	**Other current assets**		
	Prepaid expenses (After adjusting sales promotion expenses to be written off each year) (65,000 -12,500)		52,500

Question 7 - *(Inter May 2023) (15 Marks)* *Pg no._____*

G Ltd. & its subsidiary K Ltd. give the following information for the year ended 31st March, 2023:

(in crores)

Particulars	G Ltd. ₹	K Ltd. ₹
Sales and other Income	3,000	750
Increase in Inventory	750	100
Raw material consumed	600	100
Wages and Salaries	600	75
Production expenses	100	50
Administrative expenses	75	50
Selling and Distribution expenses	100	25
Interest	75	30
Depreciation	75	30

The following information is also given:

a. G Ltd. sold goods of ₹ 200 crores to K Ltd. at cost plus 25%. (1/5th of such goods were still in inventory of K Ltd. at the end of the year)

b. G Ltd. holds 75% of the Equity share capital of K Ltd. and the Equity share capital of K Ltd. is ₹ 800 crores on 01.04.2022 (date of acquisition of shares)

c. Administrative expenses of K Ltd. include ₹ 5 crore paid to G Ltd. as consultancy fees. Also, selling and distribution expenses of G Ltd. include ₹ 20 crores paid to K. Ltd. as commission.

Prepare a consolidated statement of Profit and Loss of G Ltd, with its subsidiary K Ltd. for the year ended 31st March, 2023.

Solution

Consolidated statement of profit and loss of G Ltd. and its subsidiary K Ltd.
for the year ended on 31st March, 2023

Particulars	Note No.	₹ in Crores
I. Revenue from operations	1	3,525
II. Total Income		3,525
III. Expenses		
Cost of material purchased/consumed	2	650
Changes of inventories of finished goods	3	(842)
Employee benefit expense	4	675
Finance cost	5	105
Depreciation and amortization expense	6	105
Other expenses	7	225
Total expenses		918
IV. Profit before tax (II-III)		2,607

Note: The information (i) given in the question states that G Ltd. sold goods of ₹ 200 crores to K Ltd. at cost plus 25%. In the above solution it has been considered that the amount of ₹ 200 crores is sale value. Alternatively, ₹ 200 crores may be assumed as the cost of the goods sold.

Notes to Accounts

		₹ Crores	₹ Crores
1.	Revenue from operations		
	Sales and other income		
	G Ltd.	3,000	
	K Ltd.	750	
		3,750	
	Less: Inter-company sales	(200)	
	Consultancy fees received by G Ltd. from K Ltd.	(5)	
	Commission received by K Ltd. from G Ltd.	(20)	3,525
2.	Cost of material purchased/consumed		
	G Ltd.	600	
	K Ltd.	100	
		700	
	Less: Purchases by K Ltd. from G Ltd.	(200)	500
	Direct expenses (Production)		
	G Ltd.	100	
	K Ltd.	50	150
			650
3.	Changes of inventories of finished goods		
	G Ltd.	750	
	K Ltd.	100	
		850	
	Less: Unrealized profits ₹ 40 crores × 25/125	(8)	842
4.	Employee benefits and expenses		
	Wages and salaries:		
	G Ltd.	600	
	K Ltd.	75	675
5.	Finance cost		
	Interest:		
	G Ltd.	75	
	K Ltd.	30	105
6.	Depreciation		
	G Ltd.	75	
	K Ltd.	30	105
7.	Other expenses		
	Administrative expenses		
	G Ltd.	75	
	K Ltd.	50	
		125	
	Less: Consultancy fees received by G Ltd. from K Ltd.	(5)	120
	Selling and distribution Expenses:		
	G Ltd.	100	
	K Ltd.	25	
		125	
	Less: Commission received by K Ltd. from G Ltd.	(20)	105
			225

AS-23

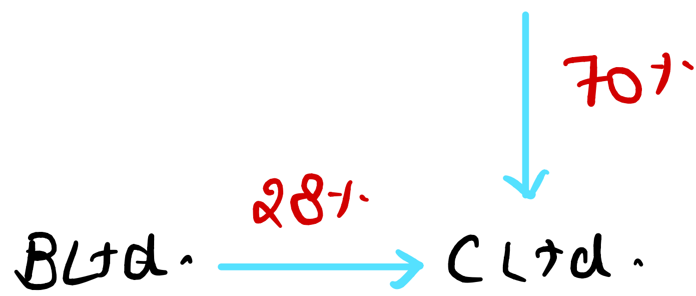
Accounting for Investment in Associates in Consolidated Financial Statements

Meaning of Associate: Enterprise in which investor has significant influence* & which is neither subsidiary or joint venture of Investor.

* **Significant Influence:** Power to participate in financial/or operating policy decisions of investee. It may be gained by statute, agreement or share ownership (Assume 20% or more unless otherwise proved)

Example:

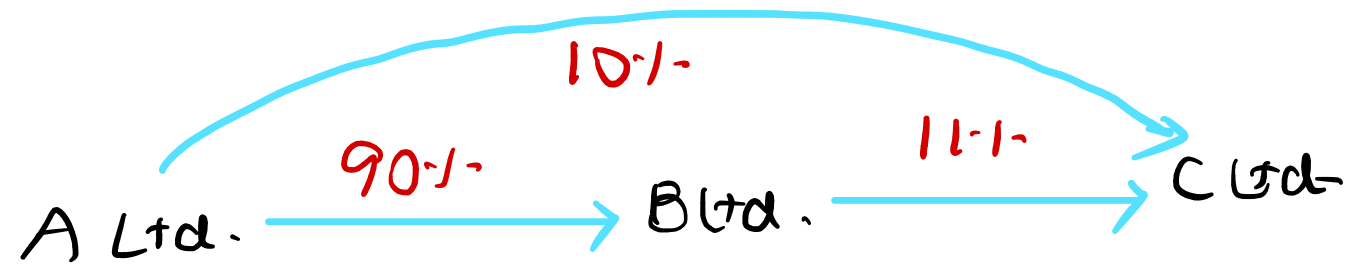
(a) A Ltd.



A Ltd. is holding co. of C Ltd.

C Ltd. will be associate of B Ltd.

(b)



A Ltd. is holding co. of B Ltd.

A Ltd. has total of direct & indirect (10% + 11%) 21% in C Ltd., so C Ltd. is associate of A Ltd.

For CFS, holding will be 19.9% (10% + 90% of 11%)

Accounting Treatment

Separate Financial Statements

Apply AS 13

Investments recorded at cost	xxx
– Pre Acquisition Dividend	(xxx)
	xxx

Consolidated Financial Statements

Temporary

Apply AS 13

Permanent

Use Equity Method of Accounting (AS 23)

Temporary:

a) Investment is acquired & held to dispose off in near future (or)

b) Investee operates under Long Term restrictions which impair its ability to transfer funds to the investor.

Equity Method of Accounting:

1) Investment recorded at cost xxx
   - Pre Acquisition Dividend (xxx) xxx

2) Calculate Goodwill / Capital Reserve (Identify / Disclose)

3) Post Acquisition Profits (Revalued): Our share

   Investment in Associate A/c – Dr
   To Consolidated P&L A/c (Post Profits Share)

4) Post Acquisition Dividend to be deducted

* **Step Acquisition:** If shares acquired in steps, that is in parts, then Goodwill / Capital Reserve should be calculated for each part.

Example: X Ltd. acquired 10% shares of B Ltd. on 1/4 & further 15% on 1/10.
Cost of Investment for 10% ₹1,00,000 & for 15% ₹1,55,000
Net Assets of B Ltd. on 1/4 850000 & on 1/10 10,00,000.

* **If Investment in Associate becomes negative:** Discontinue recording further los
* **Use Uniform Accounting Policies**
* **Treatment of Proposed Dividend:** Compute investor's share of results without taking into consideration the proposed dividend.
* **Consideration of Potential Equity Share of Investee by Investor:** It should not be taken into account for determing voting power of the investor.

ACCOUNTING FOR INVESTMENT IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

AS 23

Question 1 *(ICAI Study Material)*

A Ltd. acquire 45% of B Ltd. shares on April 01, 2021, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 2021:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 2022. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 2022.

Question 2 *(ICAI Study Material)*

A Ltd. acquired 40% share in B Ltd. on April 01, 2021 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 2021-2022, B Ltd. suffered a loss of ₹ 10,00,000; during 2022-2023 loss of ₹ 12,50,000 and during 2023-2024 again a loss of ₹ 5,00,000.

Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Question 3 *(ICAI Study Material)*

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-2021. By such an acquisition Bright can exercise significant influence over East India Ltd.

During the financial year ending on 31-03-2021 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-2021. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-2022 (assume profits to accrue evenly) and declared dividend of ₹ 60,000 on 12-06-2022.

Calculate the carrying amount of investment in:

i. Separate financial statements of Bright Ltd. as on 31-03-2022.

ii. Consolidated financial statements of Bright Ltd.; as on 31-03-2022.

iii. What will be the carrying amount as on 30-06-2022 in consolidated financial statements?

Question 4 *(ICAI Study Material)*

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2021 for ₹ 3 lakhs. TheBalance Sheet of B Ltd. as on 31.3.2021 is given below:

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

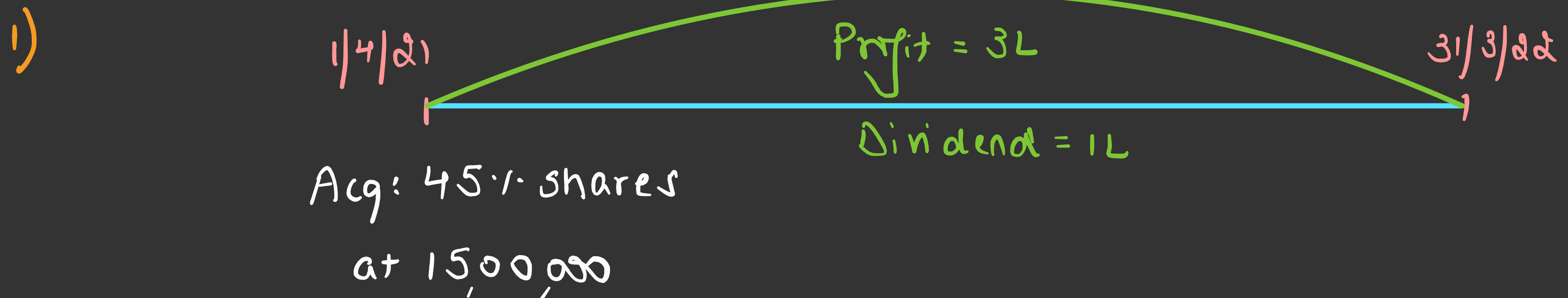
During the year ended 31.3.2022 the following are the additional informationavailable:

a. A Ltd. received dividend from B Ltd., for the year ended 31.3.2021 at 40% from Reserves
b. B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2022.
c. B Ltd., declared a dividend @ 50% for the year ended 31.3.2022 on 30.4.2022.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS21 for its various subsidiaries. Calculate:

a. Goodwill if any on acquisition of B Ltd.'s shares.
b. How A Ltd., will reflect the value of investment in B Ltd., in Consolidated Financial Statements?
c. How dividend received from B Ltd. will be shown in ConsolidatedFinancial Statements?

1)



Computation of Goodwill / Capital Reserve

Cost of Investments	15,00,000
- 45% share in Net Assets (Share cap. + Pre Profits) X 45% (10L + 1L + 5L) X 45%	(720000)
Goodwill	780000

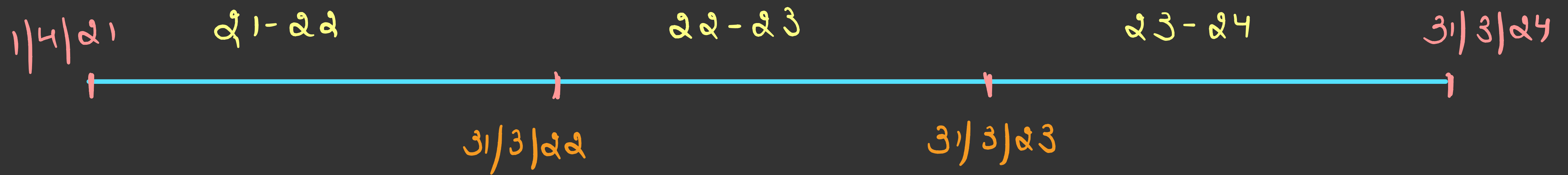
Carrying Amount of Investments on 31/3/22 in Consolidated Financial statements

Cost of Investments (incl. Goodwill of 780000)	1500000
+ Post Profits share (300000 X 45%)	135000
- Dividend Received (100000 X 45%)	(45000)
	1590000

ICAI Presentation

Share of Net Assets in B Ltd.	720000
+ Goodwill	780000
	1500000
+ Post Profits share	135000
- Dividend Received	(45000)
	1590000

2)



B/S (Extract) : Consolidated Financial statements

	1/4/21	31/3/22	31/3/23	31/3/24
Investment in Associate (40% shares of B Ltd.) (including Goodwill of 520000)	10,00,000	6,00,000	1,00,000	Nil

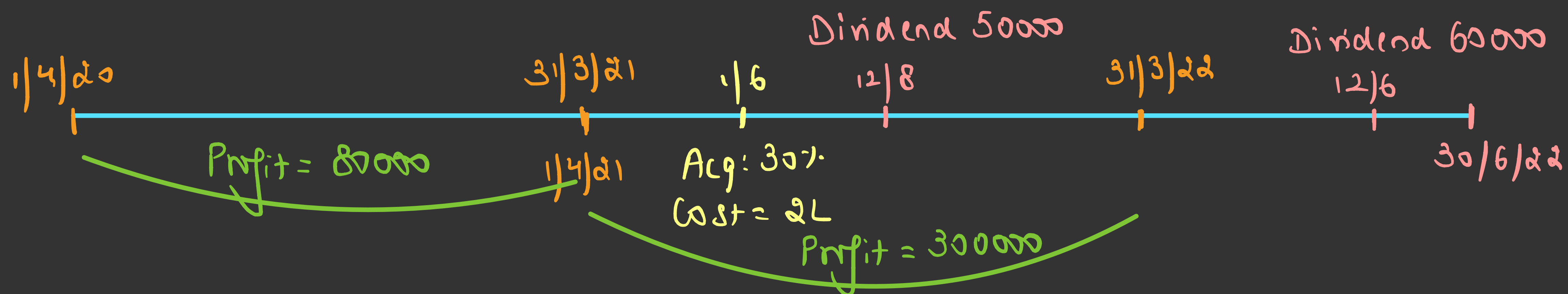
Computation of Goodwill / capital Reserve

Cost of Investments	1000000
- 40% share in Net Assets (Share cap. + Pre Profits) X 40% (10L + 2L) X 40%	(480000)
Goodwill	520000

Cost of Investment (1/4/21)	=	1000000
- Share in loss (10L X 40%)	=	(400000)
Value on 31/3/22		600000
- Share in loss (12.50L X 40%)		(500000)
Value on 31/3/23		100000
- Share in loss (5L X 40%)		(200000)
Value on 31/3/24		(100000)

Shown as NIL

3)



a) Value of Investments (31/3/22) : separate

Cost of Investments	=	200000
− Pre Acq. Dividend (50000 x 30%)	=	(15000)
		185000

b) Value of Investments (31/3/22): Consolidated Financial statements

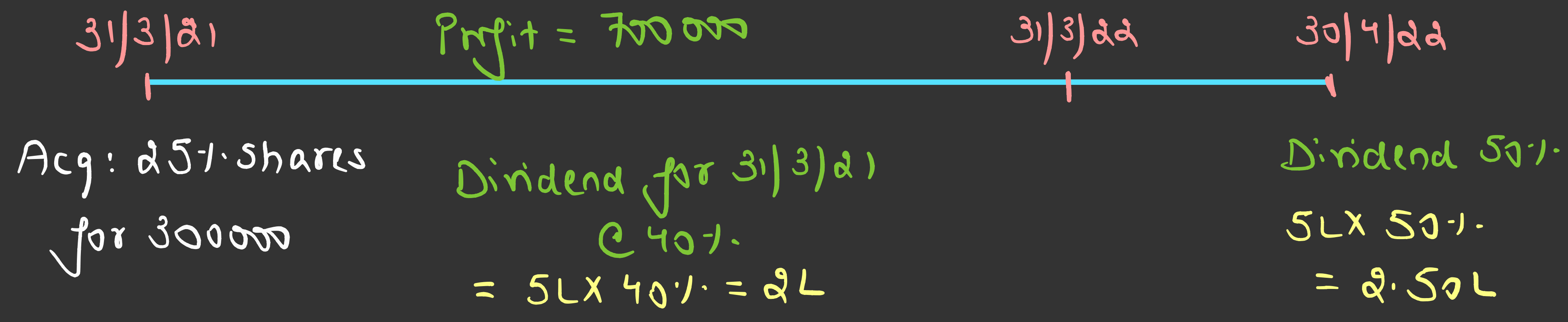
Value of Investments	185000
+ Post Profits share $\left(300000 \times \frac{10}{12}\right) \times 30\%$	75000
	260000

c) Value of Investments (30/6/22): Consolidated Financial statements

Value on 31/3/22	=	260000
+ Post Profits share (3M)	=	-
− Dividend share (60000 x 30%)		(18000)
		242000

Goodwill / capital Reserve cannot be computed so not disclosed.

4)



a) Computation of Goodwill / Capital Reserve

Cost of Investments	300000
− Pre Acq. Dividend (200000 X 25%)	(50000)
	250000
− 25% Share of Net Assets (Sh. cap + Pre Profits) X 25% (5L + 5L) X 25%	(250000)
	NIL

b) Value of Investments in CFS

Cost of Investments	250000
+ Share in Post Profits (21-22) (700000 X 25%)	175000
	425000

Inv. in Associate A/c − Dr 175000

To Cons. P&L A/c 175000

c) Dividend received (250000 X 25%) will not be shown in CFS as received after 31/3/22.

DISCONTINUING OPERATIONS

AS 24

Objective	AS 24 is applicable to all discontinuing operations. The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.
Discontinuing Operation	A discontinuing operation is a component of an enterprise: (PARA 3) a) That the enterprise, pursuant to a single plan, is: ➢ *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 ➢ *Disposing of piecemeal*, such as by selling off the component's assets and settling its liabilities individually or ➢ Terminating through *abandonment* and b) That represents a separate major line of business or geographical area of operations. c) That can be distinguished operationally and for financial reporting purposes. A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation - if all the following conditions are met: a. The operating assets & liabilities of the component can be directly attributed to it. b. Its revenue can be directly attributed to it. c. At least majority of its operating expenses can be directly attributed to it. Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 does not, in itself, bring into question the enterprise's ability to continue as a going concern. *Examples of activities* that do not necessarily satisfy criterion(a)of 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. An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Initial Disclosure event	Occurrence of one of the following, *whichever occurs earlier:* a) The enterprise has entered into a binding sale agreement for substantially all of assets attributable to the discontinuing operation or b) The enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan. A detailed, formal plan for the discontinuance normally includes: ➢ identification of the major assets to be disposed of; ➢ the expected method of disposal; ➢ the period expected to be required for completion of the disposal; ➢ the principal locations affected; ➢ the location, function, and approximate number of employees who will be compensated for terminating their services; and ➢ the estimated proceeds or salvage to be realised by disposal. An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.
Recognition and Measurement	For recognising and measuring the effect of discontinuing operations, this AS does not provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.
Presentation & Disclosure (Initial Disclosure) *(Inter Nov 2018 / Nov 2023) (5 Marks)*	An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs: ❖ A description of the discontinuing operation(s) ❖ The business or geographical segment(s) in which it is reported as per AS 17 ❖ The date and nature of the initial disclosure event. ❖ The date or period in which the discontinuance is expected to be completed if known or determinable ❖ The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled ❖ The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period ❖ The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto ❖ The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period
Presentation of the above disclosures	All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last above) which should be shown on the face of the statement of profit and loss.

Updating the disclosures	In addition to these disclosures, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes. The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed. Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received. Any disclosures required by AS 24 should be presented separately for each discontinuing operation.
Disclosure in interim financial reports *(RTP Nov 2022)*	Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including: a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and b. Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Example 1:
Co XY runs a famous chain of restaurants. It decides to sell its stake in one of the restaurant. This restaurant contributes around 5% of total revenue to the entire business. XY does not intend to sell any other restaurant as part of its strategy.

In the above case, the sale of one restaurant out of the chain does not constitute disposal of business under a single plan, or a portion that represents a major line of business or geographical area of operations. Thus, it cannot be regarded as a discontinuing operation.

Example 2:
Group MN operates in various industries including Hotels, Airlines and Software through its subsidiaries. It has decided to sell its Airline business to be able to concentrate on other verticals. As a result, it has started to sell its aircrafts and paying off the associated liabilities. During the year, it has sold off 5 aircrafts out of the fleet of 50 aircrafts so far as part of the sale. The Airline business constitutes 25% of total group revenue.

In the above case, Airline business may be considered as discontinuing operation. This is due to the fact that the assets are sold off as part of a single plan, and that the business represents a separate major line of business, and can be distinguished both operationally and for financial reporting purposes.

Example 3:
GH, a large car manufacturing company, decides to discontinue its manufacturing operations relating to the diesel cars production. It plans to restructure the business by revamping its existing operations, and starting new manufacturing process for manufacture and sale of electric vehicles.

In the above example, it needs to be evaluated whether the restructuring is a result of continuing operations, or termination of existing operations, and accordingly it can be concluded whether it is a case of discontinuing operations or not.

Example 4:
Entity RT operates in a single state and is trading in 3 products – X, Y and Z. Details with respect to the performance of each of the products are as under:

Particulars	X	Y	Z	Total
Sales	1,00,000	14,00,000	20,00,000	35,00,000
Cost of Goods Sold	(80,000)	(10,80,000)	(14,40,000)	(26,00,000)
Gross Margin	20,000	3,20,000	5,60,000	9,00,000
Operational Expenses	(15,000)	(1,70,000)	(3,60,000)	(5,45,000)
Profit before tax	5,000	1,50,000	2,00,000	3,55,000

RT has decided to sell the business relating to Product Y to another entity. Since Product Y constitutes a major product, it may be considered as a discontinuing operations.

Question 1 *(RTP May 2018) / (RTP May 2023)*

A consumer goods producer has changed the product line as follows:

	Dish Washing Bar (per month)	Clothes Washing Bar (per month)
January, 2021 – September, 2021	2,00,000	2,00,000
October, 2021 – December, 2021	1,00,000	3,00,000
January, 2022- March, 2022	0	4,00,000

The company has enforced a gradual enforcement of change in product-line on the basis of an overall plan. The Board of Directors of the company has passed a resolution in March, 2022 to this effect. The company follows calendar year as its accounting year. You are required to advise whether it should be treated as a discontinuing operation or not as per AS 24?

Solution
As per AS 24, a discontinuing operation is a component of an enterprise:
a. That the enterprise, pursuant to a single plan, is:
- (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
- (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
- (iii) Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.
c. That can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are 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.

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 2 *(Inter July 2021) (5 Marks) / (RTP May 2021) (Similar) / (ICAI Study Material)*

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:

a) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
b) 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?
c) 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

a) As per AS 24, a discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a single plan, is:
   (iv) 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
   (v) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
   (vi) Terminating through abandonment and

b. That represents a separate major line of business or geographical area of operations.

c. That can be distinguished operationally and for financial reporting purposes.

Mere gradual phasing is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operation'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

1) Gradual or evolutionary phasing out of a product line or class of service.
2) Shifting of some production or marketing activities for a particular line of business from one location to another and
3) Closing of a facility to achieve productivity improvements or other cost savings.

In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan 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.

b) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

c) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap. Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Discontinuing Operations (AS-24)

[Reporting/Disclosure information enhancing users ability to make projections]

Meaning

Component of enterprise

- Persuant to single plan
  - Disposing of Substantially in Entirety
  - Piecemeal Distribution
  - Terminating through Abandonement
- Represents separate major line of business or geographical area of operations
- Can be distinguished operationally & for financial reporting purposes

Initial Disclosure Event

Earlier of

* Entered into binding sale agreement **or**
* BOD approved formal plan & Announcement

Disclosure

* Describe Discontinuance
* Whether business or geographical segment
* Date & Nature of IDE
* Carrying Amount of Assets & Liabilities
* Revenue & Expenses Attributable
* Pre Tax Profit/(Loss) & Tax Expense (Face of Statement of P&L)
* Net Cash flows attributable

AS 25
Interim Financial Reporting

Meaning of Interim Financial Report: Financial Report containing either a complete set of financial statements or set of condensed financial statements for an interim period.

Interim Period: Financial Reporting period shorter than full financial year.

Note: First Year of operations: Annual period may be shorter than financial year, still it is not considered as interim period.

Scope: Prescribes minimum contents of an IFR & requires that an enterprise which elects to prepare & present an IFR should comply with this AS.

It is a kind of update on complete financial statements of last year. This helps in timely, better & reliable information for users.

Note:
- AS 25 does not mandate which enterprises should be required to present IFR.
- Clause 33 & 41 of SEBI Listing Requirements has no relationship with IFR. These clauses with Interim Financial Results.

However, Recognition & Measurement principles laid down in AS 25 applied in Clause 33 & 41 Reporting.

Contents of IFR: Balance sheet, Statement of P&L, Cash flow Statement & Notes to Accounts

- It can be complete/full, just like annual statements or condensed.
- If such statements are complete consider Interim Period as complete period & prepare financial statements
- If such statements are condensed, then Head & Subheads should be as in most recent annual financial statements

* Selected Notes to Accounts in condensed statements should be of significant events & transactions like
  - Gain / Loss on sale of PPE
  - Decline in value of Inventory
  - Reversal of Provision
  - Impairment loss
  - Related Party Transaction
  - Litigation Settlement

* Statement of Policies, methods & estimates if changed
* Disclosure of EPS, Segment Information
* Disclosure of Business Combinations
* Nature & Amount of items affecting Assets, Liab., Income, Exp. which is unusual.

Period for which Interim Financial Statements to be presented

Statement	Current Period	Comparitive Period
Balance Sheet	Last date of Interim Period (30/9/23)	Year End Previous Year (31/3/23)
Statement of Profit & Loss	For Interim Period For Year to Date Current Year (1/7/23 to 30/9/23) & (1/4/23 to 30/9/23)	For Previous Year Interim Period For Year to Date Previous Year (1/7/22 to 30/9/22) & (1/4/22 to 30/9/22)
Cash Flow Statement	Year to date Current Year (1/4/23 to 30/9/23)	Year to Date Previous Year. (1/4/22 to 30/9/22)

Eg: FY 23-24 Interim Period 1/7/23 to 30/9/23.

Recognition & Measurement

1) **Income / Revenue :** which is seasonal, occassional etc. should not be deferred. Recognise revenue as usual (when they occur). Apply Accrual concept.

2) **Expenses :** All expenses or losses, which are seasonal or infrequent cannot be deferred, unless appropriate. Recognise when incurred.

3) **Change in Accounting Estimate :** If any change during Interim period, its financial effect should be fully considered in Interim period.

4) **Change in Accounting Policy :** If any change during Interim period, its financial effect related to Interim period should be considered in the period.

Provision

* Entity should make best estimate for provision at the end of each Interim period.
* **Provision for Tax :** Calculate Weighted Average Tax Rate for full year & apply this rate for Interim Period.

INTERIM FINANCIAL REPORTING

Question 1 *(ICAI Study Material)*

Intelligent Corporation (I-Corp.) is dealing in seasonal products. The quarterly sales pattern of the product is given below:

Quarter I	II	III	IV
Ending 30th June 15%	30th September 15%	31st December 50%	31st March 20%

For the First quarter ending 30th June, 2021, I-Corp. gives you the following information:

	₹ crores
Sales	50
Salary and other expenses	30
Advertisement expenses (routine)	02
Administrative and selling expenses	08

While preparing interim financial report for the first quarter, 'I-Corp.' wants to defer ₹ 21 crores expenditure to third quarter on the argument that third quarter is having more sales, therefore, third quarter should be debited by higher expenditure, considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.
Calculate the result of first quarter as per AS 25 and comment on the company's view.

Solution:
Result of the first quarter ended 30th June, 2021

			(₹ in crores)
Turnover			50
Add: Other Income			Nil
Total			50
Less: Change in inventories		Nil	
Salaries and other cost		30	
Administrative and selling expenses	(8 + 2)	10	40
Profit			10

As per AS 25 on Interim Financial Reporting, the income and expense should be recognized when they are earned and incurred respectively. As per AS 25, the costs should be anticipated or deferred only when

i. it is appropriate to anticipate that type of cost at the end of the financial year,and
ii. costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of ₹ 21 crores is not tenable as expenditures are uniform throughout all quarters.

Question 2 *(ICAI Study Material)*

Accountants of Poornima Ltd. showed a net profit of ₹ 7,20,000 for the third quarter of 2021 after incorporating the following:

i. Bad debts of ₹ 40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

ii. Extra ordinary loss of ₹ 35,000 incurred during the quarter has been fully recognized in this quarter.

iii. Additional depreciation of ₹ 45,000 resulting from the change in the method of charge of depreciation assuming that ₹ 45,000 is the charge for the 3rd quarter only.

Ascertain the correct quarterly income.

Solution:

In the above case, quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows: Bad debts of ₹ 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹ 20,000 to the next quarter. Therefore, ₹ 20,000 should be deducted from ₹ 7,20,000.

The treatment of extra-ordinary loss of ₹35,000 being recognized in same quarter is correct. Recognizing additional depreciation of ₹ 45,000 in the same quarter is in tune with AS 25. Hence no adjustments are required for these two items.

Poornima Ltd should report quarterly income as ₹ 7,00,000 (₹ 7,20,000 – ₹ 20,000).

Question 3 *(ICAI Study Material)*

On 30th June, 2021, Asmitha Ltd. incurred ₹ 2,00,000, net loss from disposal of a business segment. Also, on 31st July, 2021, the company paid ₹ 60,000 for property taxes assessed for the calendar year 2021. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30th September, 2021.

Solution

As per AS 25 "Interim Financial Reporting", if an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements.

As at 30th September, 2021, Asmitha Ltd would report the entire amount of ₹ 2,00,000 as loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to interim periods on accrual basis.

Since ₹ 60,000 Property tax payment relates to entire calendar year 2021, ₹ 30,000 would be reported as an expense for six months ended on 30th September, 2021 while out of the remaining ₹ 30,000, ₹ 15,000 for January, 2021 to March, 2021 should be shown as payment of the outstanding amount of previous year and another ₹ 15,000 related to quarter October, 2021 to December, 2021 would be reported as prepaid expenses.

Question 4 *(ICAI Study Material)*

Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 4 lakhs for the third quarter ending 30-09-2021. On enquiry you observe the following. Give the treatment required under AS 25:

a. Dividend income of ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.
b. 80% of sales promotion expenses ₹ 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.
c. In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of ₹12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.
d. ₹ 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.
e. Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.
f. Sale of investment in the first quarter resulted in a gain of ₹ 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter.

Solution

Statement showing Adjusted Profit Before Tax for the third quarter

	(₹ in lakhs)
Profit before tax (as reported)	4
Add: Dividend income ₹ (4-1) lakhs	3
Excess depreciation charged in the 3rd quarter, due to change in method	-
Extra ordinary gain ₹ (2-1) lakhs	1
Cumulative loss due to change in the method of inventory valuation should be applied retrospectively ₹ (3-2) lakhs	1
	9
Less: Sales promotion expenses (80% of ₹ 15 lakhs)	(12)
Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	(8)

Question 5 *(ICAI Study Material)*

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

Question 6 *(ICAI Study Material)*

The accounting year of X Ltd. ends on 30th September, 2021 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year from 1-10-2020 to 30-9-2021, the quarterly income is as under:

1st quarter ending on 31st December, 2020	₹ 200 crores
2nd quarter ending on 31st March, 2021	₹ 200 crores
3rd quarter ending on 30th June, 2021	₹ 200 crores
4th quarter ending on 30th September, 2021	₹ 200 crores
Total	₹ 800 crores

Average actual tax rate for the financial year ending on 31st March, 2021 is 20% and for financial year ending 31st March, 2022 is 30%. Calculate tax expense for each quarter.

Solution 5:

Total estimated Income = 10 Lakhs

Total estimated Tax

0 - 5 Lakhs = 5 Lakhs × 30% = 150000

5 Lakhs - 10 Lakhs = 5 Lakhs × 40% = 200000

350000

$$\text{Average Tax Rate} = \frac{350000}{1000000} \times 100 = 35\%$$

1st = 75000 × 35% = 26250

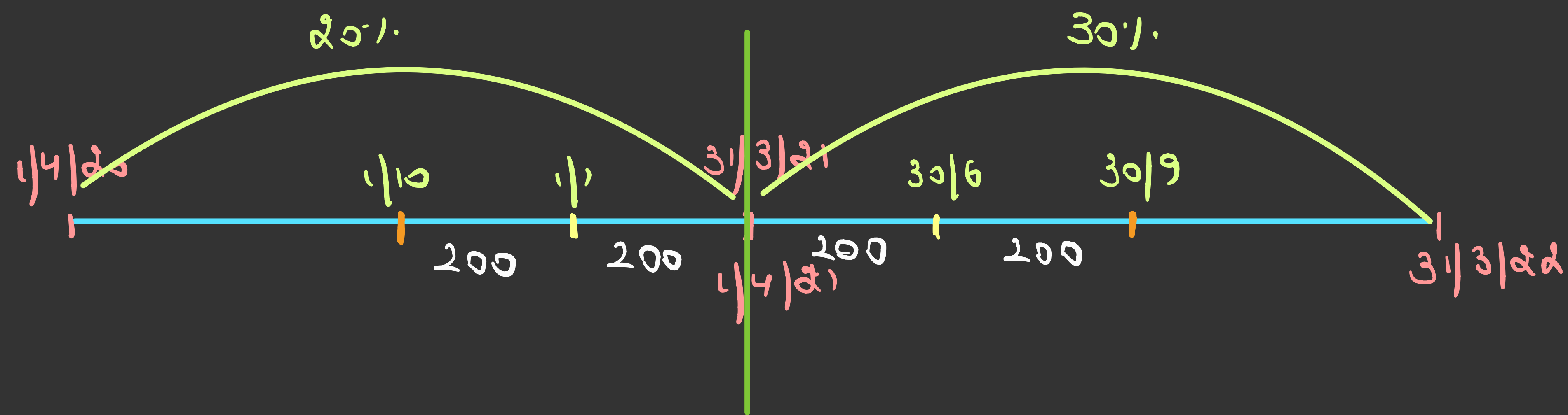
2nd = 250000 × 35% = 87500

3rd = 375000 × 35% = 131250

4th = 300000 × 35% = 105000

350000

Solution 6:



1/10/20 to 31/12/20 = 200 cr. X 20% = 40 cr

1/1/21 to 31/3/21 = 200 cr. X 20% = 40 cr.

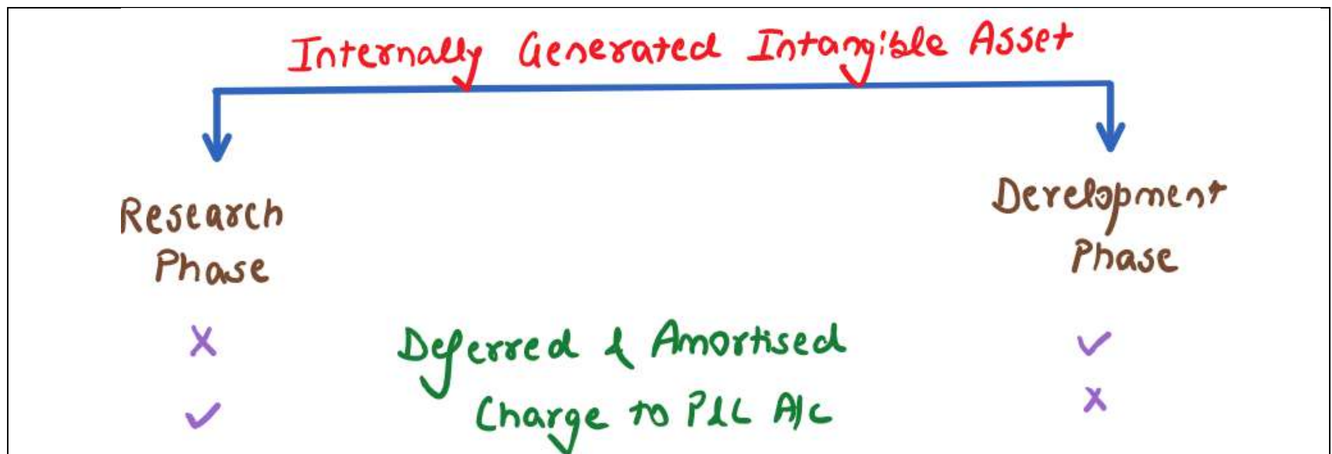
1/4/21 to 30/6/21 = 200 cr. X 30% = 60 cr.

1/7/21 to 30/9/21 = 200 cr. X 30% = 60 cr.

INTANGIBLE ASSETS

AS 26

<table>
<tr><td>Meaning of intangible asset-</td><td>It is an
→ Identifiable
→ Non monetary asset
→ Without any physical substance
→ Held for economic benefits i.e. either for use in production or supply of goods or services, for rental to others or for administrative purposes.
→ Under the control of entity</td></tr>
<tr><td>Essential components</td><td>❖ It must be identifiable i.e. the asset must be separable from other assets.
❖ It must be controlled by the enterprise
❖ Future economic benefits must be associated with an intangible asset</td></tr>
<tr><td>Recognition of Intangible asset</td><td>An intangible asset should be recognized if and only if
→ It meets all the essential elements of an intangible assets
→ It is probable that future economic benefits will flow to the enterprise
→ Cost of the asset can be measured reliably.</td></tr>
<tr><td colspan="2">MEASUREMENT OF INTANGIBLE ASSETS</td></tr>
<tr><td>Procurement /Separate Acquisition</td><td>Cost of Intangible Assets include the following:
<table>
<tr><td>Purchase price</td><td>XX</td></tr>
<tr><td>Add: Non-refundable taxes & duties</td><td>XX</td></tr>
<tr><td>Add: Directly attributable expenditure on making the asset ready for its intended use.*</td><td>XX</td></tr>
<tr><td>Less: Trade discount & rebates</td><td>(XX)</td></tr>
<tr><td>Cost of Asset</td><td>XX</td></tr>
</table>
*<u>Example</u>: Professional fees for legal services</td></tr>
<tr><td>In Exchange For Another Asset or Shares/Other Securities</td><td>Cost of Intangible Asset is
➢ Fair Market Value (FMV) of Asset given / Securities issued
or
➢ Fair Market Value (FMV) of the Asset acquired
whichever is more clearly evident.
<u>Note:</u> (a) FMV of the shares /securities to be considered & not Book value
(b) Such value is to be seen on the date of transaction</td></tr>
<tr><td>Acquisition By Way Of Government Grant</td><td>
<table>
<tr><td>Given at concessional rate</td><td>On the basis of their acquisition costs</td></tr>
<tr><td>Given free of cost</td><td>Record at nominal value</td></tr>
</table>
This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences, etc.</td></tr>
</table>



*Development Phase:

Amount Capitalised = Lower of Cost or Recoverable Amount

Where Recoverable amount = Present value of Future Cash Flows

→ If an enterprise cannot distinguish the research phase from the development phase to create an intangible asset, the expenditure should be treated as if it were incurred in the research phase only.

→ 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.

Development phase (PARA 44)	An intangible asset arising from development should be recognized if and only if an enterprise can demonstrate all of the following: → Technical feasibility established → Marketability proved → Identification of cost incurred → Realistic expectation that there will be sufficient future revenue to cover cost → Intention to complete the asset and use or sell it.
Cost of an Internally Generated Intangible Asset	The following are not components of the cost of an internally generated intangible asset: ➢ Selling, administrative & other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use. ➢ Clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance and ➢ Expenditure on training the staff to operate the asset
AMORTISATION PERIOD (PARA 63)	
Basis of allocation	Depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life.
Presumption as to the useful life	It will not exceed 10 years from the date when the asset is available for use unless there is persuasive evidence that intangible asset has higher useful life.
When should it commence?	Amortisation should commence when asset is available for use.
Notes	Given the history of rapid changes in technology, computer software and other intangible asset is susceptible to technological obsolescence, it is likely that useful life of the software etc. will be much shorter, say 3-5 years

AMORTISATION METHOD	
Which method to follow	❖ The method used should reflect the pattern in which assets economic benefits are consumed by enterprise (In the ratio of future cash flows) ❖ If that pattern cannot be determined reliably, the SLM should be used.

REVIEW OF AMORTISATION PERIOD AND METHOD
The amortisation period and method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5

DERECOGNITION OF INTANGIBLE ASSETS I.E. RETIREMENT & DISPOSAL	
When to Derecognize?	Intangible asset should be derecognized (eliminated from balance sheet) → on disposal or → when no future economic benefits are expected from its use & subsequent disposal.
Treatment	Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

Question 1 *(Inter Jan 2021) (5 Marks)* *Pg no.____*

A Company acquired for its internal use a software on 01.03.2020 from U.K. for £ 1,50,000. The exchange rate on the date was as ₹ 100 per £. The seller allowed trade discount @ 2.5%. The other expenditures were:

(i) Import Duty 10%
(ii) Additional Import Duty 5%
(iii) Entry Tax 2% (Recoverable later from tax department).
(iv) Installation expenses ₹ 1,50,000.
(v) Professional fees for clearance from customs ₹ 50,000.

Compute the cost of software to be Capitalized as per relevant AS

Solution

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

	Amount
Purchase cost of the software (UK £)	1,50,000
Less: Trade discount @ 2.5% (UK £)	(3,750)
	1,46,250
Cost in ₹ (UK £1,46,250 x ₹ 100)	1,46,25,000
Add: Import duty on cost @ 10% (₹)	14,62,500
	1,60,87,500
Add: Additional import duty @ 5% (₹)	8,04,375
	1,68,91,875
Add: Installation expenses (₹)	1,50,000
Add: Professional fee for clearance from customs (₹)	50,000
Cost of the software to be capitalized (₹)	1,70,91,875

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

Question 2 *(Inter May 2018) (5 Marks)* *Pg no.____*

A company acquired a patent at a cost of ₹ 160 lakhs for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortising the asset at ₹ 16 lakhs per year based on the economic benefits derived from the product manufactured under the patent. After 2 years it was found that the product life cycle may continue for another 5 years from then (the patent is renewable and the company can get it renewed after 5 years). The net cash flows from the product during these 5 years were expected to be ₹ 50 lakhs, ₹ 30 lakhs, ₹ 60 lakhs, ₹ 70 lakhs and ₹ 40 lakhs. Find out the amortization cost of the patent for each of the years.

Solution

Company amortized ₹ 16,00,000 per annum for the first two years. Hence, Amortization for the first two years (₹ 16,00,000 X 2) = ₹ 32,00,000.
Remaining carrying cost after two years =₹ 1,60,00,000 – ₹ 32,00,000 = ₹ 1,28,00,000
Since after two years it was found that the product life cycle may continue for another 5 years, hence the remaining carrying cost ₹128 lakhs will be amortized during next 5 years in the ratio of net cash arising from the sale of the products of Fast Limited.
The amortization cost of the patents may be computed as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount
3	50,00,000	5	25,60,000
4	30,00,000	3	15,36,000
5	60,00,000	6	30,72,000
6	70,00,000	7	35,84,000
7	40,00,000	4	20,48,000
Total	2,50,00,000	25	1,28,00,000

Question 3 *(Inter Nov 2020) (5 Marks) / (RTP Nov 2023)* *Pg no._____*

Swift Limited acquired patent rights to manufacture Solar Roof Top Panels at a cost of ₹ 600 lacs. The product life cycle has been estimated to be 5 years and the amortization was decided in the ratio of future cash flows which are estimated as under:

Year	1	2	3	4	5
Cash Flows (₹ in lacs)	300	300	300	150	150

After 3rd year, it was estimated that the patents would have an estimated balance future life of 3 years and Swift Ltd. expected the estimated cash flow after 5th year to be ₹ 75 Lacs. Determine the amortization cost of the patent for each of the above years as per AS 26.

Solution

In the first three years, the patent cost will be amortized in the ratio of estimated future cash flows i.e. (300: 300: 300: 150: 150). The unamortized amount of the patent after third year will be ₹ 150 lakh (600-450) which will be amortized in the ratio of revised estimated future cash flows (150:150:75 or 2:2:1) in the fourth, fifth and sixth year.

Amortization of cost of Patent as per AS 26

Year	Estimated future cash flow (₹ in lakhs)	Amortization Ratio	Amortized Amount (₹ in lakhs)
1	300	.25	150
2	300	.25	150
3	300	.25	150
4	150	.10	60
5	150	.10	60
6	75	.05	30
		1.00	600

Question 4 *Pg no.____*

Plymouth Ltd. is engaged in research on a new process design for its product. It had incurred ₹ 10 lakh on research during first 5 months of the financial year 2019-20. The development of the process began on 1st September, 2019 and upto 31st March, 2020, a sum of ₹ 8 lakh was incurred as Development Phase Expenditure, which meets assets recognition criteria.
From 1st April, 2020, the Company has implemented the new process design and it is likely that this will result in after tax saving of ₹ 2 lakh per annum for next five years.
The cost of capital is 10%. The present value of annuity factor of ₹ 1 for 5 years @ 10% is 3.7908.
Decide the treatment of Research and Development Cost of the project as per AS 26.

Solution

Research Expenditure – According to AS 26 'Intangible Assets', the expenditure on research of new process design for its product ₹ 10 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2019-20. Hence, it should be written off as an expense in that year itself.

Cost of internally generated intangible asset – it is given that development phase expenditure amounting ₹ 8 lakhs incurred upto 31st March, 2020 meets asset recognition criteria. As per AS 26, for measurement of such internally generated intangible asset, fair value should be estimated by discounting estimated future net cash flows.

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

The cost of an internally generated intangible asset would be lower of cost value ₹ 8 lakhs or present value of future net cash flows ₹ 7.582 lakhs.
Hence, cost of an internally generated intangible asset will be ₹ 7.582 lakhs.
The difference of ₹ 0.418 lakhs (i.e. ₹ 8 lakhs – ₹ 7.582 lakhs) will be amortized by Plymouth for the financial year 2019-20.
Amortisation - The company can amortize ₹ 7.582 lakhs over a period of five years by charging ₹ 1.516 lakhs per annum from the financial year 2020-2021 onwards.

Question 5 *(Inter Dec 2021) (5 Marks)* *Pg no.____*

Surgical Ltd, is developing a new production process of surgical equipment. During the financial year ended 31st March 2020 the total expenditure incurred on the process was ₹ 67 lakhs. The production process met the criteria for recognition as an intangible asset on 1st January 2020. Expenditure incurred till this date was ₹ 35 lakhs. Further expenditure incurred on the process for the financial year ending 31st March 2021 ₹ 105 lakhs. As on 31st March 2021, the recoverable amount of technique embodied in the process is estimated to be ₹ 89 lakhs. This includes estimates of future cash outflows and inflows. Under the provisions of AS 26, you are required to ascertain:

(i) The expenditure to be charged to Profit & Loss Account for year ended 31st March 2020;
(ii) Carrying amount of the intangible asset as on 31st March 2020;
(iii) Expenditure to be charged to Profit and Loss Account for the year ended 31st March 2021;
(iv) Carrying amount of the intangible asset as on 31st March 2021.

Solution

As per AS 26 'Intangible Assets'

(i) 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 1stJanuary 2020. This expenditure will not form part of the cost of the production process recognized as an intangible asset in the balance sheet.

(ii) Carrying value of intangible asset as on 31.03.2020
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 1st January 2020).

(iii) 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

(iv) 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

Question 6

Pg no._____

RC Ltd. is showing an intangible asset at ₹ 72 lakhs as on 31-3-20. This asset was acquired for ₹ 120 lakhs as on 01-04-14 and the same was used from that date. The company has been following the policy of amortization of the intangible assets over a period of 15 years, on straight line basis. Comment on the accounting treatment of asset with reference to AS- 26 and also give the necessary rectification journal entry.

Solution

As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. The 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 31.3.2020 at ₹ 48 lakhs i.e. ₹ 120 lakhs less ₹ 72 lakhs (₹ 120 Lakhs / 10 years x 6 years = 72 Lakhs). The difference of ₹ 24 Lakhs (₹ 72 lakhs – ₹ 48 lakhs) will be adjusted against the opening balance of revenue reserve. The carrying amount of ₹ 48 lakhs will be amortized over remaining 4 years by amortizing₹ 12 lakhs per year.
The necessary journal entry (for rectification) will be

Revenue Reserves Dr. ₹ 24 Lakhs
To Intangible Assets ₹ 24 Lakhs
(Adjustment to reserves due to restatement of the carrying amount of intangible asset)

Question 7 *(Inter Nov 2019) (5 Marks) / (RTP May 2023)* *Pg no.____*

As per provisions of AS-26, how would you deal to the following situations:

(1) ₹ 23,00,000 paid by a manufacturing company to the legal advisor for defending the patent of a product is treated as a capital expenditure.

(2) During the year 2018-19, a company spent ₹ 7,00,000 for publicity and research expenses on one of its new consumer product which was marketed in the same accounting year but proved to be a failure.

(3) A company spent ₹ 25,00,000 in the past three years to develop a product, these expenses were charged to profit and loss account since they did not meet AS-26 criteria for capitalization. In the current year approval of the concerned authority has been received. The company wishes to capitalize ₹ 25,00,000 by disclosing it as a prior period item.

(4) A company with a turnover of ₹ 200 crores and an annual advertising budget of ₹ 50,00,000 had taken up for the marketing of a new product by a company. It was estimated that the company would have a turnover of ₹ 20 crore from the new product. The company had debited to its Profit & Loss Account the total expenditure of ₹ 50,00,000 incurred on extensive special initial advertisement campaign for the new product

Solution

As per AS 26 "Intangible Assets", subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless

a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

b) expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

(1) In the given case, the legal expenses to defend the patent of a product amounting ₹ 23,00,000 should not be capitalized and be charged to Profit and Loss Statement.

(2) The company is required to expense the entire amount of ₹ 7,00,000 in the Profit and Loss account for the year ended 31st March, 2019 because no benefit will arise in the future.

(3) As per AS 26, expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements should not be recognized as part of the cost of an intangible asset at a later date. Thus the company cannot capitalize the amount of ₹ 25,00,000 and it should be recognized as expense

(4) Expenditure of ₹ 50,00,000 on advertising and promotional activities should always be charged to Profit and Loss Statement. Hence, the company has done the correct treatment by debiting the sum of 50 lakhs to Profit and Loss Account.

Intangible Assets (AS-26)

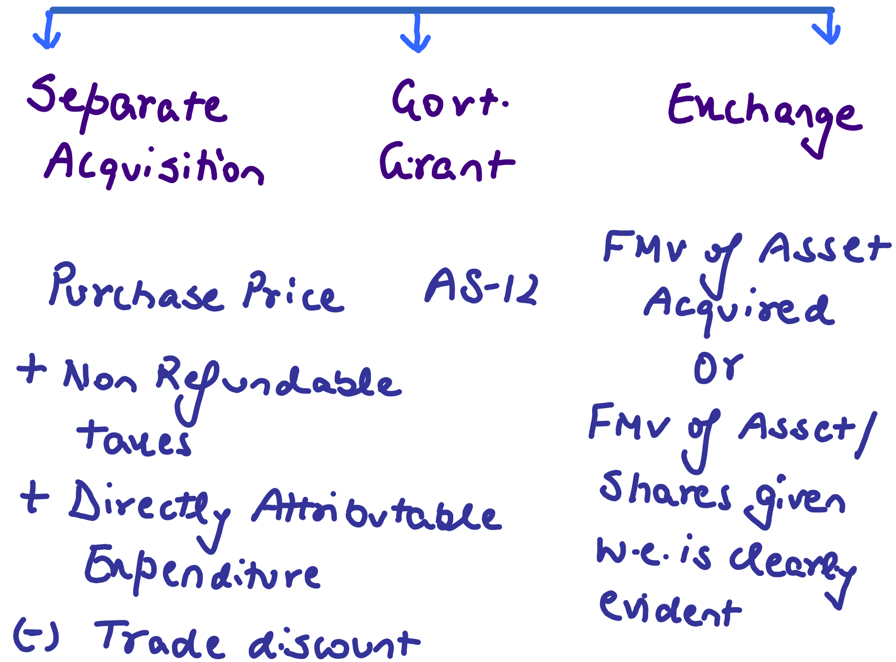
Meaning

- Identifiable
- Non Monetary Asset
- Without physical substance
- Held for economic benefits
- Under control of entity

Recognition Criteria

- Probable future economic benefits
- Cost can be reliably measured

Measurement



Subsequent Expenditure

Expense

Exception:

Future economic benefits in excess of original assessed standard of performance & amount can be reliably measured

Internally Generated

Self generated Goodwill, brandname, etc.

Not to be recognised

Other Intangible Assets like Software, Patents, copyrights, Trademark, knowhow, etc.

To be Recognised

Research Phase

Recognised as expense & Charged to P&L A/c

Development Phase

(ie. when it meets recognition criteria)**

Capitalise the cost & disclose at Lower of Cost or Recoverable Amount

(Discounted value: Present value of Cash flows)

(Difference to be trfd. to P&L A/c)

** Development Phase: Conditions

* Technical feasability established
* Marketability proved
* Identification of cost incurred
* Sufficient future revenue to cover cost
* Intention to complete asset

Amortisation

Period

- **Softwares & Website** → 3-5 years
- **G/w arising under Amalgamation in nature of Purchase** → 5 years
- **Others** → 10 years

Method

Reflecting pattern of consumption

ie. In ratio of future economic benefits.

If not obtained, then use SLM.

Note:

1) Amortisation should commence when asset is available for use.
2) Profit / Loss on disposal to be tfd. to P&L A/c.

AS 27

Financial Reporting of Interest in Joint Ventures

Meaning of Joint Venture:

- Contractual Arrangement
- Between 2 or more parties for Economic Activity
- which is subject to Joint control
  - Joint → Sharing
  - control → Power to govern Financial & operating policies so as to obtain benefits

Forms of Joint Ventures

Jointly controlled operations (JCO)

- No separate entity
- Use their own assets
- No separate books of J.V. maintained (Draft Cons. P&L A/c prepared to ascertain Profit/Loss)
- Maintain own books & record only his own transactions
- Venturers met expenses of J.V. business from their funds
- Any Income earned from J.V. is shared by venturers as per contract.

Jointly controlled Assets (JCA)

- No separate entity
- Common control over joint assets
- No separate books of J.V. (Draft Cons. B/S & P&L A/c prepared)
- Venturer shows only their share of asset & total income earned & expenses incurred by them.
- Expenses on Jointly held assets shared by venturers as per contract

Jointly Controlled Entities (JCE)

- Separate entity is formed
- Entity prepares its own books of Accounts & financial statements

Jointly Controlled Entity (JCE)

Entity
(Firm, Company, etc.)

* Own Books of A/cs as per Double Entry System
* Own Financial Statements in normal manner (B/S, P&L A/c)

Partner, venturer, etc.

Separate Financial Statements

Inv. in J.V. A/c —Dr
    To Bank A/c
(AS-13)

Consolidated Financial Statements

If J.V. Temporary *

Apply AS-13

Show Inv. in J.V. only

If J.V. not Temporary

Apply Proportionate Consolidation Method as per AS 27

Assets, Liabilities, Expenses, Income shown on line by line basis for proportionate amount.
(Venturer Share)

Share in Asset A/c —Dr
Share in Exp. A/c —Dr
    To Share in Income
    To Share in Liability
    To Investment in J.V.

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* Tempory J.V. (Non usage of PCM)

1) Investment is acquired & held for disposal in near future
   or
2) Long Term restrictions which impair ability to transfer funds by J.V. to venturer.

Transactions between Venturer & Joint Venture

- Do not record gain or loss on share of assets transferred to itself.
- Gain or loss can be recorded on share of assets sold to other venturer
- If decline in market prices / NRV or impairment loss have been reported, then loss can be recorded on own share of asset also.

Fair value of what we get vs Book value of what we give

↓

Difference is Gain / Loss

FINANCIAL REPORTING OF INTEREST IN JOINT VENTURES

AS 27

Question 1 *(ICAI Study Material)*

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, constructand sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.2021 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture.
Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000.
On 30.06.2021 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally.
You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Question 2 *(ICAI Study Material)*

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gasfrom one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a.
They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.
You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

Solution:

Consolidated Balance Sheet

		Note	(₹)
I	Equity and liabilities		
	Shareholders' funds:		
	Share Capital	1	71,40,000
			71,40,000
II	Assets		
	Non-current Assets		
	Property, Plant and Equipment:	2	71,40,000
			71,40,000

Notes to Accounts

			(₹)
1.	Share capital		
	A Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000

2.	Property, Plant and Equipment Land & Building:		
	A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery:		
	A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers:		
	A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles:		
	A Ltd.	2,40,000	
	B Ltd.	2,40,000	
	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.
Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		2,00,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of B Ltd. & C Ltd.: Same Presentation as in case of A Ltd.

Question 3 *(ICAI Study Material)*

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A Ltd. invested 49% of total capital but has an equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	Dr. (₹)	Cr. (₹)
Purchases	9,00,000	
Other Expenses	3,06,000	
Sales		13,05,000
Property, Plant and Equipment	6,00,000	
Current Assets	2,00,000	
Unsecured Loans		2,00,000
Current Liabilities		1,00,000
Capital		4,01,000

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

Solution:

Consolidated Profit & Loss Account

Particulars	Note No.	(₹)
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000
Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	(₹)
I	Equity and liabilities		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			9,00,000
II	Assets		
	Non-current Assets		
	Property, Plant and Equipment	9	6,00,000
	Current Assets		
	Inventories	10	1,00,000
	Other current assets	11	2,00,000
			9,00,000

Notes to Accounts

	Particulars		(₹)
1.	Revenue from operations		
	Sales:	7,25,000	
	A Ltd.	5,80,000	13,05,000
	B Ltd.		
2.	Purchases:		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	Other Expenses:		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	Closing Inventory:		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	Share Capital:		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	Reserve & Surplus:		
	Profit & Loss Account		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	Long term Borrowing:		
	Unsecured Loans		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	Current Liabilities:		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	Property, Plant & Equipment:		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000
10.	Inventories:		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
11.	Other Current Assets:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

Question 4 *(ICAI Study Material)*

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all thethree companies:

Particulars	A Ltd.	B Ltd.	C Ltd.
Share Capital	10,00,000	7,50,000	5,00,000
Reserve & Surplus	18,00,000	16,00,000	12,00,000
Loans	3,00,000	4,00,000	2,00,000
Current Liabilities	4,00,000	2,50,000	1,00,000
Property, Plant and Equipment	30,50,000	26,25,000	19,50,000
Investment in JV	2,50,000	2,50,000	-
Current Assets	2,00,000	1,25,000	50,000

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidationmethod.

Question 5 *(ICAI Study Material)*

JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 2021-22 (i.e., morethan 12 months). The investment has been made at par. QSR Limited hasbeen in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years.
Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.

Solution

As per para 26 of AS 27 "Financial Reporting of Interests in Joint Ventures",in a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 'Accounting for Investments'.

As per para 17 of AS 13 "Accounting for Investments", long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. Thetype and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 2021-2022 i.e., more than a year,it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution inthe value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares. Considering both the facts, in case the expectation of profitable businessplans and positive cash flows is based reliable presumptions (such as tenderin favour of QSR Ltd., strong order book etc.), the decline will be regardedas temporary in nature and the investment in equity shares will continue tobe carried at cost only.
However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

1)

Draft consolidated P&L A/c

Particulars	Amount	Particulars	Amount
To Expenses of A		By Flats taken over	
Purchase of Land	60,00,000	A	1000000
Registry fees	60,000	B	1000000
Interest on loan (50 L × 8% × 6/12)	2,00,000	C	1000000
To Expenses of B		By Sale of Flats	
Material from Godown	4,50,000	A	4000000
Material Purchased	5,00,000	B	2000000
To Expenses of C		C	1000000
Advertising, Labour, etc.	900000		
To Profit (B.f.)	18,90,000		
A 630000			
B 630000			
C 630000			
	10000000		10000000

Books of A

Joint venture A/c

Particulars	Amount	Particulars	Amount
To Bank A/c (Purch. of Land)	60,00,000	By Land & Building A/c	10,00,000
To Bank A/c (Fees)	60000	By Bank A/c	40,00,000
To Bank A/c (Interest)	200000	By Bank A/c (From B)	1420000
To share of Profit	630000	By Bank A/c (From C)	470000

Books of B

Joint venture A/c

Particulars	Amount	Particulars	Amount
To Purchase/Stock	450000	By Land & Building A/c	10,00,000
To Bank A/c	500000	By Bank A/c	20,00,000
To share of Profit	630000		
To Bank A/c (B.f.)	1420000		

Books of C

Joint venture A/c

Particulars	Amount	Particulars	Amount
To Bank A/c (Expenses)	9,00,000	By Land & Building A/c	1000000
To share of Profit	630000	By Bank A/c	1000000
To Bank A/c (B.f.)	470000		

2)

Consolidated

Expenses

Dep. & Amortisation	1260000 *
Other Expenses	600000
	1860000

Depreciation

1200000 X 5% = 60000

6000000 X 15% = 900000

300000 X 40% = 120000

900000 X 20% = 180000

= 1260000

Balance sheet

Share capital	9000000
Res. & surplus	(1860000)
	7140000
PPE	7140000

X Ltd.

When X Ltd. prepares

	Standalone Financial statements	Consolidated Financial statements
Inv in 70% shares of A Ltd.	AS 13	AS 21 (Full consolidation)
Inv in 40% shares of B Ltd.	AS 13	AS 23 (Equity Method)
Inv in 5% shares of C Ltd.	AS 13	AS 13
Inv in Joint venture (X Ltd. + Y Ltd. = Z Ltd.)	AS 13	AS 27 (Proportionate consolidation Method)

4)

For the purpose of consolidation

	A Ltd.		B Ltd.	
PPE A/c - Dr	975000		975000	
Current Assets A/c - Dr	25000		25000	
To Current liab. A/c		50000		50000
To Loans A/c		100000		100000
To Res. & Surplus *		600000		600000
To Inv. in J.V.		250000		250000

* Incomes - Expenses

Balance sheet of A Ltd. (Consolidated)

	Note No.	Amount
Equity & Liabilities		
1) Shareholder funds		
a) Share capital		10,00,000
b) Reserves & surplus	1	24,00,000
2) Non current liabilities		
a) Long Term Borrowings	2	400000
3) Current liabilities	3	450000
TOTAL		4250000
Assets		
1) Non Current Assets		
a) PPE & Intangible Assets		
i) PPE	4	4025000
2) Current Assets	5	225000
TOTAL		4250000

Notes to Accounts

1) Reserves & Surplus

A Ltd.	1800000	
C Ltd.	600000	2400000

2) Long Term Borrowings

A Ltd.	300000	
C Ltd.	100000	400000

3) Current Liabilities

A Ltd.	400000	
C Ltd.	50000	450000

4) PPE

A Ltd.	3050000	
C Ltd.	975000	4025000

5) Current Assets

A Ltd.	200000	
C Ltd.	25000	225000

Balance sheet of B Ltd. (Consolidated)

Particulars	Note No.	Amount
Equity & Liabilities		
1) Shareholder funds		
a) Share capital		750000
b) Reserves & surplus	1	2200000
2) Non current liabilities		
a) Long Term Borrowings	2	500000
3) Current liabilities	3	300000
TOTAL		37,50,000
Assets		
1) Non Current Assets		
a) PPE & Intangible Assets		
i) PPE	4	3600000
2) Current Assets	5	150000
TOTAL		37,50,000

Notes to Accounts

1) Reserves & Surplus

B Ltd.	1600000	
C Ltd.	600000	2200000

2) Long Term Borrowings

B Ltd.	400000	
C Ltd.	100000	500000

3) Current Liabilities

B Ltd.	250000	
C Ltd.	50000	300000

4) PPE

B Ltd.	2625000	
C Ltd.	975000	3600000

5) Current Assets

B Ltd.	125000	
C Ltd.	25000	150000

AS 28
Impairment of Assets

Scope: Not applicable to assets covered by AS 2, AS 7, AS 13 & AS 22.
Applicable to PPE & Intangible Assets

Impairment Loss

Meaning

Impairment loss = Carrying Amount − Recoverable Amount

- Carrying Amount → Book value after Depreciation & Amortisation at year end (This is after Revaluation)
- Recoverable Amount → Higher of Net selling Price* or Value in use**

* Net Selling Price = Expected Sale Price of Asset − Estimated selling Expenses (Excl. Tax & Finance Costs) (Eg. commission)

→ Based on Price in Active market, Binding Sale Price or management best judgement

Accounting Treatment

- **Entry:**
  1) Revaluation Reserve A/c − Dr
     Impairment Loss A/c − Dr
     To Accumulated Impairment Loss A/c
  2) P&L A/c − Dr
     To Impairment Loss A/c

- **Balance Sheet**

Asset (Cost)	xxx
− Acc. Depreciation	(xxx)
− Acc. Impairment Loss	(xxx)
	xxx

- Depreciation of future periods will get reduced due to Impairment Loss
- Income Tax does not allow this, hence create Deferred Tax Assets on it.

** Value in Use

- Present value of Net Cash Inflows from continuous use of asset & its residual value
  - Net Cash Inflows = Gross Inflows - Outflows to generate Inflows

- Such net cash flows should be reasonable & supportable to assumptions of management.
- Cash flows should be taken for maximum 5 years, unless justified
- Generally most recent management forecasts & budgets are used for calculation of net Inflow
- Outflows include repairs for which management is committed.
- Discount Rate should be Pre Tax CAPM.

Indicators of Impairment loss

External

* Low market capitalisation
* Market Price of asset has declined substantially
* Unfavourable market conditions against entity in regard to demand, technology, Govt. policies, etc.
* Market Interest rates have increased substantially.

Internal

* Poor Economic Performance by Asset
* Physical Damage to asset
* Company has plans of Restructuring or Discontinuation.

Note: If Recoverable Amount > Carrying Amount, ignore the difference & asset shown at same book value
: Review Useful life, residual value or depreciation method as per AS 10.

Cash Generating Unit (CGU)

Smallest identifiable group of assets working together to generate cash flows that are largely independent of cash inflows from other assets or group.

If asset is capable of generating cash flows on independent basis, then such single asset is CGU else identify the lowest aggregation of assets that generate independent cash inflows.

Carrying Amount of CGU: Summation of carrying amount of all assets grouped under 1 CGU. Includes liability only if it is necessary to be considered.

Impairment Loss for CGU:

* First to Goodwill allocated to CGU &
* Then to other assets on prorata basis based on carrying amount of each asset in CGU.

Goodwill: Does not generate cash flows independently from other assets or group of assets therefore recoverable amount cannot be determined.

Case 1: If G/W can be allocated on reasonable & consistent basis: Apply Bottom up test only.

Case 2: If G/W cannot be allocated on reasonable & consistent basis: Apply both Bottom up Test & Top Down Test.

Corporate Assets: Administrative assets like HO Building, EDP Equipment, Research unit, etc.

↓

Same Treatment like Goodwill.

Reversal of Impairment Loss

If Indicators due to which Impairment loss recognised earlier, no longer exist then Impairment loss to be reversed.

* Reversal is Lower of following:
    * Recoverable Amt. – Carrying Amt. (or)
    * Impairment loss recorded earlier

Note: Goodwill written off can be reversed only if certain conditions are met.

Disclosure Requirements:

* Impairment loss recorded in P&L A/c
* Impairment loss adjusted with Revaluation Reserve
* Segments affected by Impairment
* Indicator used for calculations
* Assumptions applied in calculation of Recoverable Amt.
* CGU & its identification
* Impairment loss reversed during year.

IMPAIRMENT OF ASSETS

Question 1 *(ICAI Study Material)* Pg no.______

Venus Ltd. has a fixed asset, which is carried in the Balance Sheet on 31.3.2021 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:

a. Calculate impairment loss.
b. Prepare journal entries for adjustment of impairment loss.
c. Show, how impairment loss will be shown in the Balance Sheet.

Solution:

a. Recoverable amount is higher of value in use 400 lakhs & net selling price 375 lakhs
Recoverable amount = ₹ 400 lakhs
Impairment loss = Carried Amount – Recoverable amount =
₹500 lakhs – ₹400 lakhs = ₹100 lakhs.

b. Journal Entries (₹ in lakhs)

	Particulars	Dr.	Cr.
(i)	Impairment loss account Dr.	100	
	To Provision for Accumulated Impairment Loss Account		100
	(Being the entry for accounting impairment loss)		
(ii)	Profit and loss account Dr.	100	
	To Impairment loss		100
	(Being the entry to transfer impairmentloss to P&L A/c)		

c. Balance Sheet of Venus Ltd. as on 31.3.2021

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

Question 2 *(ICAI Study Material)* Pg no.______

Ergo Industries Ltd. gives the following estimates of cash flows relating to Property, Plant and equipment on 31-12-2021. The discount rate is 15%.

Year	Cash Flow (₹ in lakhs)
2022	4000
2023	6000
2024	6000
2025	8000
2026	4000
Residual value at the end of 2026	₹ 1000 lakhs
Property, Plant and Equipment purchased on 1-1-2019	₹ 40,000 lakhs
Useful life	8 years
Net selling price on 31-12-2021	₹ 20,000 lakhs

Calculate on 31-12-2021:

(a) Carrying amount at the end of 2021
(b) Value in use on 31-12-2021
(c) Recoverable amount on 31-12-2021
(d) Impairment loss to be recognized for the year ended 31-12-2021
(e) Revised carrying amount
(f) Depreciation charge for 2022.

Question 3 *(ICAI Study Material)* *Pg no._____*

From the following details of an asset

a. Find out impairment loss
b. Treatment of impairment loss
c. 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:

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 theasset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

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

Question 4 *(ICAI Study Material)* Pg no.______

G Ltd., acquired a machine on 1st April, 2020 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, 2024, 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, 2026, 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 ofG Ltd. G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Question 5 *(ICAI Study Material)* Pg no.______

X Ltd. purchased a Property, Plant and Equipment four years ago for ₹ 150 lakhsand 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 willbe 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 AS 28 "Impairment of assets", if the recoverable amount (higherof 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 revaluationof 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

Question 6 *(ICAI Study Material)* *Pg no._____*

An asset does not meet the requirements of environment laws which havebeen 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:

Net Selling Price = Nil – 70,000 = (70,000)
Value in Use = Nil
Recoverable Amount = Higher of Above = Nil
Impairment Loss = Carrying Amount – Recoverable Amount = 6,00,000 – Nil = 6,00,000

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 AS 28.

Further, as per 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)

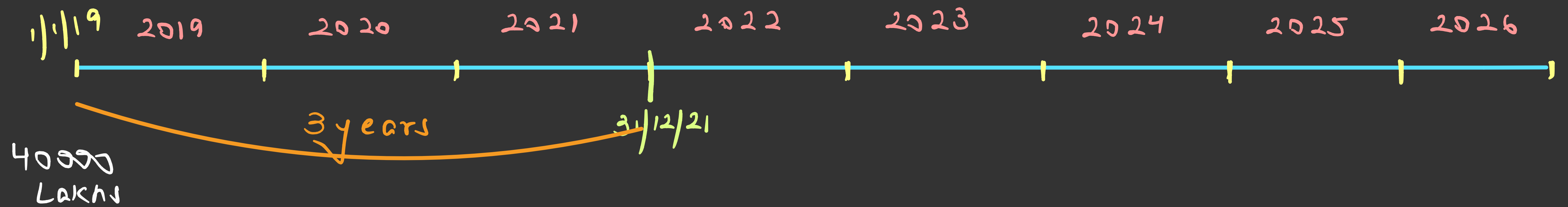
**Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In the given case, value in use is nil.

Question 7 *(ICAI Study Material)* *Pg no._____*

Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2021 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2021-2022 the carrying amountwas ₹ 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, ifsold 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 tobe 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.



a) Carrying Amount 31/12/21

Cost = 40000 Lakhs   Life = 8 years   Residual value = 1000 Lakhs

Dep. p.a. (From 2019 to 2021) $= \frac{40000 - 1000}{8} = 4875$ Lakhs p.a.

Book value / Carrying Amount (31/12/21) $= 40000 - (4875 \times 3)$

$= 25375$ Lakhs

b) Value in use 31/12/21

Year	Cash flows	PVF @ 15%	Present value
2022	4000	0.870	3480
2023	6000	0.756	4536
2024	6000	0.658	3948
2025	8000	0.572	4576
2026	4000 + 1000 (Res. value) = 5000	0.497	2485
			19025 Lakhs

c) Recoverable Amount

Higher of Net selling Price or value in use

20000 or 19025 ↑

=> 20000 Lakhs

d) Impairment loss

Carrying Amount − Recoverable Amount

$= 25375 - 20000 = 5375$ Lakhs

e) Revised carrying Amount

$25375 - 5375 = 20000$ Lakhs

f) Depreciation charge for 2022

$$\frac{20000 - 1000}{5} = 3800 \text{ Lakhs}$$

1/4/20 Cost of Machine = 7 crore

$$\text{Dep. p.a.} = \frac{7\text{ cr.} - \text{Nil}}{7} = 1 \text{ crore}$$

1/4/24 Carrying Amount / Book value = 7 crore − (1 crore × 4)

= 3 crore

Revalued Amount = 5.10 crore

Revaluation Increase credited to Revalued Reserve = 2.10 crore

31/3/26

$$\text{Dep. p.a. (From 24-25)} = \frac{5.10 - 0}{3} = 1.70 \text{ crore}$$

Carrying Amount on 31/3/26 = 5.10 cr. − (1.70 cr. × 2)

= 1.70 crore

Recoverable Amount = 0.79 crore

Impairment loss = 1.70 crore − 0.79 crore

= 0.91 crore

Treatment of Impairment loss

Since increased depreciation adjusted against Revaluation Reserve, balance in Revaluation Reserve on 31/3/26

Revaluation Reserve	=	2.10 crore
− Increased dep. adjusted	=	(1.40 crore)
$\left(\frac{2.10\ cr}{3} \times 2\right)$ or $(1.70\ cr - 1\ cr) \times 2$		
Balance		0.70 crore

Total Impairment loss	=	0.91 crore
− Adjusted against Revaluation Reserve	=	(0.70 crore)
Adjusted against P&L A/c		0.21 crore

EARNINGS PER SHARE

AS 20

Earnings per share (EPS) is a financial ratio indicating the amount of profit or loss for the period attributable to each equity share.

EPS is of 2 types

- Basic EPS
- Diluted EPS

Basic Earnings Per Share

$$\frac{\text{Net profit (loss) attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}}$$

Earnings attributable to ESH

EBIT	xx
- Interest	(xx)
EBT	xx
- Tax	(xx)
EAT/PAT	xx
- Pref. Dividend	(xx)
	xx

* Do not deduct any Reserve from PAT to calculate earnings.

Cumulative : Always

Non cumulative : Only when declared

Weighted Average O/s Equity Shares : Means average according to the period.

50000 + 40000 - 10000 80000

Weighted Avg = $\left(50000 \times \frac{12}{12}\right) + \left(40000 \times \frac{9}{12}\right) - \left(10000 \times \frac{3}{12}\right) = 77500$

Question 1 *(ICAI Study Material)* *Pg no.____*

Date	Particulars	Purchased	Sold	Balance
1st January	Balance at beginning of year	1800	-	1800
31st May	Issue of shares for cash	600	-	2400
1st November	Buy back of shares	-	300	2100

Calculate weighted number of shares. Calculate Earnings per share also if Net Profit for the year is ₹ 16,80,000.

Weighted Avg: $\left(1800 \times \frac{12}{12}\right) + \left(600 \times \frac{7}{12}\right) - \left(300 \times \frac{2}{12}\right) = 1800 + 350 - 50$

$= 2100$

Basic EPS = $\frac{1680000}{2100} = 800$

Partly Paid shares: Equate with fully paid shares

Question 2 *(ICAI Study Material)* Pg no._____

Date	Particulars	No. of Shares	Face Value	Paid up Value
1st January	Balance at beginning of year	1800	₹ 10	₹ 10
31st October	Issue of shares	600	₹ 10	₹ 5

Calculate weighted number of shares.

Weighted Avg. shares = $\left(1800 \times \frac{12}{12}\right) + \left(600 \times \frac{5}{10}\right) \times \frac{2}{12} = 1800 + 50 = 1850$

Question 3 Pg no._____

In April, 2019 a Limited Company issued 1,20,000 equity shares of ₹ 100 each. ₹50 per share was called up on that date which was paid by all shareholders. The remaining ₹ 50 was called up on 1.9.2019. All shareholders paid the sum in September, 2019, except on shareholder having 24,000 shares. The net profit for the year ended 31.3.2020 is ₹ 2,64,000 after dividend on preference shares of ₹ 64,000.

Compute basic EPS for year ended 31.3.2020 as per AS 20.

Weighted Avg. Amount

1/4 $(120000 \times 50) \times \frac{12}{12} = 6000000$

1/9 $(96000 \times 50) \times \frac{7}{12} = 2800000$

8800000

Weighted Avg. shares $= \frac{8800000}{100} = 88000$ shares

Basic EPS $= \frac{264000}{88000} = 3$

Bonus Issue: Treated as issued since beginning of year & previous year. Date not relevant.

Question 4 *(ICAI Study Material)* Pg no._____

Net profit for the year 2019	₹ 18,00,000
Net profit for the year 2020	₹ 60,00,000
No. of equity shares outstanding until 30th Sept 2020	20,00,000

Bonus issue 1st October 2020 was 2 equity shares for each equity share outstanding at 30th September, 2020. Calculate Basic Earnings Per Share.

Basic EPS (2019) $= \frac{1800000}{2000000} = 0.90$

Bonus issue on 1/1/0 = 20L × 2/1 = 40 Lakh shares

Basic EPS (2020) = $\frac{6000000}{(20L \times \frac{12}{12}) + (40L \times \frac{12}{12})}$ = $\frac{60L}{60L}$ = 1

Adjusted / Restated / Recomputed EPS (2019) = $\frac{1800000}{20L + 40L}$ = $\frac{18L}{60L}$ = 0.30

Right Issue

1) Compute Market Price / Fair value Ex-Right (Weighted Avg. Price)

2) Calculate Paid Part & Bonus Part in Right

Paid Part = Right shares × $\frac{\text{Right Price}}{\text{FV Ex-Right}}$

Bonus Part = Right shares − Paid Part

3) Compute EPS : Paid Part from date of Issue & Bonus Part from beginning.

Question 5 (RTP Nov 2023)

Pg no.______

Net Profit for 2021-22	30,00,000
Net Profit for 2022-23	50,00,000
No. of shares outstanding prior to Rights Issue	20,00,000 shares
Rights issue Ratio	One share for each five equity shares outstanding (i.e. 4,00,000 shares)
Rights Issue Price	₹ 20
Last day to exercise rights	1st June ,2022
Fair value of share before Rights Issue	₹ 26

Compute Basic EPS for FY 2021-22 , FY 2022-23 and restated EPS for FY 2021-22.

Solution

Computation of theoretical ex-rights fair value per share

= $\frac{\text{Fair value of o/s shares prior to right exercise + Total Amt. received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$

= $\frac{(26 \times 20,00,000 \text{ shares}) + (20 \times 4,00,000 \text{ shares})}{20,00,000 \text{ shares} + 4,00,000 \text{ shares}}$

Theoretical ex-rights fair value per share = ₹ 25

Paid Part in Right Issue = 4,00,000 * 20/25 = 3,20,000 shares

Bonus Part in Right Issue = 4,00,000 – 3,20,000 = 80,000 shares

Computation of earnings per share

	Year 21 – 22	Year 22 – 23
EPS for the year 21 - 22 as originally reported: (₹ 30,00,000/20,00,000 shares)	1.50	
EPS for the year 21 - 22 restated for rights issue: [₹ 30,00,000/(20,00,000 shares + 80,000 shares)]	1.44	
EPS for the year 22-23 including effects of rights issue $\frac{50,00,000}{\{(20,00,000 + 80,000) \times 12/12\} + (3,20,000 \times 10/12)}$		2.13

Question 6 *(Inter May 2022) (5 Marks) / (ICAI Study Material)* Pg no.______

NAT, a listed entity, as on 1st April,2021 had the following capital structure:

	₹
10,00,000 Equity Shares having face value of ₹ 1 each	10,00,000
10,00,000 8% Preference Shares having face value of ₹ 10 each	1,00,00,000

During the year 2021-2022, the company had profit after tax of ₹ 90,00,000
On 1st January,2022, NAT made a bonus issue of one equity share for every 2 equity shares outstanding as at 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 year ended 31st March,2021 was previously reported at ₹ 62.30.
You are required to:

(i) Calculate the basic earnings per share to be reported in the financial statements of NAT for the year ended 31st March,2022 including the comparative figure, in accordance with AS-20 Earnings Per Share.

(ii) Explain why the bonus issue of shares and the shares issue at full market price are treated differently in the calculation of the basic earnings per share?

Solution

(i) Calculation of Basic Earnings per share for the year ended 31st March, 2022 including the comparative figure:

(a) Earnings for the year ended 31st March, 2021 = EPS x Number of shares outstanding during 2020-2021

= ₹ 62.30 x 10,00,000 equity shares = ₹ 6,23,00,000

(b) Adjusted Earnings per share after taking into consideration bonus issue

Adjusted Basic EPS = Earnings for the year 2020-2021 / Total outstanding shares +Bonus issue

= ₹ 6,23,00,000 / (10,00,000+ 5,00,000)

= ₹ 6,23,00,000 / 15,00,000 = ₹ 41.53 per share

(c) Basic EPS for the year 2021-2022

Basic EPS = (Total Earnings – Preference Shares Dividend) / (Total shares outstanding at the beginning + Bonus issue + weighted average of the shares issued in January, 2022)

= (₹ 90,00,000 – ₹ (1,00,00,000 x 8%) / (10,00,000 + 5,00,000 + (2,00,000 x 3/12))

= ₹ 82,00,000 / 15,50,000 shares = ₹ 5.29 per share

(ii) In case of a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2021, the earliest period reported. However, the share issued at full market price does not carry any bonus element and usually results in a proportionate change in the resources available to the enterprise. Therefore, it is taken into consideration from the time it has been issued i.e. the time- weighting factor is considered based on the specific shares outstanding as a proportion of the total number of days in the period.

DILUTED EPS

It is Basic EPS after adjusting effects of Potential Equity Shares

Potential Equity Shares: These are those instruments against which
a) Resources / benefits have been availed & applied in business
b) but equity shares have not been issued

Example: Convertible Debentures, Convertible Preference Shares, ESOP, Share Warrants, Partly paid shares without Dividend right, etc.

$$\text{Diluted EPS} = \frac{\text{Earnings attributable to ESH} + \text{Effect of PES on Earnings}}{\text{Weighted Average Equity shares} + \text{Effect of PES on Equity Shares}}$$

Question 7

Pg no._____

Calculate the diluted earnings per share from the following information:

Net profit for the current year	₹ 85,50,000
No. of equity shares outstanding	20,00,000
No. of 8% convertible debentures of ₹ 100 each. Each debenture is convertible into 10 equity shares	1,00,000
Interest expenses for the current year	₹ 6,00,000
Tax relating to interest expenses	30%

Solution

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Diluted earnings per share = $\frac{89,70,000}{27,50,000 \text{ shares}}$

= ₹ 3.26 per share

Net profit for the current year	85,50,000
Add: Interest expense for the current year	6,00,000
Less: Tax relating to interest expense (30% of 6,00,000)	(1,80,000)
Adjusted net profit for the current year	89,70,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures = 1,00,000 X $\frac{100}{10}$

= 10,00,000 Equity shares

Weighted average number of equity shares used to compute diluted earnings per share
= [(20,00,000 x 12) + (10,00,000 x 9*)]/12 = 27,50,000 shares
*Interest on debentures for full year amounts to ₹ 8,00,000 (i.e. 8% of ₹ 1,00,00,000). However, interest expense amounting ₹ 6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

Treatment of Employee Stock Option

ESOP dealt in this standard are vested ESOP. Vested means employees have performed but shares have not been issued. Since employees are not issued shares but benefit have been availed i.e. benefit in kind hence ESOP are Potential Equity shares.

$$\text{PES in ESOP} = \text{ESOP} - \left[\text{ESOP} \times \frac{\text{Exercise Price}}{\text{Fair Value}}\right]$$

Question 8 *(Inter Nov 2022) (5 Marks)* *Pg no._____*

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:

Computation of Basic earnings per share

	Earnings	Shares	Earnings/ Share
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Basic earnings per share (72,00,000/30,00,000)			2.40

Computation of Diluted earnings per share

	Earnings	Shares	Earnings/Share
Net profit for the year 2022	72,00,000		
Weighted average no. of shares during year 2022		30,00,000	
Number of shares under option		6,00,000	
Number of shares that would have been issued at fair value (6,00,000 x 20.00)/25.00		(4,80,000)	
Diluted earnings per share	72,00,000	31,20,000	2.31 (rounded-off)

More than one PES (Steps)

Step 1: Identify PES in Question

Step 2: Calculate Incremental Earnings Per share (IEPS)

$$IEPS = \frac{\text{Effect of PES on Earnings}}{\text{Effect of PES on Equity Shares}}$$

Step 3: Calculate Diluted EPS

	Numerator	Denominator	Ratio
BEPS	XX	XX	XX
PES	XX	XX	
	XX	XX	XX

Note: 1) PES should be adjusted according to IEPS in increasing order
2) Diluted EPS should be lower than Basic EPS from continuing operations.

Question 9

Pg no.____

For Accounting year 1-4-2019 to 31-3-2020

Net profit attributable to equity shareholders	1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	75

Potential Equity Shares	
Options	1,00,000 with exercise price of ₹ 60
Convertible Preference Shares	8,00,000 shares entitled to cumulative dividend of ₹8 per share. Each preference share is convertible into 2 equity shares
12% Convertible Debentures of ₹ 100 each	Nominal amount ₹ 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

Calculate diluted earnings per share as per AS 20.

Solution

Incremental Earnings per share (IEPS) = $\frac{\text{Increase in Earnings}}{\text{Increase in number of equity shares}}$

(1) Options

IEPS = $\frac{\text{Nil}}{\text{20,000 Shares*}}$ = Nil

1,00,000(75-60)/75 = 20,000

(2) Convertible Preference Shares

IEPS = $\frac{(8*8,00,000)}{(2*8,00,000)}$ = $\frac{64,00,000}{16,00,000}$ = 4

(3) Convertible Debentures

IEPS = $\frac{(10,00,00,000)*12\%*(1-0.30)}{(4*10,00,000)}$

= $\frac{84,00,000}{40,00,000}$ = 2.10

It may be noted from the above that options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered.

Conversion of Diluted Earnings Per Share

	Net Profit Attributable	No. of Equity Shares	Earnings per Share	
As reported	1,00,00,000	20,00,000	5	
Options	-	20,000		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	84,00,000	40,00,000		
	1,84,00,000	60,20,000	3.06	Dilutive
Convertible Preference Shares	64,00,000	16,00,000		
	2,48,00,000	76,20,000	3.25	Anti Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (from ₹ 3.06 to ₹ 3.25), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is ₹ 3.06.

Question 10 *(RTP May 2022) / (ICAI Study Material)* *Pg no._____*

X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

Solution

As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share or increase loss per share from continuing ordinary operations". As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ 240 to ₹ 200.

Thus, the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

AS - 15
Employee Benefits

(Not applicable on Employee share based payments)

Employee: Contract of Service → Can be Full time, part time, casual / temporary, permanent, etc.

Employee Benefits: * All forms of consideration for services rendered that are provided under
- Formal Agreement
- Informal Practices (E.g: Diwali Bonus)
- Legislative Requirements (E.g. Provident Fund)

* Can be paid in cash or in kind
* Include benefits provided to employee, spouse, children or other dependents.

Types of Employee Benefits

Short Term Employee Benefits (STEB)	Post Employment Employee Benefits (PEEB)	Long Term Employee Benefits (LTEB)	Termination Benefits (TB)
Payable within 12 months of year end	Payable after completion of service	Payable after 12M but before retirement	Payable on Termination
E.g: Salaries, Wages, STCA (Leaves), Profit Sharing & Bonus, Non monetary benefits	E.g: Gratuity, Pension, Provident Fund, Medical care, Settlement Allowance	E.g: Long Term Compensated Absence, Profit sharing & bonus, Jubilee Awards, Long Term Disability Benefits [A/c'ing Treatment same as of PEEB]	E.g: VRS, Retrenchment Compensation. (W/off in P&L A/c)

Accounting Treatment

1) **Short Term Employee Benefits (STEB):** Recognise expense at undiscounted / absolute amount.

Salary A/c – Dr
Prepaid Salary A/c – Dr
  To Bank A/c
  To O/s Salary A/c

Short Term Compensated Absence (Leaves) (Special Treatment)

- **Non Accumulating** (Used during the year)
  - No Treatment
- **Accumulating** (Unutilised at year end)
  - **Can be used in Next 12 months**
    - Provide for full or proportionate amount of amount payable for such leaves
  - **Cannot be used**
    - No Treatment

Profit sharing & Bonus Plans

Recognise expected cost as expense if:

- Enterprise has present obligation as a result of past event &
- Reliable estimate can be made.

2) Post Employment Employee Benefits (PEEB):

Defined Contribution Plans (DCP)

Obligation to pay fixed contribution into separate fund.

Record expense based on actual contribution

Eg: Provident Fund, Pension Fund, etc.

Defined Benefit Plans (DBP)**

Employer has obligation but contribution is not required.

Eg: Gratuity, Leave Salary, Settlement Allowance, etc.

** Defined Benefit Plan / Obligation

Steps

1) Calculate Estimated Benefit Payable by applying Demographic & Financial Assumptions
2) Calculate Allocated Benefit based on balance service period
3) Calculate Current Service Cost
4) Calculate Finance Cost (Interest Cost) (P.V. factors in reverse manner)

Actuarial Gain / Loss: Actuary reviews the calculation & any gain / loss to be recognised immediately in P&L A/c. (No Deferment allowed)

DBO / PVDBO A/c

To Benefits Paid (Amt. paid on settlement)	xx	By Bal b/d	xx
		By Current Service Cost (CSC)	xx
		By Interest Cost (IC)	xx
To Actuarial Gain*	xx	By Actuarial Loss*	xx
To Bal c/d	xx		
	══		══

* Any One.

Note! If Entity has funded the obligation, then make Plan Assets A/c

Plan Assets A/c

To Bal b/d	xx	By Benefits Paid	xx
To Contribution	xx	By Actuary Loss (B.f.)	xx
To Expected Return	xx		
To Actuary Gain (B.f.)	xx	By Bal c/d (Fair value)	xx

Assumption: Contributions & Benefits paid are in middle of year

* **Expected Rate of Return:** r is calculated based on management estimate.

Chargeable Rate: $\sqrt{1+r} - 1$

Income will be calculated on Half Yearly basis.

Actual Return: Expected Return ± Actuarial Gain / (Loss)

Modification in DBO

Increase

UPSC A/c – Dr
To DBO

* Unamortised Past service cost
(It can be deferred)

Curtailment

When employer reduce no. of employees or benefits under Plan.
Gain or Loss is to be recognised & tfd. to P&L A/c.

Reduction in Gross Obligation	xx
Less: Proportionate reduction in UPSC	(xx)
Gain on curtailment	xx

Balance Sheet: Disclosure

PV of DBO new balance after Reduction	xx
Less: Fair value of Plan Assets	(xx)
Less: Unamortised Past service cost	(xx)
	xx

EMPLOYEE BENEFITS

AS 15

Question 1 *(ICAI Study Material)* *Pg no._____*

An employee Roshan has joined a company XYZ Ltd. in the year 2021. The annual emoluments of Roshan as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.
The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring. Thus he will get 5 yearly increment.
What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.
(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

Question 2 *(ICAI Study Material)* *Pg no._____*

Omega Limited belongs to the engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs. The average remaining life of the employees is estimated to be 6 years. You are required to advise the company on the following items from the viewpoint of finalization of accounts, taking note of the mandatory accounting standards.

Solution

According to AS 15 'Employee Benefits', actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expense.
Therefore, surplus amount of ₹ 6 lakhs is required to be credited to the profit and loss statement of the current year.

Question 3 *(ICAI Study Material)* *Pg no._____*

The following data apply to 'X' Ltd. defined benefit pension plan for the year ended 31.03.2022 calculate the actual return on plan assets:

- Benefits paid	2,00,000
- Employer contribution	2,80,000
- Fair market value of plan assets on 31.03.2022	11,40,000
- Fair market value of plan assets as on 31.03.2021	8,00,000

Question 4 *(ICAI Study Material)* *Pg no._____*

The fair value of plan assets of Anupam Ltd. was ₹ 2,00,000 in respect of employee benefit pension plan as on 1st April, 2021. On 30th September, 2021 the plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2022 the fair value of plan assets was ₹ 3,00,000. On 1st April, 2021 the company made the following estimates, based on its market studies and prevailing prices.

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

Calculate the expected and actual returns on plan assets as on 31st March, 2022, as per AS 15.

Solution:

Computation of Expected Returns on Plan Assets as on 31st March, 2022, as per AS 15

	₹
Return on opening value of plan assets of ₹ 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of ₹ 30,000 (i.e. ₹ 55,000 – ₹ 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500
Expected return on plan assets as on 31st March, 2022	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 2022, as per AS 15

	₹	₹
Fair value of Plan Assets as on 31st March, 2022		3,00,000
Less: Fair value of Plan Assets as on 1st April, 2021	2,00,000	
Contribution as on received as 30th September, 2021	55,000	(2,55,000)
		45,000
Add: Benefits paid as on 30th September, 2021		25,000
Actual returns on Plan Assets as on 31st March 2022		70,000

Question 5 *(ICAI Study Material)* *Pg no._____*

Rock Star Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid.

Rock Star Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at ₹18 (10% of ₹180). Calculate gain from curtailment and liability after curtailment to be recognised in the balance sheet of Rock Star Ltd. on the basis of given information:

a) Immediately before the curtailment, gross obligation is estimated at ₹ 6,000 based on current actuarial assumption.
b) The fair value of plan assets on the date is estimated at ₹ 5,100.
c) The unamortized past service cost is ₹ 180.
d) Curtailment reduces the obligation by ₹ 600, which is 10% of the gross obligation.

Solution:

Gain from curtailment is estimated as under:

	₹
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	₹
Reduced gross obligation (90% of ₹ 6,000)	5,400
Less: Fair value of plan assets	(5,100)
	300
Less: Unamortised past service cost (90% of ₹ 180)	(162)
Liability to be recognised in the balance sheet	138

1) Computation of Expected Benefit / Defined Benefit obligation

$$\left[1490210 \times (1.10)^5\right] \times 25\% \times 5$$

Last drawn salary (bracketed term); completed year of service (the 5)

$\Rightarrow$ 30,00,000

Allocated Benefit = $\frac{3000000}{5}$ = 600000 p.a.

Year	Allocated Amount	PVF @ 8%	Current service cost
1	600000	0.735	441000
2	600000	0.794	476400
3	600000	0.857	514200
4	600000	0.926	555600
5	600000	1	600000
			2587200

Total Finance / Interest cost = 3000000 - 2587200 = 412800

	Year 1	Year 2	Year 3	Year 4	Year 5
1) Opening	-	441000	952680	1543094	2222142
2) Interest cost (1) X 8%	-	35280	76214	123448	177858 (B.f.)
3) Current service cost	441000	476400	514200	555600	600000
4) Closing (1) + (2) + (3)	441000	952680	1543094	2222142	3000000

Accounting Entry

Eg: Year 2

Current service cost A/c - Dr	476400	
Finance / Interest cost A/c - Dr	35280	
To DBO / PVDBO / Prov. for DBO		511680

DBO: Defined Benefit Obligation

3)

Plan Assets A/c

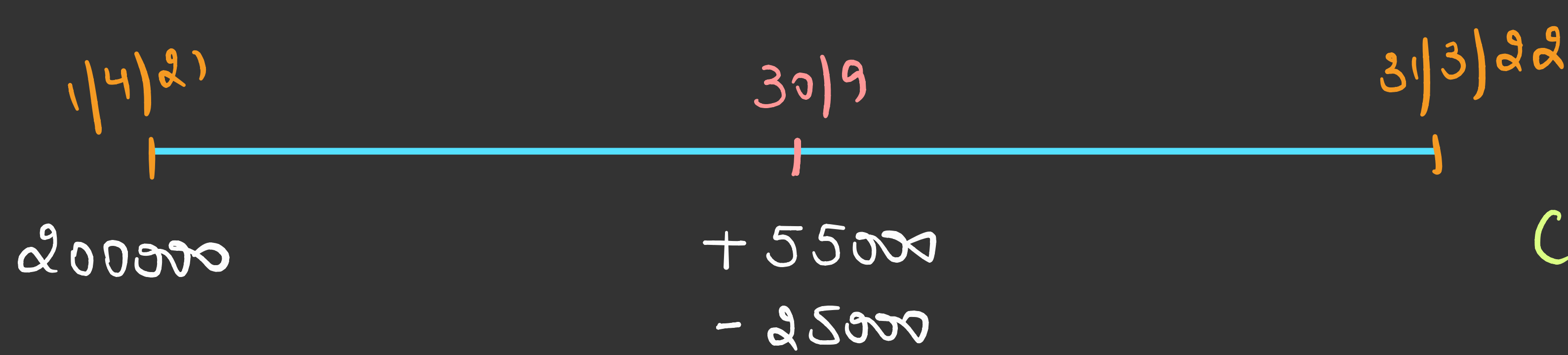
To Bal b/d	800000	By Benefits Paid	200000
To contribution	280000		
To Actual Return (B.F.)	260000	By Bal c/d	1140000

Alternative:

Fair value of Plan Assets on 31/3/21	=	800000	
+ contribution during year	=	280000	
- Benefits Paid	=	(200000)	
		880000	(A)
Fair value of Plan Assets on 31/3/22		1140000	(B)
Actual Return (B) - (A)		260000	

4)

Fair value of Plan Assets 1/4/21 =	200000
+ contribution	55000
- Benefits Paid	(25000)
	230000
Fair value of Plan Assets 31/3/22	300000
Actual Return	70000



Expected Rate = 10.25%
(Effective rate of return)

Charging rate = $\sqrt{1.1025} - 1 = 5\%$
(10% p.a. compounding half yearly)

Expected Return

Ist 6 months = 200000 × 5% = 10000 ($\nearrow$ 10% × 6/12)

Next 6 months = 200000
+ 10000
+ 55000
- 25000

240000 × 5% = 12000

22000

REVENUE RECOGNITION

AS 09

Objective	AS 9 deals with the basis for recognition of revenue in the Statement of P&L. Recognition means timing of recording the revenue in the P&L A/c of enterprise.
Scope of AS 9	❖ Revenue from Sale of goods. ❖ Revenue from Rendering of services ❖ Revenue from Interest, Royalties and Dividend
Non Applicability	❖ Revenue arising from Construction contracts (AS 7) ❖ Revenue arising from Hire purchase and lease agreements (AS 19) ❖ Revenue arising from Government grants and other similar subsidies (AS 12) ❖ Revenue of Insurance company arising under insurance contracts
Other examples of scope exclusions	Revenue does not include the following: ❖ Realized gains on disposal of non-current assets. Example: Gain on sale of fixed assets under AS 10. ❖ Unrealized gains on holding of Non- current assets Example: Appreciation in the value of fixed assets under AS 10. ❖ Unrealized holding gains resulting from change in value of current assets. ❖ Realized/unrealized gains resulting from changes in foreign exchange rates and adjustments arising on translation of foreign currency financial statement (AS11)
Meaning of Revenue	Revenue is the gross inflow of : ➢ Cash ➢ Receivables or ➢ Other consideration arising in the course of ordinary activities of an enterprise from the • Sale of goods, • Rendering of services and • Use by others of enterprise resources yielding interest; royalties and dividends. *Exception* – In an agency relationship, revenue is the amount of commission and not the gross inflow of cash, receivables or other considerations. *Note: Trade Discounts & volume rebates to be deducted while determining revenue*
CONDITIONS FOR RECOGNITION	
Sale of goods *(PARA 11)*	✓ The seller of goods has transferred to buyer the property in goods for a price or all significant risks and rewards of ownership have been transferred to the buyer. ✓ The seller retains no effective control of the goods transferred to a degree usually associated with ownership. ✓ No significant uncertainty regarding consideration

<table>
<tr><td>Rendering of services
(PARA 12)</td><td colspan="2">✓ Service is performed as per the terms of the contract i.e. either as per completed service contract method (*For Eg: Installation of machinery or repair service*) or proportionate completion method.
✓ No significant uncertainty regarding consideration</td></tr>
<tr><td rowspan="4">Use of resource of the enterprise by others
(PARA 13)</td><td>Interest</td><td>On a time proportion basis taking into account the amount outstanding and the rate applicable</td></tr>
<tr><td>Royalty</td><td>On an accrual basis in accordance with the terms of relevant agreement i.e. when the conditions attached have been complied with.</td></tr>
<tr><td>Dividend</td><td>When the owners right to receive payment is established i.e.
• In case of Final Dividend, date when it is declared at an AGM
• In case of Interim Dividend, date it is declared in Board Meeting</td></tr>
<tr><td colspan="2">Revenue should be recognised when no significant uncertainty as to measurability or collectability exists.</td></tr>
<tr><td colspan="3">**SOME IMPORTANT POINTS**</td></tr>
<tr><td>Delivery is delayed at buyer's request</td><td colspan="2">When delivery is delayed at buyer's request and buyer takes title and accepts billing, revenue should be recognized when
➢ There is every expectation that delivery will be made
➢ Item must be on hand, identified & ready for delivery at time sale is recognized.</td></tr>
<tr><td>Delivery subject to installation, inspection etc.</td><td colspan="2">Revenue should normally not be recognised until the customer accepts delivery and installation and inspection are complete.
However, in case the installation is simple (for example, a refrigerator needs to be plugged to a power connection after delivery to customer's place), revenue is recognized when the customer has agreed to purchase the goods.</td></tr>
<tr><td>Goods on Approval basis</td><td colspan="2">Revenue should not be recognized until
➢ The goods have been formally accepted by the buyer
➢ Buyer has done an act adopting the transaction
➢ Time period for rejection has lapsed</td></tr>
<tr><td>Guaranteed Sales</td><td colspan="2">In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.</td></tr>
<tr><td>Consignment</td><td colspan="2">Revenue is to be recognized when goods are sold by consignee to third party</td></tr>
<tr><td>Cash on delivery</td><td colspan="2">Revenue should not be recognised until cash is received by the seller or his agent</td></tr>
<tr><td>Sale to distributors or others for resale</td><td colspan="2">Revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.</td></tr>
<tr><td>Subscriptions for publications</td><td colspan="2">Revenue should be recognised either on straight line basis over time or, where items delivered vary in value, revenue should be based on sales value of item delivered.</td></tr>
</table>

For Advertising agencies	Amount will be recognized when advertisement appears before the public.
Artistic Performances, banquets, etc.	Revenue from artistic performances, banquets and other special events should be recognised when the event takes place
Tuition Fees	Revenue should be recognised over the period of instruction
Insurance Agent Comm.	Revenue should be recognized on the effective commencement or renewal dates of the related policies.
Installation Fees	In cases where installation fees are other than incidental to the sale of a product, they should be recognised as revenue only when the equipment is installed and accepted by the customer.
Membership Fees	➢ If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. ➢ If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided
Price revisions	Income can be recognized when there is certainty of collection
Sale and Repurchase Agreement	For transactions, where seller concurrently agrees to repurchase the same goods at later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue. Example On 1st January 2023, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac. You are required to do the accounting for above transactions in the books of M/s KJ.

→ When the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition should be postponed to the extent of uncertainty involved. *(PARA 10)*

→ When the uncertainty regarding collection arises subsequent to the sale or rendering of services, then provision should be created instead of reducing the amount originally recorded.

Question 1 *(RTP May 2020) / (ICAI Study Material)*

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

a) Goods of ₹ 60,000 were sold on 20-3-2020 but at the request of the buyer these were delivered on 10-4-2020.

b) On 15-1-2020 goods of ₹ 1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2020.

c) ₹ 1,20,000 worth of goods were sold on approval basis on 1-12-2019. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2020 and no approval or disapproval received for the remaining goods till 31-3-2020.

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

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 and also determine the total revenue to be recognized for the year ending 31-3-2020.

Solution

As per AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

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

In case (a):

The sale is complete but delivery has been postponed at buyer's request. M/s Paper Products Ltd. should recognize the entire sale of ₹ 60,000 for the year ended 31st March, 2020.

In case (b):

20% goods lying unsold with consignee should be treated as closing inventory and sales should be recognized for ₹ 1,20,000 (80% of ₹ 1,50,000). In case of consignment sale revenue should not be recognized until the goods are sold to a third party.

In case (c):

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed. Therefore, in case (c) revenue should be recognized for the total sales amounting ₹ 1,20,000 as the time period for rejecting the goods had expired.

In case (d):

Trade discounts given should be deducted in determining revenue. Thus ₹ 39,000 should be deducted from the amount of turnover of ₹ 7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹ 7,41,000.

Thus total revenue amounting ₹ 10,41,000 (60,000 + 1,20,000+ 1,20,000+7,41,000) will be recognized for the year ended 31st March, 2020 in the books of M/s Paper Products Ltd.

Question 2 - *(ICAI Study Material)*

Zigato runs a food-delivery business. As per the arrangement, Zigato allows customers to order food from local restaurants and is responsible the delivery of the food within stipulated time. During a particular year, it collects the money on orders made online as under:

Total price for the food item -	₹ 200 lakhs
Delivery charges -	₹ 60 lakhs
GST -	₹ 40 lakhs
Total -	₹ 300 lakhs

Zigato has received ₹ 300 lakhs for the above orders from customers and the orders were delivered to the customer in stipulated time. How much revenue should be recognised by restaurants and how much revenue should be recognised by Zigato for the year?

Solution

The risks and rewards associated with the food item are not with Zigato. When a customer has ordered a food item, whether the item will be prepared or not is the responsibility of the restaurant and not Zigato. Similarly, the responsibility to deliver the food item is with Zigato and the restaurant does not undertake responsibility for the same.

Therefore, the restaurant undertakes the principal's responsibility to prepare the food and ensure its quality. Zigato, on the other hand, is only responsible to deliver the food. Thus, Zigato is acting as an agent. Hence, it can only recognize revenue relating to that activity (which it does in the ordinary course of business). The revenue for Zigato, therefore, is ₹ 60 lakhs, whereas, the revenue for restaurants will be ₹ 200 lakhs.

It may be noted that the GST of ₹ 40 lakhs is a liability payable to the Government (third party), hence it does not form part of revenue.

Question 3 *(ICAI Study Material)*

AB sells goods to CD on 1st March 2023. CD is having significant cash flows issues since last few months. However, it is trying to raise funding through bank loan to be able to run its operations in future. On 5th of May 2023, CD is able to seek the funding and is expected to be able to pay for the goods in future. At the time of sale, it is difficult for AB to ascertain whether it will be able to collect the amount from CD due to poor financial conditions. Explain how the recognition of revenue be done by AB?

Solution

In the above case, AB should not recognise any revenue on 1st of March and until that uncertainty of recovery is clear. Hence, the revenue can only be recognised by AB on 5th of May 2023. The inventory transferred to CD until that date is required to be shown as its own inventory [inventory lying with customers].

Question 4 *(ICAI Study Material)*

AB sells goods to CD on 1st January 2023 for ₹ 2 lakhs. After the sale was made, CD is having significant cash flows issues. It is trying to raise funding through bank loan to be able to run its operations in future. However, it is unable to do so and has gone under liquidation on 15th of March 2023. At the time of sale, there was no reason for AB to believe that it will not be able to collect the amount from CD in future.

Explain how the recognition of revenue be done by AB for the year ended 31st March 2023?

Solution

In the above case, at the time of sale, it was not unreasonable for AB to expect ultimate collection from CD. Therefore, AB should recognise the revenue of ₹ 2 lakhs on 1st of January 2023 and recognise a receivable for the same amount. Later, since CD went into liquidation, AB should write off the receivables and book a loss in his books.

Accounting in the books of AB

Question 5

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2020, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9?

Solution

As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

Question 6 *(RTP Nov 2019) / (ICAI Study Material)*

The Board of Directors decided on 31.3.2020 to increase the sale price of certain items retrospectively from 1st January, 2020. In view of this price revision with effect from 1st January 2020, the company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1st January, 2020 to 31st March, 2020. Accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2019-2020. Advise.

Solution

As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors, of ₹ 15 lakhs to be recognised as income for financial year 2019-20, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Question 7 *(Inter Nov 2019) (5 Marks)/ (RTP May 2022)*

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

(1) Trade discount and volume rebate received.
(2) Where goods are sold to distributors or others for resale.
(3) Where seller concurrently agrees to repurchase the same goods at a later date.
(4) Insurance agency commission for rendering services.
(5) On 11-03-2019 cloths worth ₹ 50,000 were sold to X mart, but due to refurbishing of their showroom being underway, on their request, clothes were delivered on 12-04-2019.

Solution

(1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.
(2) When goods are sold to distributor or others, revenue from such sales can generally be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.
(3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.
(4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.
(5) On 11.03.2019, if X mart takes title and accepts billing for the goods then it is implied that the sale is complete and all risk and reward on ownership has been transferred to the buyers. Revenue should be recognized for year ended 31st March, 2019 notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made and items were ready for delivery to the buyer at the time.

Question 8 *(Inter Nov 2022) (5 Marks)*

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

a) Delivery is delayed at buyer's request but buyer takes title and accepts billing.
b) Instalment Sales.
c) Trade discounts and volume rebates.
d) Insurance agency commission for rendering services.
e) Advertising commission.

Solution:

a) Delivery is delayed at buyer's request and buyer takes title and accepts billing : Revenue should be recognized notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognized rather than there being simply an intention to acquire or manufacture the goods in time for delivery.
b) Instalment sales: When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognized at the date of sale. The interest element should be recognized as revenue, proportionately to the unpaid balance due to the seller.

c) Trade discounts and volume rebates: Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.
d) Insurance agency commissions for rendering services: Insurance agency commissions should be recognized on effective commencement or renewal dates of the related policies.
e) Advertising commission: Revenue should be recognized when the service is completed. For advertising agencies, media commissions will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognized when the project is completed.

Question 9 *(ICAI Study Material)*

For the year ended 31st March 2023, KY Enterprises has entered into following transactions. On 31 March 2023, KY supplied two machines to its customer ST. Both machines were accepted by ST on 31 March 2023. Machine 1 was a machine that was routinely supplied by KY to many customers and the installation process was very simple.
Machine 1 was installed on 2 April 2023 by ST's employees.
Machine 2 being more specialised in nature requires an installation process which is more complicated, requiring significant assistance from KY. Machine 2 was installed between 2 and 5 April 2023. Details of costs and sales prices are as follows:

	Machine 1	Machine 2
Sale Price	3,20,000	3,00,000
Cost of production	1,60,000	1,50,000
Installation fee	Nil	10,000

How should above transactions be recognized by KY Enterprises for the year ended 31st March 2023?

Solution

Machine 1: As the installation process is simple, revenue from Machine 1 will be recognized on 31 March 2023.

Revenue (Machine 1)	₹ 3,20,000
Cost of Goods Sold	₹ 1,60,000
Profit during the period	₹ 1,60,000

Since the question specifies that the machine is already accepted by ST on 31 March 2023, the revenue arising from sale of the machine needs to be recognized for the year ending 31 March 2023. This is because acceptance of the machine indicates that the risks and rewards pursuant to the ownership are transferred to ST.

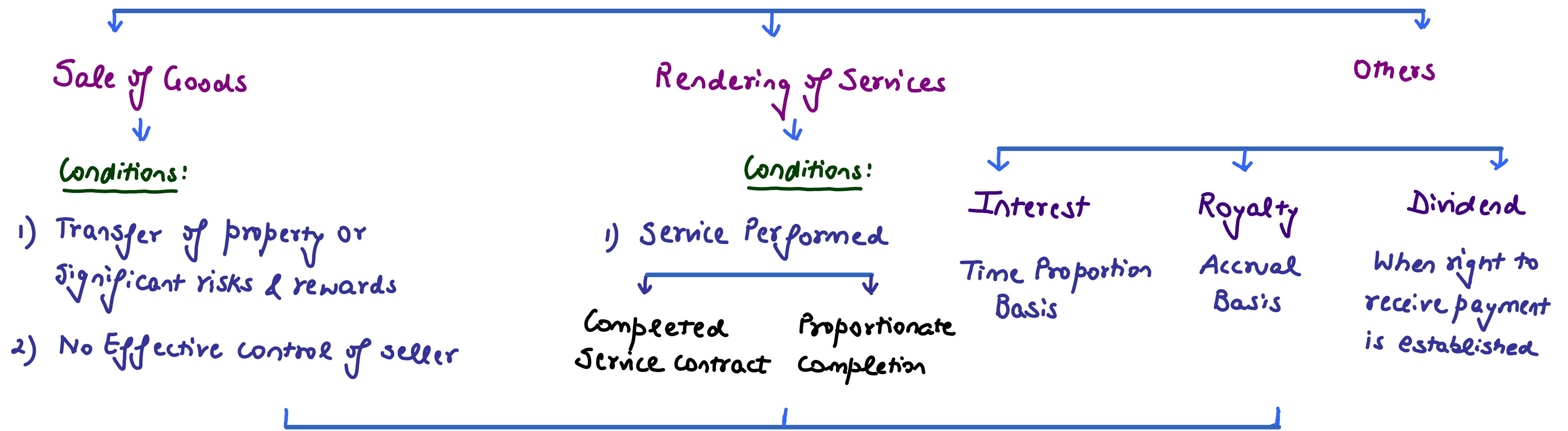
Machine 2: Installation process for Machine 2 is more complicated, requiring significant assistance from KY Ltd. However, question specifies that the machine is already accepted by ST on 31 March 2023. Assuming that there is no further approval/acceptance required from the buyer for the Machine sold, revenue from sale of Machine 2 can be recognized for the year ending 31 March 2023.

Revenue (Machine 2)	₹ 3,00,000
Cost of Goods Sold	₹ 1,50,000
Profit during the period	₹ 1,50,000

However, installation fee which is for rendering installation services cannot be recognized until the installation is complete. Since the machine is pending installation, the revenue in respect of installation charges ₹10,000 needs to be recognized on 5 April 2023 once the installation process gets completed.

Revenue Recognition (AS-9)

[Gross Inflow of Cash, receivable or other consideration. Exception : Agency]



Common Conditions !

1) No significant uncertainity regarding consideration
2) No significant uncertainity regarding collection

Uncertanity of Collection:
(1) At time of Raising claim : Postpone Revenue Recognition
(2) Subsequently : Create Provision

Special Cases

Case	Treatment
Delivery delayed at Buyer's Request	Expectation that delivery will be made & Item on hand, identified & ready for delivery
Delivery subject to Installation, etc.	Acceptance of delivery & completion of Installation & Inspection
Goods on Approval Basis	(1) Formal Acceptance by buyer (2) Act adopting transaction (3) Lapse of time
Guaranteed Sales	Recognise sales but make suitable provision
Consignment sales	Sale by consignee to 3rd party
Cash on Delivery Sales	When cash received by seller or his agent
Sale to distributors or others	If significant risks of ownership passed; in some situations agent sale
Subscription for Publication	SLM or If value variation then sales value of Item delivered
Advertising Agencies	When advertisement appears before public
Artistic performances, banquet, etc	When event takes place
Tution fees	Over period of Instruction
Insurance Agent Commission	Effective commencement or renewal dates of related policies
Installation fees	When equipment is installed & accepted by Customer
Membership fees	If separately → when received ; If services entitled → systematic & rational basis
Price Revision	Certainity of collection
Sale / Repurchase Agreement	Financing agreement so no revenue

CONSTRUCTION CONTRACT

AS 07

<table>
<tr><td>Objective</td><td colspan="2">To prescribe accounting for revenue and costs associated with construction contracts</td></tr>
<tr><td>Scope</td><td colspan="2">Accounting for construction contracts in the financial statements of <u>contractors</u> (not contractee)</td></tr>
<tr><td>Meaning of construction contract</td><td colspan="2">It is a contract specifically negotiated for
→ construction of an asset
<u>Example</u>: Bridge, Building, Dam, etc.
→ Combination of assets that are closely interrelated or interdependent in terms of design, technology, function or ultimate purpose or use.
<u>Example</u>: Refineries, Other complex pieces of plant or equipment etc.

Construction contracts also include:
(a) contracts for rendering of services which are directly related to construction of the asset, for eg., those for the services of project managers & architects;
(b) contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.</td></tr>
<tr><td rowspan="2">Types of construction Contracts:</td><td>Fixed price contract</td><td>In this contract, the contractor agrees to fixed contract price or fixed rate per unit of output. It may be with or without escalation clause</td></tr>
<tr><td>Cost plus contract</td><td>In this contact, the contractor is reimbursed for the cost incurred plus percentage of these costs or fixed fee.<table><tr><td>Cost incurred (allowable/defined cost)</td><td>XX</td></tr><tr><td>+ % of cost or fixed fee</td><td><u>XX</u></td></tr><tr><td></td><td>XX</td></tr></table></td></tr>
<tr><td>Contract revenue</td><td colspan="2">It means the revenue which is agreed upon between the contractor and contractee<table><tr><td>Initial contract revenue</td><td>XX</td></tr><tr><td>+/- Variations (alteration in job like change in specifications)*</td><td>XX</td></tr><tr><td>+ Incentive payments (price for timely completion of job)**</td><td>XX</td></tr><tr><td>+ Price escalation (extra compensation for increased cost)</td><td>XX</td></tr><tr><td>+ Claims (losses in contract due to contractee like customer caused delays, error in specification or design etc.</td><td>XX</td></tr><tr><td>Any penalty (from delays caused by contractor)</td><td>(XX)</td></tr><tr><td>Contract Revenue</td><td>XX</td></tr></table>
* included in contract revenue when it is probable that the customer will approve the variation and amount of revenue arising from the variation;
**included in contract revenue when the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded;
<u>These should be included in contract revenue if it is probable that they will result in revenue & they are capable of being measured.</u></td></tr>
</table>

Contract cost	It means the expenses incurred at site along with the apportioned contract cost	
	Direct cost	Relate directly to specific contract *Example*: Site labour cost, cost of material used, depreciation of plant and equipment, etc.
	Allocated cost	Attributable to contract in general and can be allocated *Example*: Insurance of machinery, salary of supervisor who is supervising more than 1 contract, etc.
	Specific cost	Specifically chargeable to customer under the terms of contract *Example*: General administration cost and development cost for which reimbursement is specified under contract
	Note	Direct cost may be reduced by any incidental income that is not included in contract revenue *Example*: Income from sale of surplus material and disposal of plant & equipment at the end of contract.
	Exclusions	*Example*: • general administration & research & development costs for which reimbursement is not specified in the contract • selling costs • depreciation of idle plant and equipment that is not used on a particular contract
Recognition of contract revenue and expenses	When to recognize	When the outcome of construction contract can be estimated reliably
	Conditions	❖ Total contract revenue can be measured reliably ❖ It is probable that economic benefits associated with contract will flow to the enterprise ❖ Contract cost can be clearly identified and measured reliably.
	Basis of recognition	By reference to the stage of completion of the contract activity at the reporting date. Methods to determine stage of completion of contract 1. % completion = Costs till date/Total Estimated Cost *100 2. Survey of work performed (Certification by surveyor) 3. Completion of a physical proportion of the contract work. (Eg. Contract to place tiles)
Computation of Profit	Contract Revenue x Stage of Completion (%) = XXX Less: Contract Costs till date = (XXX) Total Profit till date = XXX Less: Profit recognized till last year = (XXX) Profit for the Current Year = XXX	
Recognition of expected losses	Para 35	When it is probable that Total contract cost will exceed Total contract revenue, Expected loss should be recognized as expense immediately.

<table>
<tr><td></td><td>Para 36</td><td>Amount of such loss is determined irrespective of
❖ Whether or not work has commenced on the contract.
❖ Stage of completion of contract activity
❖ Amount of profits expected to realize on other contracts which are not treated as single construction contract</td></tr>
<tr><td>When outcome of construction contract cannot be estimated reliably</td><td colspan="2">❖ Revenue should be recognized only to the extent of contract costs incurred of which recovery is probable; and
❖ Contract costs should be recognised as expense in the period in which they are incurred.</td></tr>
<tr><td rowspan="2">Combining & Segmenting Construction Contracts (CONDITIONS)</td><td>Separate</td><td>❖ separate proposals have been submitted
❖ separate negotiations have been carried out
❖ costs and revenue of each asset can be separately identified</td></tr>
<tr><td>Combining</td><td>❖ they are negotiated as a single package;
❖ they are closely interrelated and
❖ they will be performed in sequence i.e. concurrently</td></tr>
<tr><td>Disclosure requirements</td><td colspan="2">❖ Amount of contract revenue recognized
❖ Method used to determine such revenue
❖ Method used to determine stage of completion of contract in progress.
❖ Following to be disclosed for contract in progress:
• Aggregate cost incurred
• Profit recognized till date
• Advance received
• Amount of retention
• Progress Billings
An enterprise should also present:
a) the gross amount due from customers for contract work as an asset &
b) the gross amount due to customers for contract work as a liability</td></tr>
</table>

Question 1

Pg no._____

M/s Action Construction Company Ltd. undertook a fixed price construction contract to construct a building within 3 years time for ₹ 10,000 lakhs.
A summary of the financial data during the construction period is as follows:

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

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

Solution

The amounts of revenue, expenses and profit recognized in the statement of profit and loss in three years are computed below:

	Amount (In Lacs)		
	Up to the reporting date	Recognized in previous years	Recognized in current year
Year 1			
Revenue (10,000 x 30%)	3,000		3,000
Expenses (8,050 x 30%)	2,415		2,415
Profit	585		585
Year 2			
Revenue (10,500 x 75%)	7,875	3,000	4,875
Expenses (8,500 x 75%)	6,375	2,415	3,960
Profit	1,500	585	915
Year 3			
Revenue (11,000 x 100%)	11,000	7,875	3,125
Expenses (8,500 x 100%)	8,500	6,375	2,125
Profit	2,500	1,500	1,000

Working Note – Calculation of stage of completion of contract

	Year 1	Year 2	Year 3
Revenue after considering variations	10,000	10,500	11,000
Less: Estimated profit for whole contract	1,950	2,000	2,500
Estimated total cost of the contract (A)	8,050	8,500	8,500
Actual cost incurred upto the reporting date (B)	2,415	6,375	8,500
Degree of completion (B/A)	30%	75%	100%

Question 2 *(Inter Nov 2020) (5 Marks)* Pg no._____

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed.
In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000.
In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000.
In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed.
Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

Solution

Year 1	₹
Actual expenditure	8,60,000
Future estimated expenditure	10,00,000
Total Expenditure	18,60,000

% of work completed = $\frac{8,60,000 \times 100}{18,60,000}$ = 46.24% (rounded off)

Revenue to be recognized = 20,00,000 x 46.24% = ₹ 9,24,800

Year 2	₹
Expenditure incurred in Year 1	8,60,000
Actual expenditure in Year 2	4,75,000
Future estimated expenditure	4,00,000
	17,35,000

% of work completed = $\frac{4,75,000 + 8,60,000}{17,35,000}$ = 76.95% (rounded off)

Revenue to be recognized (cumulative) = 20,00,000 × 76.95% = 15,39,000
Less: Revenue recognized in Year 1 = (9,24,800)
Revenue to be recognized in Year 2 = 6,14,200

Year 3
Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000.
Note: Calendar year has been considered as accounting year.

Question 3 *(Inter July 2021) (5 Marks)* *Pg no._____*

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

(i) Contract Price - ₹ 85 lakhs

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

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

(iv) Specific Contract Costs - ₹ 5 Lakhs

(v) SubContract Costs for work executed 7 Lakhs, Advances paid to subcontractors 4 Lakhs

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

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

Solution

Computation of contract cost

	₹ Lakh	₹ Lakh
Material cost incurred on the contract (net of closing stock)	(21- 4)	17
Add: Labour cost incurred on contract (incl. outstanding amount)		16
Specified contract cost	given	5
Sub-contract cost (advances should not be considered)		7
Cost incurred (till date)		45
Add: further cost to be incurred		35
Total contract cost		80

Percentage of completion = Cost incurred till date/Estimated total cost

= ₹ 45,00,000/₹ 80,00,000 = 56.25%

Contract revenue and costs to be recognized

Contract revenue (₹ 85,00,000 x 56.25%) = ₹ 47,81,250 Contract costs = ₹45,00,000

Question 4 *(RTP Nov 2021)* *Pg no._____*

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

Solution

According to AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract.

Incentive payments are included in contract revenue when:

(i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and

(ii) the amount of the incentive payment can be measured reliably.

In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract

Question 5

Pg no.______

M/s Highway Constructions undertook the construction of a highway on 01.04.2019. The contract was to be completed in 2 years. The contract price was estimated at ₹ 150 crores. Up to 31.03.2020 the company incurred ₹ 120 crores on the construction. The engineers involved in the project estimated that a further ₹ 45 crores would be incurred for completing the work. What amount should be charged to revenue for the year 2019-20 as per the provisions of Accounting Standard 7 "Construction Contracts"? Show the extract of the Profit & Loss A/c in the books of M/s. Highway Constructions.

Solution

Statement showing the amount to be charged to Revenue as per AS 7

	₹ in crores
Cost of construction incurred upto 31.03.2020	120
Add: Estimated future cost	45
Total estimated cost of construction	165
Degree of completion (120/165 x 100)	72.73%
Revenue recognized (72.73% of 150)	109 (approx.)
Total foreseeable loss (165 – 150)	15
Less: Loss for the current year (120 – 109)	11
Loss to be provided for	4

Profit & Loss A/c (Extract)

	₹ in crores		₹ in crores
To Construction costs	120	By Contract Price	109
To Provision for loss	4	By Net Loss	15
	124		124

Question 6 *(Inter May 2022) (5 Marks)* *Pg no.______*

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

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

From the above information, you are required to:

(i) Compute the contract revenue to be recognized.

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

Solution

Calculation of total estimated cost of construction

	(₹ in '000)	(₹ in '000)
Cost of Contract incurred till date		
Work certified	17,500	
Work not certified (3,815 thousand – 140 thousand)	3,675	21,175
Add: Estimated future cost		17,325
Total estimated cost of construction		38,500
Contract Price (35,000 thousand x 1.08)		37,800

Stage of completion

Percentage of completion till date to total estimated cost of construction

= [Cost of work completed till date / total estimated cost of the contract] x 100

= [₹ 21,175 thousand / ₹ 38,500 thousand] x 100= 55%

Revenue to be recognized for the year ended 31st March, 2022

Proportion of total contract value recognized as revenue = Contract price x percentage of completion = ₹ 37,800 thousand x 55% = ₹ 20,790 thousand

Loss to be recognized for the year ended 31st March, 2022

Loss for the year ended 31st March, 2022 = Cost incurred till date – Revenue to be recognized for the year ended 31st March, 2022

= ₹ 21,175 thousand – ₹ 20,790 thousand = ₹ 385 thousand

Provision for loss to be made at the end of 31st March, 2022

	(₹ in '000)	(₹ in '000)
Total estimated loss on the contract		
Total estimated cost of the contract	38,500	
Less: Total revised contract price	(37,800)	700
Less: Loss recognized for the year ended 31st March, 2022		(385)
Provision for loss to be made at the end of 31st March, 2022		315

Question 7 – *(Inter May 2023) (5 Marks)* *Pg no.______*

Fisher Construction Co. obtained a contract for construction of a commercial complex. The following details are available in records of a company for the year ended 31st March, 2023:

Particulars	Amount in Lakhs
Total contract price	24,000
Work certified	12,500
Work not certified	2,500
Estimated further cost to completion of work	17,500
Progress payment received	11,000
Progress payment to be received	3,000

Applying the provisions of AS 7, you are required to compute:

a. Profit / Loss for the year ended 31st March, 2023.
b. Contract work in progress at the end of financial year 2022-2023.
c. Revenue to be recognized out of the total contract value.
d. Amount due from/ to customers as at the year end.

Solution

		(₹ In lakhs)
(i)	Profit or Loss for the year ended 31.03.2023	
	Total cost of construction (12,500 + 2,500 + 17,500)	32,500
	Less: Total contract price	(24,000)
	Total foreseeable loss to be recognized as expense	8,500

According AS 7, when it is probable that total contract costs will exceed total contract revenue; the expected loss should be recognized as an expense immediately.

		(₹ in lakhs)
(ii)	Contract work-in-progress i.e. cost incurred to date are 15,000 lakhs	
	Work certified	12,500
	Work not certified	2,500
	Contract work in progress at the end of 2022-23	15,000

(iii) Proportion of total contract value recognized as revenue:

For this, cost incurred till 31.03.2023 is 46.154% (15,000/32,500 x 100) to total costs of construction.

Therefore, Proportion of total contract value recognized as revenue is

46.154% of ₹ 24,000 lakhs = ₹ 11,076.96 lakhs Or

46.15% (Approx.) of ₹ 24,000 lakhs = ₹ 11,076 lakhs

(iv) Amount due from/ to customers =

(Contract costs + Recognised profits – Recognised Losses)

– (Progress payments received + Progress payments to be received)

= (15,000 + Nil – 8,500) – (11,000 + 3,000) ₹ in lakhs

= [6,500 – 14,000] ₹ in lakhs

Amount due to customers = ₹ 7,500 lakhs

Question 8 *(RTP May 2019)* *Pg no._____*

GTI Ltd. negotiates with Bharat Oil Corporation Ltd. (BOCL), for construction of "Retail Petrol & Diesel Outlet Stations". Based on proposals submitted to different Regional Offices of BOCL, the final approval for one outlet each in Region X, Region Y, Region Z is awarded to GTI Ltd. A single agreement is entered into between two. The agreement lays down values for each of the three outlets i.e. ₹102 lacs, ₹150 lacs, ₹130 lacs for Region X, Region Y, Region Z respectively. Agreement also lays down completion time for each Region.
Comment whether GTI Ltd. will treat it as single contract or three separate contracts with reference to AS-7?

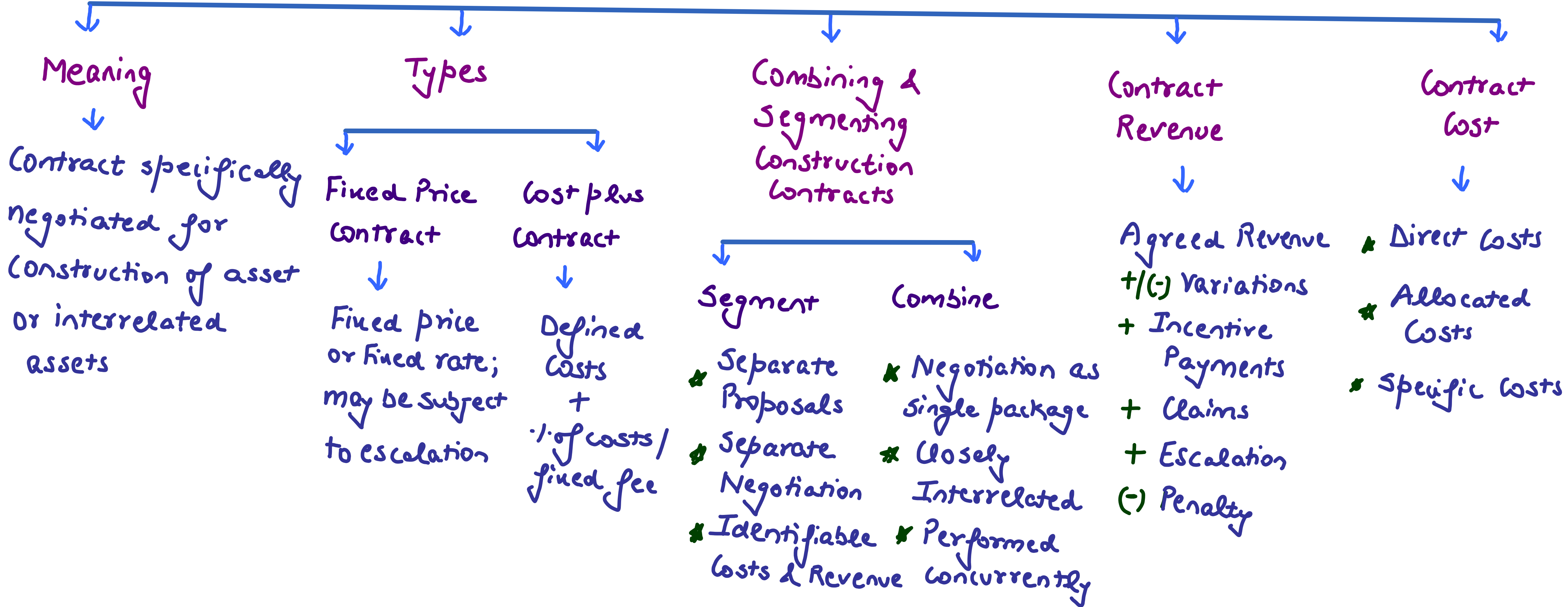
Solution

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

a) separate proposals have been submitted for each asset;
b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
c) the costs and revenues of each asset can be identified.

In the given case, each outlet is submitted as a separate proposal to different Zonal Offices, which can be separately negotiated, and costs and revenues thereof can be separately identified. Hence, each asset will be treated as a "separate contract" even if there is one single agreement for contracts.

Therefore, three separate contract accounts must be recorded and maintained in the books of GTI Ltd. For each contract, principles of revenue and cost recognition must be applied separately and net income will be determined for each asset as per AS 7.


Construction Contract (AS 7)
Meaning
Contract specifically negotiated for construction of asset or interrelated assets
Types
Fixed Price Contract
Fixed price or Fixed rate; may be subject to escalation
Cost plus Contract
Defined Costs + % of costs / fixed fee
Combining & Segmenting Construction Contracts
Segment
Separate Proposals
Separate Negotiation
Identifiable Costs & Revenue
Combine
Negotiation as single package
Closely Interrelated
Performed concurrently
Contract Revenue
Agreed Revenue
+/(-) Variations
+ Incentive Payments
+ Claims
+ Escalation
(-) Penalty
Contract Cost
Direct Costs
Allocated Costs
Specific Costs

Recognition of Contract Revenue & Expenses

Outcome of construction contract can be estimated reliably

Yes

Conditions:

* Probable future benefits
* Contract revenue & costs can be measured reliably

Stage of Completion:

1) % of completion = $\frac{\text{Costs till date}}{\text{Total estimated cost}} \times 100$
2) Survey of work performed
3) Completion of physical proportion

No

Recognise Revenue to the extent of costs of which recovery probable

&

Recognise contract costs as expense in period in which incurred

Recognition of Expected Losses

Para 35

When Total contract cost

Total Contract Revenue

Recognise expected loss immediately

Para 36

* Whether work commenced or not
* Stage of Completion
* Profits expected on other contracts

Computation of Profit

Contract Revenue x % of completion	xx
Costs till date	(xx)
Profits till date	xx
Earlier Profits	(xx)
Current Year Profits	xx

Disclosure Requirements

* Contract Revenue Recognised
* Method to determine Revenue
* Method to determine DOC
* Costs, Profits, Retentions
* Amount due from/(to) customers

AS-1: DISCLOSURE OF ACCOUNTING POLICIES

Objectives

- *Disclosure of significant accounting policies followed in preparing and presenting financial statements.*
- *Manner in which accounting policies are disclosed in financial statements*

Accounting Policies

Meaning	**These are:** → Specific accounting principles (Like AS 2 – Lower of Cost or NRV) and → Methods of applying those principles (Like AS 2 – FIFO or Weighted Average) adopted by the enterprise in the preparation & presentation of financial statements.
Notes	• There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which the enterprises operate make alternative accounting policies acceptable. • Choice of the appropriate accounting policies in these specific circumstances of each enterprise requires considerable judgement by the management of the enterprise.

Fundamental Accounting Assumptions *(PARA 10)*

Name	***Going concern***	It is assumed that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.
	Consistency	It is assumed that accounting policies are consistent from one period to another.
	Accrual	Under this basis of accounting, transactions are recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.
Notes	• If the above said assumptions are followed in financial statements, specific disclosure is not required. • If a fundamental accounting assumption is not followed, the fact should be disclosed. • Disclosure is necessary if not followed.	

Considerations in the selection of Accounting Policies

Primary consideration	Financial statements should present true and fair view of → The state of affairs of the enterprise as at the balance sheet date and → The profit or loss for the period ended on that date	
Secondary consideration	**Prudence**	While recognizing the incomes, expenses and losses the principle of prudence should be followed. The income should be recognized only when it is certain to be received. (Profits are not anticipated) The provision should be created for all the known liabilities and losses.
	Substance over form	It implies that suitable changes may be made in the legal form of presentation to disclose the substance in a true and fair manner. ***Example***: a) Agreement to Sell b) Hire Purchase Transaction
	Materiality	Any item of financial statements which can influence the decision of the user is termed as material item and all the material items should be disclosed in the financial statements

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Disclosure of Accounting Policies	
Points to note	➢ All the accounting policies need to be disclosed at one place ➢ These should form an integral part of the financial statements. ➢ These are usually disclosed in "Notes to Accounts"
Examples (Areas in which different accounting policies may be adopted)	• Valuation of Inventory • Treatment of Goodwill • Valuation of Investment • Treatment of Retirement benefit • Valuation of Fixed assets • Treatment of Contingent liabilities. • Treatment of Expenditure during construction • Conversion or translation of Foreign currency items.

Change in an Accounting Policy *(PARA 26)*	
When change can be done?	Accounting policy may be changed only if → Required by Statute → For Compliance with an Accounting Standard → For better presentation or true and fair view of the financial statements
Points to note (PARA 26)	• Any change in an accounting policy which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed • The amount by which any item is affected by such change should also be disclosed to the extent ascertainable. • Where such amount is not ascertainable wholly or in part, the fact should be indicated. • Any change in policy which does not affect the current period but can have material effect in the later periods, then such fact should be disclosed.
Disclosure requirement	• Old policy • New policy • Reason for change in policy • Impact of such change

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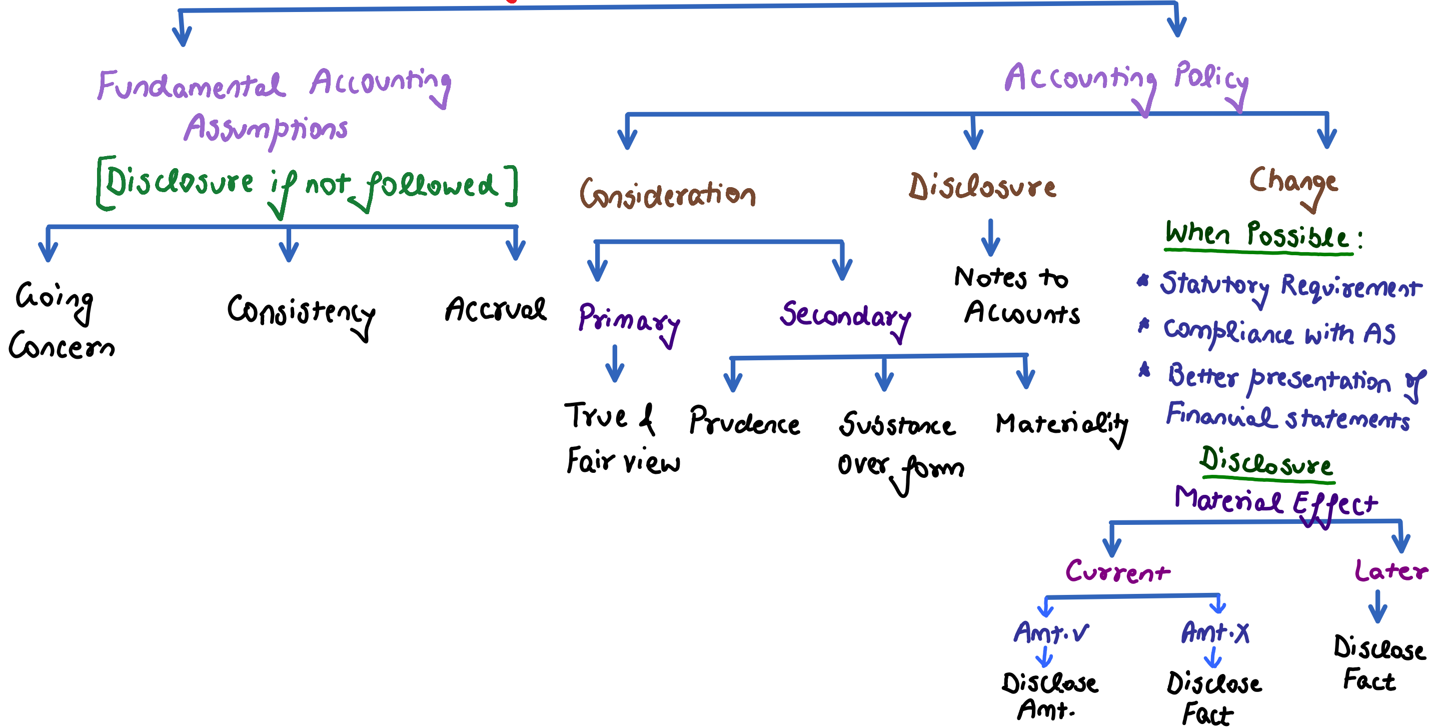

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Question 1

X Limited has sold its building for Rs. 50 lakhs to the purchaser who has paid the full price. Company has given possession to the purchaser. The book value of the building is Rs. 35 lakhs. As at 31st March, 2020, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this accounting treatment done by X Ltd.? What accounting treatment should the buyer give in its financial statements?

Solution

Although legal title has not been transferred, the economic reality and substance is that the rights and beneficial interest in the immovable property have been transferred. Therefore, recording of disposal by the transferor would in substance represent the transaction entered into.

In view of this, X Ltd. should record the sales and recognize the profit of Rs. 15 lakhs in its Statement of Profit and Loss. It should remove building account from its balance sheet.

Further, in its 'Notes to Accounts', X Ltd. should disclose the following:
"Building has been sold and full consideration has been received and possession of the same has been handed over to the buyer. However, documentation and legal formalities are pending as on 31.3.2020."

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

Question 2

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

(i) Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
(ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
(iii) All significant accounting policies adopted in the preparation & presentation of financial statements should form part of the financial statements.
(iv) Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the facts need not to be indicated.
(v) There is no single list of accounting policies which are applicable to all circumstances

Solution

(i) **False**; As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.
(ii) **False;** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
(iii) **True;** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and they should be disclosed in one place.
(iv) **False;** Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
(v) **True;** As per AS 1, there is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

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Question 3

In the books of M/s Prashant Ltd. closing inventory as on 31.03.2021 amounts to Rs. 1,63,000 (on the basis of FIFO method).
The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2020-21. On the basis of weighted average method, closing inventory as on 31.03.2021 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.2021 amounts to Rs. 1,95,000.
Discuss disclosure requirement of change in accounting policy as per AS-1.

Solution

As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2020-21, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by Rs. 16,000'.

Question 4

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2020. The company now wants to make provision based on technical evaluation during the year ending 31.03.2021.

Total value of stock Rs. 120 lakhs
Provision required based on technical evaluation Rs. 3.00 lakhs.
Provision required based on 12 months no issues Rs. 4.00 lakhs.

You are requested to discuss the following points in the light of Accounting Standard (AS)-1:
(i) Does this amount to change in accounting policy?
(ii) Can the company change the method of accounting?

Solution

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving inventory from Rs. 4 lakhs to Rs. 3 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2020-21 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by Rs. 1 lakh."

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Question 5

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

Solution

AS 1 recognizes 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognized only when realized though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information. Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions.

Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for non-payment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest.

In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled. Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.

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