Advance Accounts

Case-Based Scenarios: Multiple choice Questions

Case Scenario 1

AstraVeda Pharma Ltd., headquartered in Hyderabad, is in the process of finalising its financial statements for the year ended 31 March 2025. During the year, the company initiated a major project to develop a novel diabetes medication. From May to December 2024, AstraVeda incurred ₹ 1.2 crore in research costs to explore the feasibility of various compounds. Starting January 2025, the project moved into the development phase, with the company spending an additional ₹ 1.8 crore. A preliminary patent application has been filed, but final regulatory approval and clinical trials are still pending.

Early in February 2025, the finance department discovered that a significant customer incentive expense of ₹ 30 lakh was mistakenly recognised as "Sales Promotion Income" in the financial statements for the year ended 31 March 2024. Moreover, the company had extended credit facilities to multiple distributors. One of these distributors, owing AstraVeda ₹ 40 lakh as of 31 March 2025, signaled financial distress in late March. On 6 April 2025, this distributor declared insolvency and ceased operations entirely.

Shortly thereafter, on 12 April 2025, AstraVeda received a legal notice from a competitor alleging patent infringement. The competitor has claimed damages of ₹ 1.5 crore. AstraVeda's legal counsel believes that while the claim might lack solid grounds, there is a possibility of an out-of-court settlement if negotiations fail.

Additionally, the management is reviewing how best to treat an equipment warranty arrangement introduced in March 2025. Under the new scheme, AstraVeda provides a one-year warranty on certain manufacturing equipment sold to local clinics. Although no warranty claims have been made yet, there is concern that some claims may arise given the complexity of the equipment.

Management must determine the appropriate accounting treatment under Accounting Standard (AS) 4 (Contingencies and Events Occurring After the Balance Sheet Date), AS 5 (Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), AS 29 (Provisions, Contingent Liabilities and Contingent Assets), and AS 26 (Intangible Assets). Among other considerations, they need to decide which post-balance sheet events require adjustments, how to rectify the discovery of incorrect accounting in the previous year, whether a provision or contingent liability disclosure is necessary for the lawsuit, and how to account for research vs. development costs associated with the new medication.

Question 1: Which of the following items is most likely to be classified as an adjusting event for the year ended 31 March 2025, according to AS 4?

- **(a)** The distributor's insolvency declared on 6 April 2025
- **(b)** The competitor's patent infringement claim on 12 April 2025
- **(c)** Both (a) and (b)
- **(d)** Neither (a) nor (b)

Answer: (a) The distributor's insolvency declared on 6 April 2025

Reasoning: Since the distributor's financial distress existed before 31 March, the insolvency announcement on 6 April confirms a pre-existing condition at the balance sheet date. Therefore, it is an adjusting event. The patent infringement notice received on 12 April does not, on its face, confirm a

condition that existed as of 31 March and is generally treated as a non-adjusting event requiring disclosure rather than adjustment.

Question 2: How should AstraVeda Pharma Ltd. rectify the ₹ 30 lakh customer incentive expense that was incorrectly recognised as income in the year ended 31 March 2024?

- **(a)** Record it as an expense in the current year (2024–25)
- **(b)** Recognise a prior period item, adjusting the opening reserves/retained earnings of 2024–25
- **(c)** Disclose as an extraordinary loss in the current year's financial statements
- **(d)** Write off half in the current year and half in the next year

Answer: (b) Recognise a prior period item, adjusting the opening reserves/retained earnings of 2024–25

Reasoning: AS 5 requires material errors from earlier periods to be corrected retrospectively as prior period items. Hence, the opening balances for 2024–25 should be adjusted, rather than merely reflecting the expense in the current year's Profit & Loss.

Question 3: Regarding the newly introduced one-year warranty on equipment, which of the following is the most appropriate accounting treatment under AS 29 for the year ended 31 March 2025?

- **(a)** Recognise a full provision for warranty costs based on best estimates
- **(b)** Make no provision or disclosure, as no claims have been made yet
- **(c)** Recognise a contingent asset since it may generate future reputational benefits
- **(d)** Disclose the warranty obligation as a contingent liability without recognising a provision

Answer: (a) Recognise a full provision for warranty costs based on best estimates

Reasoning: Under AS 29, a provision should be recognised when there is a present obligation resulting from a past event (the sale and warranty offer), and a reliable estimate of the outflow can be made. The fact that no claims have occurred yet does not negate the obligation; management should estimate likely costs based on historical data or industry benchmarks and recognise a provision accordingly.

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Question 4: How should AstraVeda account for the ₹ 1.2 crore spent on research (May–December 2024) and ₹ 1.8 crore on development (January–March 2025) for the new diabetes medication, given that regulatory approval is still pending?

- **(a)** Capitalise both research and development costs as intangible assets
- **(b)** Expense both costs in the current year's Profit & Loss
- **(c)** Expense research costs and capitalise development costs if future economic benefits are probable and other criteria are met
- **(d)** Defer both until final regulatory approvals are obtained

Answer: C. Expense research costs and capitalise development costs if future economic benefits are probable and other criteria are met

Reasoning: AS 26 prescribes expensing of research costs because they cannot be directly linked to probable future economic benefits. Development costs can be capitalised only if certain conditions—such as technical feasibility, intention to complete and use or sell, and ability to measure costs—are satisfied. Pending regulatory approval alone does not necessarily prevent capitalization, provided the company has adequate evidence that the project will likely be successful.

Case Scenario 2

Dharini Infrastructures Private Limited, based in Pune, is engaged in multiple lines of business, including construction of commercial complexes and provision of technology solutions. During the financial year ending 31 March 2025, the company undertook a significant construction project for a state-owned university to build a modern research block. The contract value is ₹ 25 crore, with milestones defined for foundation work, structural completion, and finishing. By 31 March, the company had completed roughly 60% of the structural work, but the university had only certified 50% of the total project value based on partial inspection.

In parallel, Dharini Infrastructures also entered into an agreement with a private corporate client to develop a specialised inventory management software. The contract provided for a single lump-sum payment upon final delivery. Although the software was substantially developed by 31 March, the final module for real-time analytics remained pending. Despite requests, the client insisted that revenue would only be recognised after fully testing the final module.

During the year, Dharini Infrastructures received a government grant of ₹ 2 crore from the Department of Science and Technology to fund the development of a new eco-friendly concrete mix. The grant is repayable if the final testing fails to meet specified environmental standards. Initial trials suggest favorable results, but the final testing is slated for mid-2025.

The company also financed part of its construction equipment purchase through a bank loan of ₹ 10 crore at 8% interest per annum. The equipment is exclusively used for building the new research block. Construction commenced on 1 July 2024, and management commenced interest capitalization on the same date. However, work halted for one month (November 2024) due to heavy rain, during which no significant activities were performed. The finance team is now debating whether interest for that idle month should continue to be capitalised or charged to expenses.

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As 31 March 2025 approaches, the finance department must carefully decide how to recognise revenue from the partially completed construction and the software project, determine how to treat the grant received, and handle the interest costs for the period of inactivity. Proper adherence to the relevant accounting guidelines is essential to present a true and fair view of the financial statements.

Question 1: With respect to the partially completed software project, which of the following approaches to recognise revenue would be most appropriate?

- **(a)** Recognise the entire contract amount based on substantial completion
- **(b)** Recognise no revenue until the pending module is completed and accepted by the client
- **(c)** Recognise revenue on a percentage-of-completion basis linked to estimated effort
- **(d)** Recognise a nominal amount, treating the project as a separate performance obligation

Answer: (b) Recognise no revenue until the pending module is completed and accepted by the client

Reasoning: Under the standard for revenue recognition, revenue should be recognised only when significant risks and rewards of ownership are transferred, or when the seller's performance is substantially complete and can be reliably measured. In this case, the contract terms and the client's stance indicate final acceptance is contingent on delivering and testing the last module.

Question 2: For the ongoing university project, how should Dharini Infrastructures measure the amount of revenue to be recognised as of 31 March 2025?

(a) Based on the 60% physical completion
(b) Based on the 50% certified by the university
(c) The lower of physical completion (60%) or certification (50%)
(d) Defer revenue until project completion

Answer: (a) Based on the 60% physical completion

Reasoning: Under the standard dealing with long-term contracts, revenue is typically recognised based on the stage of completion, provided it can be reliably measured. Certification delays by the customer do not necessarily override the actual progress of work if the contractor can reliably estimate completion percentage.

Question 3: How should the ₹ 2 crore government grant for developing the eco-friendly concrete mix be treated at the end of the financial year, given that final testing results are still pending?

(a) Recognise the grant fully as income in the current year
(b) Defer the grant as a liability until the conditions are fulfilled
(c) Recognise half of the grant as income and defer the rest
(d) Recognise the grant as income only if the tests are likely to succeed

Answer: (b) Defer the grant as a liability until the conditions are fulfilled

Reasoning: The standard on government grants requires that grants related to specific conditions be deferred until there is reasonable assurance that those conditions (in this case, successful testing) have been met. Since failure to meet the criteria may require repayment, the grant should not be taken to income immediately.

Question 4: Should Dharini Infrastructures continue to capitalise interest on the equipment loan during the month-long period of inactivity in November 2024?

(a) Yes, capitalise interest for the entire period since the loan is dedicated to construction
(b) No, cease capitalization for the period of inactivity and expense it
(c) Capitalise only 50% of the interest for that month
(d) Defer the interest to a suspense account until construction resumes

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Answer: (b) No, cease capitalization for the period of inactivity and expense it

Reasoning: According to the standard on borrowing costs, capitalization should be suspended during extended periods in which active development or construction is interrupted. The interest for the idle period does not directly contribute to the creation or production of the qualifying asset.

Case Scenario 3

Himalaya Biotech Pvt. Ltd., headquartered in Bengaluru, specialises in herbal healthcare products. On 1 April 2024, the company purchased a state-of-the-art extraction and processing machine for ₹ 80 lakh to expand its production capacity. An additional ₹ 10 lakh was spent on transportation and ₹ 5 lakh on installation. Soon after the machine was operational, management decided to replace a major component (originally included in the purchase price) with a more advanced part for better efficiency. The new component cost ₹ 8 lakh, and the old component had a remaining carrying amount of ₹ 3 lakh.

Meanwhile, Himalaya Biotech initiated a project to develop a new herbal remedy targeting lifestyle-related disorders. During the research phase, the team incurred ₹ 20 lakh in salaries and laboratory costs. By the end of October 2024, promising test results led management to classify the project as commercially viable. From November 2024 onwards, they spent an additional ₹ 30 lakh refining the formula and preparing for

a patent application. However, a regulatory hurdle surfaced in March 2025, creating uncertainty about final approval.

In the same financial year, the company entered into a three-year agreement to lease specialised laboratory space. The monthly payments are substantial, and the lease term covers most of the asset's useful economic life. Himalaya Biotech also has an option to purchase the premises at a nominal price at the end of three years.

Towards the close of the fiscal year, the company received reports that a major overseas competitor launched a similar herbal remedy, potentially diminishing the future cash flows from Himalaya Biotech's upcoming product. Additionally, one of the existing product lines using the new processing machine experienced a sharp drop in sales due to heightened competition in the local market. The finance team is now evaluating whether these developments indicate any potential value loss for its newly purchased processing machine or intangible project assets.

Management faces critical decisions on how to account for the replacement of the machine's component, the ongoing development project, classification of the leased laboratory space, and whether to write down any assets due to the competitor's market entry and declining sales figures.

Question 1: When replacing the major component of the newly purchased machine, how should the carrying amount of the replaced component be treated in the financial statements?

- **(a)** Continue to include it in the asset's cost and also capitalise the new component
- **(b)** Remove it from the asset's cost and recognise a loss equal to its carrying amount
- **(c)** Transfer the carrying amount to the new component's cost
- **(d)** Retain the carrying amount as part of accumulated depreciation

Answer: (b) Remove it from the asset's cost and recognise a loss equal to its carrying amount
Reasoning: When a component is replaced, the carrying amount of that component is derecognised. Any difference between its carrying amount and any proceeds (if sold or scrapped) is recognised in profit or loss.

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Question 2: How should the company treat the costs incurred after November 2024 for the new herbal remedy, considering the regulatory hurdles?

- **(a)** Continue to expense all further costs until final approval is obtained
- **(b)** Capitalise the development costs since the project was deemed commercially viable, unless there is evidence it no longer meets recognition criteria
- **(c)** Retroactively capitalise the research costs, merging them with the development costs
- **(d)** Capitalise only the patent filing fees; expense the rest

Answer: (b) Capitalise the development costs since the project was deemed commercially viable, unless there is evidence it no longer meets recognition criteria
Reasoning: Costs incurred during the research phase must be expensed. Once a project is deemed commercially viable, subsequent development costs may be capitalised if it is probable that future economic benefits will flow to the entity. However, new evidence of uncertainty (e.g., regulatory risk) could change this assessment.

Question 3: Given the lease of the specialised laboratory space covers most of its economic life and includes a purchase option at a nominal price, how should it be classified in the financial statements?

- **(a)** As an operating lease, since payments are made monthly

(b) As an operating lease, because real estate typically cannot be fully transferred
(c) As a finance lease, as substantially all risks and rewards are transferred
(d) As a service contract rather than a lease

Answer: (c) As a finance lease, as substantially all risks and rewards are transferred

Reasoning: If the lease term covers the majority of the asset's economic life and the lessee has a purchase option at a nominal price, the lease typically transfers substantially all the risks and rewards of ownership, indicating finance lease classification.

Question 4: Considering the competitor's product launch and declining sales of one product line, which factor best indicates that an impairment test might be necessary for the company's newly purchased machine?

(a) The presence of a new competitor in the market, regardless of impact on cash flows
(b) A general industry downturn, though the machine is still fully operational
(c) Observable evidence that expected cash flows from using the machine may be negatively affected
(d) The fact that the machine's replacement component cost more than anticipated

Answer: (c) Observable evidence that expected cash flows from using the machine may be negatively affected

Reasoning : An indication of impairment arises if there are events or changes in circumstances suggesting the carrying amount of an asset may not be recoverable. Declining cash flows or increased competition impacting future revenue streams are typical impairment indicators.

Case Scenario 4

Edu Nurture Innovations Pvt. Ltd., a Bengaluru-based ed-tech start-up, offers a diverse portfolio of online courses, live tutoring sessions, and skill-development programs. As part of its expansion strategy, the company issued equity shares to new investors in April 2024, bringing its total share capital to 1 crore equity shares of ₹ 10 each. To maintain transparency with its stakeholders, Edu Nurture implemented several new accounting policies during the year but faced challenges aligning them with its existing disclosures.

Over the past twelve months, Edu Nurture made a strategic investment of ₹ 2 crore in a publicly listed e-learning aggregator, intending to hold it for at least three years to benefit from potential appreciation. However, market conditions have been volatile, and the investment's market value fluctuated significantly by 31 March 2025.

Edu Nurture's finance team is finalising the company's first full-year financial statements and encountered complexities in drafting the cash flow statement. A large portion of receipts came from subscription sales and tutoring fees, but the company also received a one-time grant from a government skill-building initiative. Additionally, the team must address the classification of a significant lease deposit as they are unsure if it should be disclosed as part of investing activities or operating activities.

Meanwhile, on the operational side, Edu Nurture recorded a strong surge in enrollments toward the end of the year, which boosted its net profit considerably. The finance team is now calculating basic and diluted earnings per share. They are evaluating the impact of 5 lakh employee stock options granted at the start of the year, half of which have already vested. The rest are subject to future performance milestones. The team must also clarifies how the newly adopted accounting policies affect the EPS calculation, particularly regarding the weighted average number of shares.

As Edu Nurture completes its reporting for the year ended 31 March 2025, management must ensure that the chosen accounting policies are disclosed consistently, the cash flow statement accurately reflects the nature of each transaction, the investment in the e-learning aggregator is valued and classified correctly, and that the earnings per share figures capture the effect of existing and potential equity instruments.

Question 1: EduNurture introduced new accounting policies during the year and aligned them with existing ones. Which statement best reflects the appropriate approach regarding these policies in the financial statements?

(a) Omit them if they do not affect the company's final profit figures
(b) Disclose them separately only if they conflict with earlier policies
(c) Disclose all material policies, ensuring clarity and consistency
(d) Provide a high-level summary without detailed explanation

Answer: (c) Disclose all material policies, ensuring clarity and consistency
Reasoning: The entity must present and consistently follow significant accounting policies. Full disclosure is essential for users to understand how transactions and events are recognised and measured.

Question 2: How should the significant lease deposit paid by EduNurture for its new office space be classified in the cash flow statement?

(a) As an outflow from operating activities
(b) As an outflow from investing activities
(c) Apportioned between operating and financing activities
(d) Exclude it entirely from the cash flow statement

Answer: (b) As an outflow from investing activities
Reasoning: Typically, deposits paid that relate to long-term asset usage (such as property) are considered investing outflows because they represent expenditures intended to generate future economic benefits.

Question 3: In the context of EduNurture's ₹ 2 crore strategic investment in the e-learning aggregator, which classification is most appropriate at year-end, considering it is intended to be held for more than a year?

(a) Current asset measured at fair value
(b) Long-term investment measured at cost, subject to diminution if decline is other than temporary
(c) Long-term investment revalued each month in the profit or loss
(d) Current asset measured at net realisable value

Answer: (b) Long-term investment measured at cost, subject to diminution if decline is other than temporary
Reasoning: Investments intended for long-term holding are generally carried at cost, with provisions made for any permanent diminution in value. Short-term market fluctuations are not necessarily recognised unless the decline is judged to be other than temporary.

Question 4: While calculating diluted earnings per share for the year, how should EduNurture treat the 5 lakh employee stock options granted at the start of the year, given that half are vested and the rest are contingent on future performance milestones?

(a) Exclude all options until they are fully vested
(b) Include only the vested 2.5 lakh options in diluted EPS
(c) Include all 5 lakh options, assuming they will vest eventually
(d) Include only the portion of unvested options that would be dilutive based on current performance

Answer: (b) Include only the vested 2.5 lakh options in diluted EPS

Reasoning: For diluted EPS, only those potential equity shares that have a realistic chance of conversion (i.e., vested or likely to vest based on current conditions) are considered. Unvested options contingent on uncertain future conditions are typically excluded until the vesting criteria are expected to be met.

Case Scenario 5

Indicolor Paints Pvt. Ltd., headquartered in Mumbai, specialises in a variety of paint products ranging from decorative household paints to high-performance industrial coatings. As of 31 March 2025, the company is finalising its annual financial statements. During the year, it procured large quantities of titanium dioxide and other raw materials from multiple international suppliers. With a view to improving production efficiency, Indicolor introduced a refined overhead allocation system, raising questions about which types of storage and handling costs should form part of inventory valuation. Towards year-end, the market price of certain critical raw materials declined sharply due to global supply chain adjustments, and one batch of premium pigment showed potential signs of obsolescence.

In mid-April 2025, Indicolor's Board of Directors announced a final dividend for the financial year ended 31 March 2025. The finance department is considering whether this post-balance-sheet event necessitates any liability recognition or adjustment in the current year's financials. Another complexity arises from a substantial purchase of specialty chemicals from a UK-based supplier, invoiced at GBP 200,000 on 1 February 2025. Payment is due on 30 April 2025, and the exchange rate has fluctuated between ₹ 100 and ₹ 105 per GBP. Indicolor initially recorded the liability at the spot rate on the invoice date, but the rate on 31 March stood at ₹ 103 per GBP.

Furthermore, Indicolor Paints operates in three distinct lines of business—decorative paints, industrial coatings, and automotive finishes—and also has a separate trading arm for specialty painting tools. Management reviews each category's performance internally for resource allocation and evaluates profitability by segment. Recently, the company introduced inter-segment transfers of certain advanced coating materials from the industrial division to the automotive segment at near-market prices. The finance team is debating the most appropriate method to record such inter-segment transactions in the segment reports.

With the reporting deadline approaching, Indicolor Paints must ensure (1) correct application of overheads in the cost of inventory, (2) proper treatment of the final dividend declared post year-end, (3) recognition of foreign exchange differences on the GBP-denominated liability, and (4) an appropriate basis for measuring inter-segment transfers in its segment disclosures. These decisions will significantly affect the overall presentation of the company's financial performance and health.

Question 1: Indicolor Paints introduced a refined overhead allocation system. Which of the following overheads can legitimately form part of the cost of raw material inventory?

- **(a)** General administrative expenses unrelated to the procurement process
- **(b)** Abnormal wastage and idle storage costs
- **(c)** Variable production overheads directly attributable to bringing materials to their usable condition
- **(d)** Selling and distribution expenses

Answer: C. Variable production overheads directly attributable to bringing materials to their usable condition

Reasoning: Only overheads that are directly related to the production or procurement process and necessary for bringing inventory to its present location and condition can be included in the cost. Abnormal or unrelated costs should be expensed in the period they are incurred.

Question 2: In April 2025, Indicolor's Board declared a final dividend for the year ended 31 March 2025. How should this be reflected in the financial statements for 2024–25?

- **(a)** Recognise it as a liability on 31 March 2025
- **(b)** Disclose it only in the director's report but not in the financial statements
- **(c)** Include it as part of retained earnings without separate mention
- **(d)** Show it as a note to the accounts, without adjusting the 31 March 2025 figures

Answer: (d) Show it as a note to the accounts, without adjusting the 31 March 2025 figures
Reasoning: A dividend declared after the balance sheet date generally does not create a liability as of 31 March. It is disclosed in the notes, rather than recognised as an adjusting event, because the conditions did not exist at year-end.

Question 3: How should Indicolor Paints reflect the exchange difference on the GBP 200,000 liability as of 31 March 2025, given that the exchange rate moved from ₹ 100 to ₹ 103 per GBP by that date?

- **(a)** Recognise no exchange difference until payment is made
- **(b)** Capitalise the entire difference as part of the inventory cost
- **(c)** Record the exchange difference in profit or loss at the rate prevailing on 31 March
- **(d)** Adjust the difference against equity reserves

Answer: (c) Record the exchange difference in profit or loss at the rate prevailing on 31 March
Reasoning: Monetary items denominated in a foreign currency must be reported using the closing rate at the balance sheet date, with any resulting exchange differences recognised in profit or loss.

Question 4: For inter-segment transfers of advanced coating materials from the industrial division to the automotive segment, how should Indicolor Paints measure these transfers in its segment disclosures?

- **(a)** At cost, excluding any segment profit
- **(b)** At the same price used for external sales
- **(c)** At the lowest feasible price to minimize inter-segment profit
- **(d)** At a basis that is consistently applied and reflects the segments' operating results fairly

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Answer: (d) At a basis that is consistently applied and reflects the segments' operating results fairly
Reasoning: Inter-segment transfers should be measured on a consistent and reasonable basis—often either cost or a market-based approach—so that each segment's performance is accurately reflected for internal and external reporting.

Case Scenario 6

Samriddhi Bank Limited, headquartered in Mumbai, has a diverse retail and corporate banking portfolio. During the financial year ended 31 March 2025, the bank experienced several significant events that require careful consideration in its upcoming financial statements and disclosures.

In January 2025, Samriddhi Bank decided to discontinue its microfinance operations, primarily offered in rural areas of Maharashtra and Gujarat. Over the past few years, the microfinance division struggled to achieve sustainable profitability due to heightened competition and regulatory constraints. The board approved a plan to cease all new microfinance lending, sell or transfer the existing loan portfolio to a specialised non-banking financial institution, and redeploy staff to other segments. By 31 March, negotiations for the portfolio sale were almost finalised, and the bank anticipates completing the sale by mid-2025.

Meanwhile, Samriddhi Bank has been publishing quarterly financial statements to keep investors informed of its performance. In the second quarter of 2024–25, the bank reported a higher-than-expected loss provision due to non-performing corporate loans in the infrastructure sector. The loss triggered concerns among analysts about the bank's asset quality. However, the third-quarter results showed a partial recovery, driven by improved collections and renewed lending in the housing finance segment. Now, as the year draws to a close, the finance team is preparing the fourth-quarter and full-year statements, ensuring that intra-year fluctuations are accurately portrayed.

Additionally, the bank conducted an internal assessment of certain properties and intangible IT systems used for its retail banking operations. Following intensifying market competition and an upgrade to a newer software platform, management suspects that the carrying values of certain older systems could be higher than their recoverable amounts. Preliminary estimates indicate that an impairment may be required, but final calculations are still pending a fair value assessment by an external consultant.

On the human resources front, Samriddhi Bank has a well-established contributory pension plan for its employees. This year, the bank introduced an early retirement scheme for senior staff, offering enhanced payouts and additional post-retirement medical benefits if they opt for voluntary separation. More than 100 employees applied for the offer by 31 March. The finance team must now evaluate how these changes affect the bank's obligations under its employee benefit programs, particularly whether the current year's expenses will materially increase due to one-time benefit costs.

As Samriddhi Bank prepares its financial statements, the management must decide on the proper presentation of the discontinued microfinance business, ensure accurate interim reporting for the quarterly statements, evaluate any impairment losses on its aging IT systems, and correctly measure and disclose the impact of the revised employee benefits. Each of these decisions will significantly influence the bank's reported performance and financial position.

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Question 1: How should Samriddhi Bank most appropriately present the microfinance division's results in the year-end financial statements, given that the plan to sell its loan portfolio is nearly finalised?

- **(a)** Combine the microfinance results with the bank's regular business, with no separate disclosure
- **(b)** Disclose the microfinance division's results separately as part of continuing operations
- **(c)** Present the microfinance division as a separate segment but not classify it as discontinued
- **(d)** Classify the microfinance division as discontinued and disclose its results separately

Answer: (d) Classify the microfinance division as discontinued and disclose its results separately

Reasoning: Once an entity has a formal plan and is committed to disposing of a significant line of business, its results and cash flows should be presented separately from continuing operations.

Question 2: While preparing quarterly reports, how should Samriddhi Bank deal with the second-quarter additional loss provision due to non-performing corporate loans?

- **(a)** Reverse it in the annual financials if results have improved in the third and fourth quarters
- **(b)** Spread it evenly across all four quarters of the financial year
- **(c)** Reflect it fully in the second-quarter results and carry forward its impact to subsequent quarters
- **(d)** Defer recognition until year-end when more information is available

Answer: (c) Reflect it fully in the second-quarter results and carry forward its impact to subsequent quarters

Reasoning: Revenues and expenses should be recognised in the period in which they are incurred or earned. A loss provision must be recognised as soon as it is identified, with no deferral or smoothing into future periods.

Question 3: Given the suspicion that certain older IT systems may not be recoverable due to upgrades and market competition, what is the most appropriate first step for Samriddhi Bank?

- **(a)** Immediately write off the entire carrying amount of the old systems
- **(b)** Continue depreciating without change until a sale decision is made
- **(c)** Estimate the recoverable amount for the suspected impaired assets and compare it with their carrying amount
- **(d)** Disclose only a contingency note without performing any asset review

Answer: (c) Estimate the recoverable amount for the suspected impaired assets and compare it with their carrying amount

Reasoning: When indicators of impairment exist, an entity must first determine the recoverable amount (the higher of net selling price and value in use) of the relevant assets. If the carrying amount exceeds the recoverable amount, the difference is recognised as an impairment loss.

Question 4: In light of the early retirement scheme introduced for senior staff, how should the associated one-time additional payouts and post-retirement benefits be treated in the bank's current year financial statements?

- **(a)** Recognise them as a non-recurring cost in the following financial year
- **(b)** Spread the cost evenly over the remaining working lives of the employees
- **(c)** Recognise the liability and expense immediately in the period the offer is accepted
- **(d)** Disclose only in the director's report, without recording any expense or liability

Answer: (c) Recognise the liability and expense immediately in the period the offer is accepted

Reasoning: When an entity commits to providing additional benefits through a voluntary retirement program and employees accept the offer, the resulting cost must be recognised in the financial statements in the period in which the commitment is made and accepted.

Case scenario 7

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HindRakshak Systems Pvt. Ltd., headquartered in Bengaluru, specialises in manufacturing advanced radar and missile guidance solutions for the Indian defense sector. In April 2024, the company secured a long-term loan of ₹ 200 crore at an annual interest rate of 9% to finance the construction of a new production facility. Construction commenced on 1 May 2024, and the facility was expected to be completed by 31 March 2025. However, heavy monsoon rains halted significant construction work for six weeks between July and August 2024, leading to debates on whether the associated borrowing costs should continue to be capitalised during this downtime.

During the year, HindRakshak Systems changed its depreciation method on certain specialised machinery from the straight-line method to the written-down value method, citing faster obsolescence in defense technology. The finance team discovered that if this method had been applied in the previous financial year, depreciation expense would have been significantly higher. Now, they are considering whether this constitutes a change in accounting policy or an adjustment for an error.

Meanwhile, the company operates under a government incentive program that allows accelerated capital allowances for defense manufacturers. This leads to timing differences between accounting and taxable profits. The accountants project that these differences may reverse over the next three to five years, raising questions about how to measure and present the resulting deferred tax balances.

Furthermore, HindRakshak Systems has a wholly owned subsidiary, Lakshya Avionics, which provides specialised testing equipment. During the current financial year, HindRakshak purchased equipment

worth ₹ 50 crore from Lakshya Avionics under favorable terms. Since Lakshya Avionics is fully controlled by HindRakshak's key management personnel, the group's auditors have asked for detailed disclosures on the nature and volume of these intra-group transactions.

By 31 March 2025, the new production facility was nearly 80% complete. The company's board of directors is eager to confirm whether the interest costs for the prolonged break in construction qualify for continued capitalization. They also want clarity on properly reflecting the change in depreciation method, determining the best approach for recognising deferred tax assets or liabilities arising from accelerated tax depreciation, and fully complying with disclosure requirements for related parties—particularly in light of the significant transaction with Lakshya Avionics.

In preparation for the annual audit, HindRakshak's finance team is finalising the company's financial statements and seeks to ensure that all critical judgments align with the recognised accounting guidelines. They must address each of the following: (a) the treatment of borrowing costs during construction delays, (b) the categorization of the depreciation method shift and any resultant adjustments, (c) the accurate presentation of current and deferred tax impacts, and (d) the comprehensive disclosure of material related party transactions. The manner in which these items are resolved will materially affect both the reported profits and the transparency of HindRakshak Systems' financial statements.

Question 1: During the six-week construction halt caused by monsoon rains, how should HindRakshak Systems treat the associated interest costs on the ₹ 200 crore loan?

- **(a)** Continue capitalising the interest throughout the entire period
- **(b)** Suspend capitalization for the six-week delay and charge that interest to the profit and loss account
- **(c)** Expense half the interest and capitalise the remainder
- **(d)** Defer the interest until construction activity resumes, without expensing it

Answer: (b) Suspend capitalization for the six-week delay and charge that interest to the profit and loss account

Reasoning: Capitalization of interest should cease during extended periods in which active construction is interrupted and no significant development activities are taking place.

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Question 2: Given the timing differences arising from accelerated capital allowances, which of the following best describes how HindRakshak Systems should record the tax effect?

- **(a)** Recognise a deferred tax asset or liability only after the differences actually reverse
- **(b)** Calculate and recognise deferred tax balances in the current period, reflecting future reversal
- **(c)** Disclose the tax effect in the notes without recording any amount
- **(d)** Amortize the timing differences over the life of the assets without creating a separate balance

Answer: (b) Calculate and recognise deferred tax balances in the current period, reflecting future reversal

Reasoning: Timing differences that are likely to reverse in future periods should be recognised as deferred tax assets or liabilities in the current financial statements.

Question 3: HindRakshak Systems switched from a straight-line method to a written-down value method for specialised machinery. If this is considered a change in accounting policy, how should the resulting impact be reflected?

- **(a)** Adjust the opening retained earnings and restate prior period figures
- **(b)** Apply the new method prospectively from the current year only

(c) Recognise the difference in the current year's profit or loss as an extraordinary item

(d) Ignore the change since it has no immediate cash flow impact

Answer: (a) Adjust the opening retained earnings and restate prior period figures

Reasoning: A change in depreciation method that meets the definition of a change in accounting policy (rather than an estimate change) is generally applied retrospectively, adjusting opening balances and restating comparatives.

Question 4: HindRakshak Systems purchased equipment worth ₹ 50 crore from its wholly owned subsidiary, Lakshya Avionics. What is the most appropriate approach to disclosing this transaction in the financial statements?

(a) No special disclosure is required since it is an intra-group transaction

(b) Disclose only if the transaction was done at below-market rates

(c) Provide complete details, including the amount and nature of the relationship, even if it was at market terms

(d) Show it as a contingent liability

Answer: (c) Provide complete details, including the amount and nature of the relationship, even if it was at market terms

Reasoning: Transactions with related parties must be disclosed in sufficient detail to highlight the relationship, the amount involved, and any terms that could differ from those in an arm's-length transaction.

Case Scenario 8

SuryaShakti Power & Infrastructure Pvt. Ltd., headquartered in Nagpur, is a major player in thermal and solar power generation. As of 31 March 2025, the company is wrapping up its financial statements, but several complicated transactions this year require careful consideration.

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In June 2024, SuryaShakti Power entered into a 10-year agreement to lease two high-capacity steam turbines from a global supplier. Along with fixed periodic lease payments, the contract stipulates an additional usage-based fee for every hour of operation exceeding a specified threshold. The finance team is debating the most appropriate method to account for these variable lease payments in the company's books. Although the turbines are critical for plant operations, the management's focus has shifted from lease classification to properly reflecting the contingent fee structure under the relevant accounting guidelines.

Meanwhile, the same thermal plant encountered unexpected downtime in October 2024 when one of its primary boilers malfunctioned, halting production for two weeks until repairs were completed. Management fears the boiler's carrying amount might exceed its recoverable amount, prompting an impairment review to determine whether the asset has suffered a permanent loss in value.

In November 2024, SuryaShakti upgraded its solar farm by replacing outdated inverters with a newly developed, more efficient model. The total cost, including transportation and installation, amounted to ₹ 15 crore. The old inverters, fully depreciated but still recorded at a nominal value, have not yet been removed from the books. Additionally, the finance department is uncertain whether the associated project management fees should be capitalised or expensed as incurred, given their direct relevance to commissioning the new equipment.

Late in the financial year, an internal audit revealed that a previous overhauling expense of ₹ 2 crore had been incorrectly recorded as revenue expenditure in the prior year's statements, even though the company's policy is to capitalise major overhauls that extend asset life. The management team is now contemplating whether to treat this as a prior period item requiring retrospective restatement or to simply adjust current year figures.

As SuryaShakti Power finalises its accounts, four primary concerns loom large: (1) correctly handling the usage-based lease payments for the steam turbines, (2) determining if the boiler's damage triggers an impairment loss, (3) establishing the proper accounting for the solar inverter replacement project, and (4) deciding how to address the prior year's misclassified overhaul expense. Each decision carries significant implications for the company's reported profits, asset values, and disclosures.

Question 1: Under the lease agreement for the steam turbines, SuryaShakti Power must pay additional usage-based fees whenever operating hours surpass a set threshold. How should these variable payments be accounted for?

- **(a)** Include them in the initial measurement of the lease liability
- **(b)** Recognise them as an expense in the period in which the contingent event (excess hours) occurs
- **(c)** Capitalise all such amounts as part of the cost of the leased asset
- **(d)** Allocate them evenly over the entire lease term

Answer: (b) Recognise them as an expense in the period in which the contingent event (excess hours) occurs

Reasoning: Variable lease payments that depend on usage or performance are typically recognised as expenses in the period when the contingency (e.g., exceeding certain operating hours) is met, rather than being included in the initial lease liability.

Question 2: With respect to the malfunctioning boiler, which indicator most strongly suggests an impairment review is necessary?

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- **(a)** general industry slowdown in thermal power
- **(b)** Repairs that lasted only two weeks
- **(c)** Observed damage that may affect the boiler's future operational capacity
- **(d)** The boiler's age surpassing its useful life in the next five years

Answer: (c) Observed damage that may affect the boiler's future operational capacity

Reasoning: An indication of impairment arises if there are physical damages or other evidence suggesting the asset's carrying amount might not be recoverable through future cash flows.

Question 3: How should SuryaShakti Power account for the newly installed solar inverters and the related project management fees?

- **(a)** Capitalise only the inverter cost; expense all other expenditures
- **(b)** Capitalise both the inverter cost and directly attributable project management fees
- **(c)** Expense the entire amount as routine maintenance
- **(d)** Defer recognition of any costs until completion of the entire solar farm upgrade

Answer: (b) Capitalise both the inverter cost and directly attributable project management fees

Reasoning: Costs directly attributable to bringing an asset to its intended use, such as installation and necessary project management fees, should be included in the asset's carrying amount.

Question 4: How should SuryaShakti Power treat the previously misclassified overhauling expenses discovered this year?

(a) Recognise them in the current year's expense only
(b) Increase the current year's revenue to offset the error
(c) Adjust the opening reserves and restate the prior year's figures
(d) Defer the adjustment until the next financial year

Answer: (c) Adjust the opening reserves and restate the prior year's figures
Reasoning: Material errors from prior periods must be corrected retrospectively by adjusting the opening balances of equity and restating comparative figures, rather than just adjusting in the current period.

Case Scenario 9

TechNova Solutions Private Limited, headquartered in Bengaluru, provides bespoke enterprise software services for clients across various industries. During the financial year ended 31 March 2025, the company undertook a major software development contract for an overseas telecom operator. Valued at USD 5 million, the contract commenced on 1 April 2024 and spans 12 months. By 31 March 2025, TechNova's project managers estimate that around 70% of the work is complete; however, the client has officially accepted deliverables covering only 60% of the project scope, citing pending integrations. The finance team is debating whether to measure progress based on costs incurred, technical milestones, or client acceptances.

Over the same period, TechNova made a strategic investment of ₹ 3 crore in RoboSense, an AI-driven start-up, intending to retain the shares for collaborative ventures. At year-end, RoboSense's share price had dipped below the purchase cost. Internally, TechNova believes the decline is temporary, since RoboSense is on track to secure a large funding round. Yet, there is uncertainty about whether the investment should be carried at cost or written down due to the current market loss.

In November 2024, TechNova revised its policy on certain in-house development tools. Previously, the company expensed such tools fully upon purchase. Under the new approach, it capitalises and amortises them over three years. The CFO considers this change essential for better matching costs with the related revenue, but the shift must be appropriately disclosed and justified.

To enhance processing power, TechNova entered a five-year lease for high-performance servers. The servers have an estimated total useful life of seven years, and the lease contract provides an option to extend for an additional three years at a nominal rate. The arrangement puts most maintenance and upgrade obligations on TechNova, prompting discussions on whether this lease effectively transfers the risks and rewards of ownership, requiring recognition of the servers on TechNova's balance sheet.

With the financial year closing, the company's leadership must determine how to disclose and present the revised policy on development tools, recognise revenue on the partially accepted software project, classify and measure the RoboSense investment, and assess whether the server lease is a finance lease or an operating lease for financial reporting purposes.

Question 1: How should TechNova Solutions reflect the newly adopted capitalization policy for its in-house development tools in its financial statements?

(a) Apply the revised policy only to tools acquired after 31 March 2025
(b) Present the change in a footnote without adjusting any figures
(c) Disclose the nature and reasons for the policy change and apply it consistently from the effective date
(d) Treat the policy change as an error and restate all prior period statements

Answer: (c) Disclose the nature and reasons for the policy change and apply it consistently from the effective date

Reasoning: When an entity changes its accounting policy, it must clearly state the rationale and apply the new policy consistently from the date of change (or retrospectively, if required by the standard). Full transparency is essential for users to understand the financial impact.

Question 2: Which basis is most appropriate for recognising revenue from the software development project, given that TechNova has completed about 70% of the work but the client has only formally accepted 60%?

- **(a)** Recognise revenue only to the extent of client-approved deliverables (60%)
- **(b)** Recognise 70% of the contract value based on cost and technical progress\
- **(c)** Defer all revenue until the client formally accepts 100% of the project
- **(d)** Split revenue: 60% as earned and 10% as a conditional asset

Answer: (b) Recognise 70% of the contract value based on cost and technical progress

Reasoning: Typically, revenue is recognised by reference to the stage of completion when the outcome of a contract can be reliably estimated. Physical and cost-based progress can provide a more accurate measure of performance than client acceptance milestones alone.

Question 3: How should TechNova measure its long-term investment in RoboSense at 31 March 2025, given that the market value is temporarily below cost?

- **(a)** Write down the entire investment to market value immediately
- **(b)** Continue to carry it at cost if the decline is deemed temporary
- **(c)** Recognise a partial provision based on management's discretion
- **(d)** Mark it to market at each reporting date through the profit and loss account

Answer: (b) Continue to carry it at cost if the decline is deemed temporary

Reasoning: For a long-term investment, a temporary decline in market value does not necessarily require a write-down. A provision is made only if there is a permanent diminution in value.

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Question 4: Given the 5-year term, the servers' 7-year economic life, and TechNova's option to extend at a nominal rate, how should the company classify the lease arrangement?

- **(a)** As an operating lease, since legal title remains with the lessor
- **(b)** As a finance lease, since substantially all risks and rewards appear to transfer
- **(c)** Exclude the servers from the balance sheet, treating payments as service fees
- **(d)** Treat the first two years as operating and the remaining three as finance

Answer: (b) As a finance lease, since substantially all risks and rewards appear to transfer

Reasoning: If a lease term covers a major part of the asset's useful life and includes an option at a nominal rate, it generally indicates that the risks and rewards of ownership are transferred to the lessee, thus classifying the lease as a finance lease.

Case Scenario 10

ZenCure Pharmaceuticals Ltd., headquartered in Hyderabad, focuses on developing and distributing a wide range of prescription medicines and over-the-counter supplements. In the current financial year ending 31 March 2025, the company launched a new antibiotic in collaboration with a government research institute. ZenCure purchased large volumes of active pharmaceutical ingredients (API) to meet the anticipated high demand. Mid-year, however, the finance department decided to change the cost

formula for certain expensive raw materials from weighted-average to FIFO, prompting questions about whether this policy shift would significantly alter the recorded inventory costs and reported profits.

Meanwhile, ZenCure entered into milestone-based supply contracts for its newly launched antibiotic, receiving partial prepayments from institutional buyers (like hospitals and government agencies). Under these contracts, revenue is recognised at various stages: development, trial results acceptance, and final product delivery. With some shipments still en route or awaiting final approval, the finance team is grappling with how much revenue to record at year-end.

In December 2024, ZenCure took a strategic step to acquire HealthOne MedTech Pvt. Ltd., a smaller player specialising in diagnostic devices and hospital equipment. Under the agreement, all assets and liabilities of HealthOne MedTech would transfer to ZenCure, with shares issued to HealthOne's shareholders in a fixed ratio. Management expects to leverage HealthOne's distribution network to cross-sell ZenCure's product range to clinics and diagnostic centers.

Additionally, ZenCure raised new equity capital in January 2025 to support an upcoming research program on antiviral drugs. The company issued 2 million shares at a premium, leading to a larger shareholder base for the final quarter of the financial year. The finance department is now evaluating how this mid-year issuance impacts the calculation of the company's basic earnings per share (EPS), as the total number of shares outstanding changed partway through the reporting period. Investors and analysts have sought clarity on whether ZenCure should adjust prior quarters' EPS figures retroactively or simply reflect the weighted impact of the new shares.

As 31 March 2025 approaches, ZenCure Pharmaceuticals is finalising its financial statements. The key tasks include deciding how to account for the switch in cost formula from weighted-average to FIFO, determining the stage at which milestone-based revenue should be recognised, reflecting the effect of the HealthOne MedTech acquisition in the books, and correctly computing the basic EPS given the additional shares issued in January. Each of these decisions will materially affect the company's reported results, balance sheet, and the transparency of its disclosures to stakeholders.

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Question 1: ZenCure decided to switch from weighted-average to FIFO for certain costly raw materials mid-year. Which of the following is most appropriate for presenting this change in the financial statements?

- **(a)** Apply FIFO only to new purchases after the decision date, leaving older stocks on weighted-average
- **(b)** Treat it as a change in accounting policy and, if material, restate comparative figures or disclose the impact clearly
- **(c)** Keep using weighted-average for final reporting to maintain consistency, ignoring the mid-year decision
- **(d)** Record any differences arising from the switch as miscellaneous income or expense in the current year

Answer: (b) Treat it as a change in accounting policy and, if material, restate comparative figures or disclose the impact clearly

Reasoning: A significant change in the method used to determine inventory costs is considered a change in accounting policy. The company should either restate comparatives (if practicable) or clearly disclose the nature of the change, reasons for it, and its financial impact on the current period.

Wafaa wafaaabar2180@gmail.com 918328265989

Question 2: When should ZenCure recognise revenue for the milestone-based contracts on the newly launched antibiotic?

- **(a)** Recognise all revenue upon signing the contract, since partial prepayments were received
- **(b)** Recognise revenue only after the final product is accepted by the customer
- **(c)** Recognise revenue progressively upon achieving contractual milestones if they represent valid completion stages
- **(d)** Defer revenue recognition until at least 80% of the product is delivered

Answer: (c) Recognise revenue progressively upon achieving contractual milestones if they represent valid completion stages

Reasoning: In milestone-based arrangements, revenue should be recognised at each stage when the seller has performed the agreed tasks and the entitlement to payment is established.

Question 3: ZenCure acquired all assets and liabilities of HealthOne MedTech, issuing shares to HealthOne's shareholders in a specified ratio. How should this transaction generally be reflected in ZenCure's books?

- **(a)** Record only the incremental assets from HealthOne at fair market value, ignoring liabilities
- **(b)** Present HealthOne MedTech's balance sheet separately under a consolidation note
- **(c)** Combine all assets and liabilities at book values or fair values based on the method of amalgamation
- **(d)** Keep the carrying amounts unchanged but do not issue any share capital

Answer: (c) Combine all assets and liabilities at book values or fair values based on the method of amalgamation

Reasoning: When one entity acquires another, assets and liabilities are generally combined in the acquirer's books using either book values or fair values, depending on the nature and method (pooling or purchase) of the amalgamation.

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Question 4: In January 2025, ZenCure issued 2 million new equity shares. How should this mid-year share issuance affect the basic EPS reported for the year ended 31 March 2025?

- **(a)** Recalculate and restate basic EPS for all prior quarters as if the shares were always in issue
- **(b)** Ignore the new shares until the next financial year's reporting
- **(c)** Weight the new shares for the fraction of the year they were outstanding when calculating the yearly average
- **(d)** Treat the entire 2 million shares as if they existed for the full 12 months

Answer: (c) Weight the new shares for the fraction of the year they were outstanding when calculating the yearly average

Reasoning: Basic EPS is computed using the weighted average number of shares outstanding during the period. Shares issued partway through the year are included only from the date of issuance, rather than for the full financial year.

Wafaa wafaamahak218@gmail.com 918328265949