

ADVANCED ACCOUNTS

UNIQUE QUESTIONS OF RTPs

INDEX

<u>RTP Sep. 24</u>	Page 2
<u>RTP Jan 25</u>	Page 10

UNIQUE QUESTIONS OF RTP Sep. 24**AS 4**

5. For five companies whose financial year ended on 31st March, 2023, the financial statements were approved by their approving authority on 15th June, 2023.

During 2023-2024, the following material events took place:

- (a) A Ltd. sold a major property which was included in the balance sheet at ₹ 1,00,000 and for which contracts had been exchanged on 15th March, 2023. The sale was completed on 15th May, 2023 at a price of ₹ 2,50,000.
- (b) On 30th April, 2023, a 100% subsidiary of B Ltd. declared a dividend of ₹3,00,000 in respect of its own shares for the year ended on 31st March, 2023.
- (c) On 31st May, 2023, the mail order activities of C Ltd. (a retail trading group) were shut down with closure costs amounting to ₹ 2.5 million.
- (d) On 1st July, 2023 the discovery of sand under D Ltd.'s major civil engineering contract site causes the cost of the contract to increase by 25% for which there would be no corresponding recovery from the customer.
- (e) A fire, on 2nd April, 2023, completely destroyed a manufacturing plant of E Ltd. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company

You are required to state with reasons, how each of the above items numbered (a) to (e) should be dealt with in the financial statement of the various companies for the year ended 31st March, 2023.

Answer

Treatment as per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date

(a)	A Ltd.	The sale of property should be treated as an adjusting event since contracts had been exchanged prior to the year-end. The effect of the sale would be reflected in the financial statements ended on 31.3.2023 and the profit on sale of property ₹ 1,50,000 would be treated as an extraordinary item.
(b)	B Ltd.	The declaration of dividend on 30 th April, 2023 of ₹ 3,00,000 would be treated as a non-adjusting event in the financial statements of 2022-2023. This is because, the dividend has been declared after the balance sheet date and no conditions existed on the balance sheet date for such declaration of dividend. Further as per AS 9, right to receive dividend is established when it is declared and not before that.

(c)	C Ltd.	A closure not anticipated at the year-end would be treated as a non-adjusting event. Memorandum disclosure would be required for closure of mail order activities since non disclosure would affect user's understanding of the financial statements.
(d)	D Ltd.	The event took place after the financial statements were approved by the approving authority and is thus outside the purview of AS 4. However, in view of its significance of the transaction, the directors may consider publishing a separate financial statement/additional statement for the attention of the members in general meeting.
(e)	E Ltd.	The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.

AS 9

8. When will the revenue be recognized in the case of inter divisional transfers?

Answer

The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the interdivisional transfers/sales are not revenue as per AS 9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

AS 12

10. Energy Ltd. has acquired a generator on 1.4.2023 for ₹ 100 lakh. On 2.4.2023, it applied to Indian Renewal Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2024 after the accounts for 2023-2024 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2024.

State

- (i) Is this a prior period item?
- (ii) How should the subsidy be accounted in the accounting year 2024-2025?

Answer

- (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2023-2024 by not recognising the subsidy?

The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that –

- (i) the enterprise will comply with the conditions attached to them and
- (ii) the subsidy will be received.

Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2024 after approval of accounts, non-recognition of grant in 2023-2024 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2023-2024.

- (iii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life. Alternatively, the same may be treated as 'deferred income' and allocated over the remaining useful life in the proportion in which depreciation is charged.

AS 13

11. A company is engaged in the business of refining, transportation and marketing of petroleum products. During the financial year ended 31st March, 2024, the company acquired controlling interest from Government of India in another public sector undertaking @ ₹1,551 per share as against the book value of ₹192.58 per share and market value of ₹ 876 per share as on 18th February, 2024.

Thus, the strategic premium of ₹ 675 per share has been paid considering various tangible and intangible factors.

The above investment in the shares of the acquired company has been considered as long term strategic investment and, therefore, has been accounted for at cost, i.e. at ₹ 1,551 per share in the financial statements. No provision for diminution in value has been made in the books of account

As per the requirement of Schedule III to the Companies Act, 2013, the aggregate market value of the quoted shares has been properly reflected in the financial statements.

On 28th March, 2024, the acquired shares were quoted at ₹ 880 per share on BSE and the current market price as on 18th July was around ₹300.

Considering the tangible and intangible benefits the Management is of the view that there is no permanent diminution in the value of the strategic investment in the acquired company, as the same has been considered as a long-term investment. Therefore, there is no need for provision for diminution in the value of the shares of the acquired company.

Required:

- (i) Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13.
- (ii) If any provision for diminution in the value is to be made, whether such provision should be charged to the profit and loss account or whether same can be considered as deferred expenditure and amortised over a period of 5 years. Whether it is open for the company to charge off such diminution in the value in the books of account instead of creating provision.
- (iii) Whether the premium paid for strategic benefits for investment described in facts of the case, can be accounted for separately in the books of account keeping in view that AS 13 specifies that long term investments should be recorded at cost and there is no specific provision in the standard in respect of accounting for premium paid for strategic benefits.

Answer

- (i) The accounting treatment 'at cost' under the head 'Long Term Investment' in the separate financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment.
- (ii) The provision for diminution in the value of investment should be a charge to the profit and loss statement. As per the requirements of AS 13, the diminution in the value of investment can neither be accounted for as deferred revenue expenditure nor it can be written off in the statement of profit and loss.
- (iii) The long-term investments should be carried at cost as per the requirements of AS 13. The amount paid over and above the market price should be treated as cost and cannot be accounted for separately.

AS 16

12. Loyal Ltd. has undertaken a project for expansion of capacity as per the following details:

	Plan (₹)	Actual (₹)
October, 2023	5,00,000	4,00,000
November, 2023	6,50,000	7,95,000
December, 2023	20,00,000	-
January, 2024	2,00,000	50,000
February, 2024	9,00,000	2,00,000
March, 2024	10,00,000	12,00,000

The company pays to its bank interest at a rate of 15% p.a., which is debited on a monthly basis. During the half year, company had ₹ 20 lakh overdraft up to 31st December, surplus cash in January and again overdraft of ₹ 14 lakh from 1.2.2024 and ₹ 30 lakh from 1.3.2024. The company had a strike during December and hence could not continue the work during said period. However, the substantial administrative work related to the

project was continued. Onsite work was again commenced on 1st January and all the work were completed on 31st March. Assume that expenditure was incurred on 1st day of each month.

Calculate interest to be capitalized giving reason wherever necessary. Assume overdraft will be less, if there is no capital expenditure.

Answer

Month	Actual Expenditure (₹)	Interest on outstanding amount @ 15% p.a.	Interest capitalized (₹)	Outstanding amount	Cumulative amount (₹)
	1		2	3	
October, 2023	4,00,000	$4,00,000 \times 15\% \times 1/12$	5,000	4,05,000	4,05,000
November, 2023	7,95,000	$(4,05,000 + 7,95,000) \times 15\% \times 1/12$	15,000	$(4,05,000 + 7,95,000 + 15,000)$	12,15,000
December, 2023	-	$12,15,000 \times 15\% \times 1/12$	15,188	$12,15,000 + 15,188$	12,30,188
January, 2024	50,000	-	-	$12,30,188 + 50,000$	12,80,188
February, 2024	2,00,000	$14,00,000 \times 15\% \times 1/12$	17,500	$12,80,188 + 2,00,000 + 17,500$	14,97,688
March, 2024	<u>12,00,000</u>	$(14,97,688 + 12,00,000) \times 15\% \times 1/12$	<u>33,721</u>	$14,97,688 + 12,00,000 + 33,721$	27,31,409
	<u>26,45,000</u>		<u>86,409</u>		

Note:

- As per para 18 of AS 16, 'Borrowing Cost', capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Therefore, the interest for that period i.e. for the month of December has also been capitalized.
- During January, the company did not incur any interest as there was surplus cash in January. Therefore, no amount should be capitalized during January as per para 14(b) of AS 16.
- During February, actual overdraft (borrowings) was ₹ 14 lakh only. Hence, interest of ₹ 17,500 on ₹14,00,000 has been calculated even though actual expenditure on project exceed ₹ 14 lakh.

AS 17

- Whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not?

Answer

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

AS 23

15. Hill Ltd. has a share capital of 50,000 shares @ ₹ 100 per share. Sun Ltd. acquired 15% shares in Hill Ltd. on 1.4.2024. It also acquired all the 5,000, 12% convertible debentures of ₹ 100 each of Hill Ltd. These debentures will be converted at par into equity shares of Hill Ltd. after 3 years. State whether, as per AS 23, Hill Ltd. is an Associate of Sun Ltd. or not with reasons?

Answer

As per para 3 of AS 23 'Accounting for Investments in Associates in Consolidated Financial Statements', an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Standard further explains in para 4 that as regards share ownership, if an investor holds, directly or indirectly through subsidiary (ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

Further as per an explanation to para 4 of the standard, for the purpose of classification of associate, the potential equity shares of the investee held by the investor will not be taken into account for determining the voting power of the investor. In other words, the voting power should be determined on the basis of the current outstanding securities with voting rights.

As per the information given in the question, Sun Ltd. presently holds indirectly 22.7% shares (with and without voting rights) (Refer W.N.) in Hill Ltd. However, the current outstanding securities with voting rights in Hill Ltd. is only 15% and the remaining holding is on account of potential equity shares. Since potential equity shares do not have voting rights they will not be taken into consideration while determining the significant influence of Sun Ltd. on Hill Ltd. Hence, Hill Ltd. is not an associate of Sun Ltd.

Working Note:**Calculation of percentage of holding of shares after conversion ₹**

Current holding is 15% i.e. 7,500 shares of ₹100 each	7,50,000
Potential equity shares i.e. 5,000 shares of ₹100 each	5,00,000
	12,50,000

Total share capital of Hill Ltd. after conversion of debentures into equity shares will be = ₹ 50,00,000 + ₹ 5,00,000 = ₹ 55,00,000

Percentage of holding = ₹ (12,50,000/55,00,000) x 100 = 22.7% approx.

AS 24

16. Arzoo Ltd. is in the business of manufacture of Passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the Passenger car segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner.

- (i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.
- (ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24?
- (iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?

Answer

Mere gradual phasing out is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

- (1) Gradual or evolutionary phasing out of a product line or class of service;
- (2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- (3) Shifting of some production or marketing activities for a particular line of business from one location to another; and
- (4) Closing of a facility to achieve productivity improvements or other cost savings.

In view of the above the answers are:

- (i) No, 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. Above all, the new segment i.e. commercial vehicle production line in a new factory has not started.
- (ii) No, the resolution is salient 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, closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable.
- (iii) Yes, phased and time bound programme 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.

AS 28

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

Whether it will be a cash-generating unit as per AS 28?

Answer

It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the

other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

AS 29

18. A company incorporated under Section 8 of the Companies Act, 2013, have main objective to promote the trade by organizing trade fairs / exhibitions. When company was organizing the trade fair and exhibitions it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
1. A suitable disclosure to this effect is also made in the notes forming part of accounts.

Required:

- (i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29
- (ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet.

Answer

- (i) Para 14 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets" states that a provision should be recognised when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.
- (ii) "Provision" is the amount retained by the way of providing for any known liability. Since the contingencies stipulated by the company are not known at the balance sheet date, the provision in this regard cannot be created. Therefore, the provision so created by the company shall be treated as a 'Reserve'.

UNIQUE QUESTIONS OF RTP JAN 25**For Video Solutions scan this -****AS 5**

5. During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write it back to the Profit and Loss account as a prior period item.

Is the company's proposed accounting treatment correct? Discuss.

SOLUTION

The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The balance amount left in the provision created earlier is not as a result of error in the past. So it will not be considered as prior period item. Such write back of provision is not an ordinary feature of the business, it shall be considered as an extra-ordinary item.

As per paragraph 8 of AS 5, extraordinary items should be disclosed in the Statement of Profit and Loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the Statement of Profit and Loss in a manner that its impact on current profit or loss can be perceived. Hence, the amount so written-back (if material) should be disclosed as an extraordinary item as per AS 5 rather than as prior period items.

AS 9

7. Mithya Ltd. Entered into agreement with Satya Ltd. For sale of goods costing Rs. 8 lakh at a profit of 20% on cost. The sale transaction took place on 1st February, 2024. On the same day, Satya Ltd. Entered into another agreement with Mithya Ltd. To resell the same goods at Rs. 10.80 lakh on 1st August, 2024. State the treatment of this transaction in the financial statements of Mithya Ltd. As on 31.03.2024. The pre- determined re-selling price covers the holding cost of Satya Ltd. Give the Journal Entries as on 31.03.2024 in the books of Mithya Ltd.

SOLUTION

In the given case, Mithya Ltd. concurrently agreed to repurchase the same goods from Satya Ltd. on 1st February, 2024. Also the re-selling price is pre-determined and covers purchasing and holding costs of Satya Ltd. Hence, the transaction between Mithya Ltd. and Satya Ltd. on 1st February, 2024 should be accounted for as financing rather than

sale. The resulting cash flow of Rs. 9.60 lakh received by Mithya Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of Mithya Ltd.

				Rs. in lakh
1.2.2024	Bank Account To Advance from Satya Ltd*. (Being advance received from Satya Ltd. amounting [Rs. 8 lakh + 20% of Rs. 8 lakh = 9.60 lakh] under sale and re-purchase agreement)	Dr.	9.60	9.60
31.3.2024	Financing Charges Account To Satya Ltd. (Financing charges for 2 months [(10.80 - 9.60) x 2/6])	Dr.	0.40	0.40
31.3.2024	Profit and Loss Account To Financing Charges Account (Being amount of finance charges transferred to P& L Account)	Dr.	0.40	0.40

AS 14

10. Astha Ltd. is absorbed by Nistha Ltd.; the consideration being the takeover of liabilities, the payment of cost of absorption not exceeding Rs. 10,000 (actual cost Rs. 9,000); the payment of the 9% debentures of Rs. 50,000 at a premium of 20% through 8% debentures issued at a premium of 25% of face value and the payment of Rs.15 per share in cash and allotment of three 11% preference shares of Rs. 10 each and four equity shares of Rs.10 each at a premium of 20% fully paid for every five shares in Astha Ltd. The number of shares of the vendor company are 1,50,000 of Rs. 10 each fully paid. Calculate purchase consideration as per AS 14.

SOLUTION

As per AS 14 'Accounting for Amalgamations', the term 'consideration' has been defined as the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

The payment made by transferee company to discharge the Debenture holders and outside liabilities and cost of winding up of transferor company shall not be considered as part of purchase consideration.

Computation of Purchase Consideration

	Rs.
Cash payment Rs.15 x 1,50,000	22,50,000
11% Preference Shares of Rs. 10 each [(1,50,000 x 3/5) x Rs. 10]	9,00,000
Equity shares of Rs. 10 each @ 20% premium [(1,50,000 x 4/5) x Rs. 12]	14,40,000
Total Purchase consideration	45,90,000

AS 16

11. How will interest be capitalized when qualifying assets are funded by borrowings in the nature of bonds that are issued at a discount?

X Ltd. issued in year 1, a 3 year 10% p.a. (interest paid annually) bond with a face value of Rs. 1,00,000 at a price of Rs. 90,000 to finance a qualifying asset which is ready for intended use at the end of year 2. Compute the amount of borrowings costs to be capitalized if the company uses for amortization of discount straight line basis

SOLUTION

As per AS 16, "Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds". Further, as per para 4 (b) of the standard, "amortization of discounts or premiums relating to borrowings" as a component of borrowing costs. Thus, the borrowing costs comprise the periodic interest payable on the bonds in question and the amount of discount amortised during the period.

Paragraph 6 of the Statement, inter-alia, states that "Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset".

Further, paragraph 19 states that "Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". Thus, only that portion of the amortised discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Straight line basis

(Amount in Rs.)

Years	Interest	Amortisation of discount	Total borrowing costs
Year 1	10,000	3,333	13,333
Year 2	10,000	3,333	13,333
Year 3	10,000	3,334	13,334

In the above case, the amount of borrowing costs capitalized would be Rs. 13,333 in Year 1 and Year 2. The borrowing costs of Rs. 13,334 incurred in Year 3 would be expensed since the asset is ready for its intended use at the end of Year 2.

AS 18

13. Will transactions with related parties, for services provided/received free of cost, be required to be disclosed?

A Limited has a corporate communications department, which centralises the public relations function for the whole group of A Limited and its subsidiaries. No charges are, however, levied by A Limited on its subsidiaries and accordingly, these transactions are not given accounting recognition. Would these constitute related party transactions requiring disclosure under AS 18 in the standalone financial statements of A Limited?

SOLUTION

These transactions would require disclosure under AS 18 in the standalone financial statements of A Limited. As per paragraph 10 of AS 18, a related party transaction is "a transfer of resources or obligations between related parties, regardless of whether or not a price is charged". In the given situation, there is a transfer of resources from A Limited to its subsidiaries, though no price is charged for the same. Hence, it will constitute as related party transaction and will require disclosure in the financial statements of A Ltd.

AS 20

15. XYZ Limited has a wholly owned subsidiary BC Limited. The Group prepares consolidated Financial Statements for the year ended 31st March, 2024. XYZ

Limited (in its separate financial statements) has incurred a loss of Rs. 2 crore during the year, while the consolidated profit for the group during the year is Rs. 40 lakh.

XYZ Limited has 5,00,000 shares outstanding as at 31st March, 2024. Further, it has granted options to issue equity shares as at that date. In respect of such options, 1,00,000 shares are considered to be the shares issued for no consideration. There are no changes in income or expenses that are expected from the issue of equity shares on exercise of these options.

Calculate Basic and Diluted EPS for XYZ Limited for separate financial statements and for the Group.

SOLUTION

Computation of earnings per share

Particulars	Consolidated financial statements	Standalone financial statements of XYZ Limited
Basic earnings/(loss) per share	Rs. 8 [40,00,000/5,00,000]	(Rs. 40) [2,00,00,000/5,00,000]
Diluted earnings/ (loss) per share	Rs. 6.66	[40,00,000/ 6,00,000]

As per paragraph 39 of 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 from continuing ordinary operations.

In the above case, if the exercise of options was considered for separate financial statements of XYZ Limited, the diluted loss per share would have reduced to Rs. 33.33 [2,00,00,000/6,00,000]. As this is antidilutive, the options would not be treated as potentially dilutive equity shares. Accordingly, in the separate financial statements of XYZ Limited, the Diluted EPS would be same as Basic EPS.

AS 22

16. ABC Ltd. prepares its accounts annually on 31st March. On 1st April, 2022, it purchases a machine at a cost of Rs. 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of Rs. 2,00,000 each year and corporate tax rate is 40 percent each year.

The purchase of machine at a cost of Rs. 1,50,000 in 2022 gives rise to a tax saving of Rs. 60,000. The corporate tax rate has been assumed to be same in each of the three years. Calculate deferred tax and pass necessary journal entries.

What will be the amount of deferred tax, if the substantively enacted tax rates for 2022, 2023 and 2024 are 40%, 35% and 38% respectively.

SOLUTION

If the cost of machine is spread over three years of its life for accounting purposes, the amount of the tax saving should also be spread over the same period as shown below:

Statement of Profit and Loss (for the three years ending 31st March, 2022, 2023, 2024)

		(Rs. in thousand)		
		2022	2023	2024
	Profit before depreciation and taxes	200	200	200
Less:	Depreciation for accounting	50	50	50

	purposes			
	Profit before taxes	150	150	150
Less:	Tax expense			
	Current tax:			
	0.40 x (200 - 150)	20		
	0.40 x 200		80	80
	Deferred tax:			
	Tax effect of timing differences originating during the year leading to DTL			
	0.40 (150-50)	40		
	Tax effect of timing differences reversing during the year			
	0.40 (0-50)	-	(20)	(20)
	Tax expense	60	60	60
	Profit after tax	90	90	90
	Net timing differences	100	50	0
	Deferred tax liability balance	40	20	0

In 2022, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purpose by Rs. 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of Rs. 40,000. In 2023 and 2024 accounting income is lower than taxable income because the amount of depreciation charged for accounting purposes exceeds the amount of depreciation allowed for tax purposes by Rs. 50,000 each year. Accordingly, deferred tax liability is reduced by Rs. 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 2022, the profit and loss account is debited and deferred tax liability account is credited with the amount of tax on the originating timing difference of Rs. 1,00,000 while in each of the following two years, deferred tax liability account is debited and profit and loss account is credited with the amount of tax on the reversing timing difference of Rs. 50,000.

The following Journal entries will be passed:

Year 2022			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2022 provided for)	Dr.	20,000	20,000
Profit and Loss A/c To Deferred tax liability A/c (Being the deferred tax liability created for originating timing difference of Rs. 1,00,000)	Dr.	40,000	40,000
Year 2023			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2023 provided for)	Dr.	80,000	80,000
Deferred tax liability A/c To Profit and Loss A/c (Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)	Dr.	20,000	20,000

Year 2024			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2024 provided for)	Dr.	80,000	80,000
Deferred tax liability A/c To Profit and Loss A/c (Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)	Dr.	20,000	20,000

Presentation:

In the year 2022, the balance of deferred tax account i.e. Rs. 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of AS 22. In the year 2023, the balance of deferred tax liability account would be Rs. 20,000 and be shown separately from the current tax payable for the year as in year 2022. In year 2024, the balance of deferred tax liability account would be nil.

If the rate of tax changes, it would be necessary for the enterprises to adjust the amount of deferred tax liability carried forward by applying the tax rate that has been enacted or substantively enacted by the balance sheet date on accumulated timing differences at the end of the accounting year

The amount of deferred tax liability would be computed as follows:

The deferred tax liability carried forward each year would appear in the balance sheet as under:

31st March, 2022	= 0.40 (1,00,000)	= Rs. 40,000
31st March, 2023	= 0.35 (50,000)	= Rs. 17,500
31st March, 2024	= 0.38 (Zero)	= Rs. Zero

Accordingly, the amount debited (credited) to the profit and loss account (with corresponding credit or debit to deferred tax liability) for each year would be as under:

31st March, 2022	Debit	= Rs. 40,000
31st March, 2023	(Credit)	= Rs. (22,500)
31st March, 2024	(Credit)	= Rs. (17,500)

AS 23

17. A Ltd. Invested Rs. 1,00,000 to acquire 10% stake (Investment I) in B Ltd. And later invested Rs. 3,00,000 to acquire additional 20% (Investment II). The net asset value of the B Ltd. At the respective investment dates was Rs. 7,50,000 and Rs. 12,50,000 respectively. Determine whether B Ltd. Is an associate of A Ltd. Also, calculate goodwill arising on the acquisition of the associate.

SOLUTION

As per para 3 of AS 23 an associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. In this case, A Ltd. has invested 30 % in B Ltd. so B Ltd. is to be considered as an associate of A Ltd.

The goodwill arising on the acquisition of the associate will be computed as follows:

		Rs.
Investment I		1,00,000

Share of net assets	(10 percent of Rs. 7,50,000)	(75,000)
Goodwill (A)		25,000
Investment II		3,00,000
Share of net assets	(20 percent of Rs. 12,50,000)	(2,50,000)
Goodwill (B)		50,000
Total goodwill (A + B)		75,000

AS 29

20. During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2023 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2023, the Company commenced legal action against F claiming damages in respect of the supply of defective raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2023, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crore. This estimate was revised to Rs. 5.2 crore as on 31st March, 2024 and Rs. 5.25 crore as at 15th May, 2024. This case was eventually settled on 1st June, 2022, when the Company paid damages of Rs. 5.3 crore to K.

On 1st December, 2023, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crore from F. This estimate was revised to Rs. 3.6 crore as at 31st March, 2024 and Rs. 3.7 crore as on 15th May, 2024. This case was eventually settled on 1st June, 2022 when F paid Rs. 3.75 crore to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2024, provided Rs. 3.6 crore as the financial statements were approved by the Board of Directors on 26th April, 2024.

- Whether the Company is required to make provision for the claim from customer K as per applicable AS? If yes, please give the rationale for the same.
- If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2024?
- What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable AS?

SOLUTION

- Yes, QA Ltd. is required to make provision for the claim from customer K as per AS 29 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs. 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2024.
- | | | |
|----------------------------------|-----|---------------|
| Statement of Profit and Loss A/c | Dr. | Rs. 5.2 crore |
| To Current Liability A/c | | Rs. 5.2 crore |
- As per para 30 of AS 29, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.